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About Condo

DECLARANTS' BUDGET STATEMENTS

The *Condominium Act, 1998* (the "Act") requires that amongst the information to be disclosed by the developer (AKA the "declarant") to purchasers of new condominium units is a budget statement that sets out the projected expenses for the first year of operation of the condominium. The first year is the year commencing on the date of registration of the declaration and description creating the condominium plan and corporation.

The purpose of this budget statement is to inform purchasers how much it is expected to cost them to live in the condominium, in terms of their contributions to the common expenses of the property. Those are the expenses of running and maintaining the property to which every unit owner must contribute in the proportions that are set out for their respective units in a schedule to the declaration. Such expenses are over and above the mortgage, tax, insurance and other costs that belong solely to each unit owner.

LOW BALLING IS NOT ADVISABLE

Virtually every purchaser hopes that the common expenses for the unit he or she is buying will not be too expensive. Although, based on the target market and nature of the project, what is considered expensive could vary widely from project to project, from a marketing perspective, declarants usually prefer to show common expenses to be reasonably low. Also, the fact that the declarant will have to pay common expenses on account of any unsold units once the project is registered can prompt a desire to keep common expenses low.

These are reasonable considerations. However, what declarants considering these things should avoid is the temptation to "low ball" the projected first year budget; that is, to set the figures in the budget unrealistically low in order to make the units appear more attractive to buyers.

Such low balling is usually short-sighted. Amongst other things, it does not take into account the risk to the declarant's reputation over time. A declarant who gains a reputation for providing unrealistic disclosure will likely be viewed as unreliable, at best, or, at worst, dishonest. Whether such a reputation exists in the eyes of homeowners with whom the declarant might still have some dealings (i.e., over warranty issues) past the end of the first year of operation of the condominium, or in the eyes of potential purchasers of the declarant's future projects or, or both, it would be good to avoid.

Low balling also doesn't take into account what the declarant may have to deal with if it still owns units in the condominium by the time the first year budget is found to have

been flawed. If the declarant still owns units at that time, it will be in the same position as other unit owners of being responsible to pay suddenly, and likely substantially, increased common expenses or special assessments (particularly if the declarant no longer controls the condominium because a majority of the units have been sold). Not only would the declarant have to pay the proportions of such increases or special assessments that are allocated to its units, but such increases and special assessments could also diminish the marketability of the units that it has not yet sold.

In addition, if it were able to be shown that the budget statement was carelessly or deliberately low balled, the declarant might become liable to unit owners for damages on account of misrepresentation, or at least could incur the costs and aggravation of having to defend against such a claim.

Lastly, the declarant should consider that a low balled budget could ultimately result in increased expenses to itself even if there is no allegation of misrepresentation and if all units have been sold prior to the end of the first year. This is because the Act makes the declarant responsible for the aggregates of both excess expenditures and revenue shortfalls experienced by the condominium in the first year, based upon a comparison of the audited financial statements for the first year and the declarant's budget figures.

Although in some cases the declarant might be able to avoid responsibility for some excess expenses, in general the declarant is simply required to pay up (to the condominium) within thirty days of receiving notice from the condominium of the differences between the actual and budgeted amounts.

Note that the declarant is responsible for the *aggregate* excess expenditures and *aggregate* revenue shortfalls. Therefore, the declarant is not responsible if there are excess expenditures or revenue shortfalls in only one or more categories of either that are set out in the budget, so long as the overall amounts set out in the declarant's proposed budget are the same as or better than actual.

(With respect to the latter comment on segregating out shortfalls or excesses, there might be reason to think that, notwithstanding the wording in the Act, the declarant could be held separately responsible in an appropriate case if the actual amount collected for the reserve fund is inadequate even if the overall revenue is collected or the overall budgeted expenditures are accurate. This is only speculation at this point, but it is a possibility that should probably be considered when assessing the risks of low balling the budget, or if even just the reserve fund contributions are being set to only the minimum requirements of the Act rather than to a professionally recommended reasonable estimate of the amount that actually should be adequate for the purposes of such fund. It is likely best to set the figure in the budget for reserve fund contributions as close to actual as can reasonably be determined.)

PREPARING THE BUDGET

Basic Contents

The Act indicates that the declarant's proposed budget for the first year of operation of the condominium following registration of the declaration and description is to contain all of the following information:

- An overall statement of the common expenses of the condominium;
- the proposed amount of each individual expense (category) of the condominium, including the cost of the reserve fund study required for the year, the cost of the performance audit and the cost of preparing audited financial statements (if the declarant is required to deliver them within one year following the registration of the declaration and description);
- particulars of the type, frequency and level of the services to be provided;
- a statement of the projected monthly common expense contribution for each type of unit;
- a statement of the portion of the common expenses to be paid into a reserve fund;
- a statement of the status of all pending lawsuits material to the property of which the declarant has actual knowledge and that may affect the property after the registration of a deed to the unit from the declarant to the purchaser;
- a statement of the amounts of all current or expected fees, charges, rents or other revenue to be paid to or by the condominium or by any of the owners for the use of the common elements or other facilities related to the property (unless a turn over meeting has been held under section 43);
- a statement of all services not included in the budget that the declarant provides, or expenses that the declarant pays and that might reasonably be expected to become, at any subsequent time, a common expense and the projected common expense contribution attributable to each of those services or expenses for each type of unit;
- a statement of the projected amounts in all reserve funds at the end of the current fiscal year; and
- a summary of the most recent reserve fund study, if any.

Prior to preparing its budget statement, the declarant should have its legal counsel confirm that there have been no additional requirements set out in the regulations made under the Act.

Professional Input

In our view, it is also advisable for the declarant to seek the input of competent professionals as to the amounts that should be estimated and set out in its first year budget. For example, an experienced professional property manager with extensive experience managing condominiums of the type that the declarant is producing will likely be capable of providing a reasonable estimate of the actual costs of running the property for the first year.

Accountants (auditors) and lawyers may be able to provide reasonable estimates of the professional fees condominiums typically incur in the first year as well, though it is more likely that the professional manager can do this. However, if there are any specific legal or accounting functions that it is known will have to be performed and will be charged to the condominium during its first year (such as the preparation of the first financial statements after turnover, entering into specific agreements or the preparation of by-

laws) such professionals' information could help to make the budget more accurate. Likewise, to estimate the costs of preparing the Performance Audit and Reserve Fund Study, which are mandatory expenses for the first year after registration for all condominiums, an engineer or other professional who regularly provides such services should be consulted.

It is also generally advisable for the declarant to obtain advice from an engineer or other qualified professional as to the estimated amount that should be designated for contribution to the reserve fund of the corporation during its first year of operation. At times, this can require that a reserve fund study, or something like it, be completed, particularly where the condominium is a conversion consisting of existing earlier constructed buildings. For new construction, it might be sufficient to rely on information that can be provided by the project engineer or person who is preparing and submitting the Bulletin 19 report for the Tarion Warranty Corporation.

Organization

In our experience, it usually makes sense to arrange the declarant's budget statement (either actually or conceptually) with the following three main sections:

1. Proposed Expense Categories and Amounts

This section should set out in a summary manner the expense categories and projected amounts required or likely to be paid by the condominium during its first year of operation. A chart format is often suitable. All categories of costs that could be expected to arise and need to be paid by the condominium within its first year should be included. This can be as simple or as detailed as the actual circumstances of the condominium require.

The list of budget categories will vary from project to project although there are some standard items, such as performance audits, reserve fund studies, auditing costs, legal costs, insurance (for common elements and the "standard unit" as well as directors' and officers' and other liability insurance) and the costs of running common element utilities, if any, and maintaining or repairing the common elements.

In determining what should be included in its budget statement for the condominium, the declarant should carefully review the project plans and may want to review work proposals and quotes and from various service providers and contractors (such as landscape professionals, property managers, if any are proposed, and persons who conduct reserve fund studies and performance audits). Often an experienced condominium property manager can be a very helpful resource for determining what categories and amounts of expenses should be included in the first year budget for the condominium.

In addition, the declarant should consider getting an engineering firm to come up with at least a rough estimate of required reserve fund contributions, even if based only on the drawings and plans of the proposed condominium.

For some phased condominium developments, budgets have been made that set out the costs in stages, showing how common expenses will change as each new phase is added to the condominium. This is reasonable, but added work. If only a single set of

figures is to be set out in the budget statement for a phased condominium project, it is likely best to use the figures that represent the estimated costs during the year following registration of the final phase of the condominium. Where the final phase could be registered several years in the future, this might not be practical, in which case it would likely be best to set out separate figures for each stage of the development.

2. Details of Each Category and Amount

Closely associated (and sometimes reasonably combined) with the foregoing list or chart of proposed individual expenditure categories is the required explanation of "*particulars of the type, frequency and level of the services to be provided*". However, rather than just estimated figures, this section should provide relatively detailed information about the items included in the budget, to explain clearly what is included in the budgeted amount, and what is not.

It is important that this section be clear and precise as to such inclusions and exclusions, so that it cannot later be alleged that the budget was intended to cover the costs of special services or facilities that the developer never intended (but that the unit owner elected board of directors decided to obtain or implement). When the budgeted figures are later compared with the audited financial statements for the first year of operation of the condominium, any excess expenditure that relates to an item specifically excluded from the budget should not be able to form the basis for a claim by the condominium for the declarant to pay for such excess (possibly provided such exclusion was reasonable).

It is also advisable for this section to clearly indicate whether taxes or inflation have been considered in the budget. Such statements might or might not afford the declarant any protection from a requirement to pay for excess expenditures or shortfalls of revenue on account of such matters, but they will contribute to more accurate and fulsome disclosure.

We also recommend that the budget statement indicate that expenses to be borne individually and paid directly by the unit owners (such as for taxes on, maintenance of and utilities for their own units, where applicable) are not included in the budget statement.

3. Other Notes and Statements

The third and last section of the declarant's budget should include the balance of the information required by the Act in the form of a series of "statements" or "notes" to the budget. Other commentary appropriate to the budget can also be included here. If it has not been set out already, this section should include a statement of the projected monthly common expense contribution for each type of unit.

In conclusion, it should be restated that provision of a proposed budget for the first year of operation of the condominium is not optional. The declarant is required by the Act to provide it. Further, the Act expects, and good business sense suggests, that such budget statement should be as accurate, realistic and fair a portrayal of the costs of living in the proposed condominium as the declarant can determine.

Michael H. Clifton (March 2007)