



# About Condo

## FINANCIAL MATTERS

### THINGS THE BOARD SHOULD CONSIDER ABOUT BUDGETING AND COLLECTING AND INVESTING COMMON EXPENSES

Effective and legally correct management of the condominium finances is essential. It is especially important in view of the statement in section 115(1) of the *Condominium Act, 1998* (the "Act") that,

*A person who receives money on behalf of or for the benefit of the corporation... shall hold the money... in trust for the performance by the corporation of its duties and obligations.*

A trust obligation is very serious and ought not to be treated lightly or in an over confident manner by those who bear it.

The majority of condominium board members, when elected, are not experienced in property management or very familiar with all the provisions of the Act and other legislation describing and determining their responsibilities. Amongst the many matters that may be foreign and somewhat daunting to them are those pertaining to the corporation's finances. Even where there is a professional property manager, he or she may not be especially adept at money management.

In all cases, and regardless of their levels of competence, condominium boards and managers should seek to rely on the advice and assistance of knowledgeable accountants and other professional financial consultants, to help ensure that the condominium's funds are handled in a manner that is consistent with the general obligation of the board to manage the affairs of the corporation honestly and in good faith, exercising the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (see sections 27 and 37 of the Act).

It is also important that the condominium's funds be handled in accordance with the provisions of the Act. In relation to this latter matter, lawyers can also be of assistance.

While we are not professionals in the area of financial management and cannot provide advice such as whether a particular transaction is a "good deal" or a certain investment is advisable, in this memorandum we provide an outline of the most basic legal obligations of condominium boards and managers relating to the management of condominium finances. While significantly more detail would be required to address specific problems or questions that arise from time to time, it is hoped that this outline of fundamental principles and practices will help boards and managers remain out of legal trouble in relation to financial matters.

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*About Condo* memoranda are provided for general information only relating to Ontario condominium law. They are not intended as legal advice. Anyone requiring legal advice relating to any aspect of condominium law should consult competent and qualified legal counsel.

## COLLECTION OF COMMON EXPENSE CONTRIBUTIONS

We start with this topic only because some of the information in it is referred to when discussing other matters.

It is a core principle of condominiums in Ontario that every unit owner is required to contribute a portion of the common expenses of the condominium. The Act does not admit to any exceptions to this rule, including that an owner is not entitled to withhold his or her contribution to the common expenses because of a dispute with the corporation or on account of the fact that the owner lacks the use of certain of the common elements or assets of the corporation.

The amount of the common expenses that a unit owner is to pay is determined by reference to the schedule in the declaration of the condominium (usually Schedule D) that sets out the proportionate share for which each unit is responsible as a percentage of the overall costs of operating the condominium.

For example, the schedule for a six-unit condominium might read as follows:

UNIT	LEVEL	PROPORTION OF CONTRIBUTIONS TO COMMON EXPENSES IN PERCENTAGES	PROPORTION OF COMMON INTEREST IN PERCENTAGES
1	1	17.5%	17.5%
2	1	17.0%	17.0%
3	1	17.0%	17.0%
1	2	16.5%	16.5%
2	2	16.0%	16.0%
3	2	16.0%	16.0%
<b>Total</b>		<b>100.0%</b>	<b>100.0</b>

If the total annual budget for this condominium is \$15,000, then the unit owners would be required to contribute as follows:

UNIT	LEVEL	PROPORTION OF CONTRIBUTIONS TO COMMON EXPENSES IN PERCENTAGES	AMOUNT PAYABLE ANNUALLY	AMOUNT PAYABLE MONTHLY
1	1	17.5%	\$2,625.00	\$218.75
2	1	17.0%	\$2,550.00	\$212.50
3	1	17.0%	\$2,550.00	\$212.50
1	2	16.5%	\$2,475.00	\$206.25
2	2	16.0%	\$2,400.00	\$200.00
3	2	16.0%	\$2,400.00	\$200.00
<b>Total</b>		<b>100.0</b>	<b>\$15,000.00</b>	<b>\$1,250.00</b>

Subject to the by-laws of the corporation, the board can determine when and how common expense contributions are to be paid by the unit owners. Generally common expenses are collected on a monthly basis on the first day of the month, in the same way that rent is usually collected in rental properties. The board may wish to require 'post dated' cheques or some form of automatic withdrawal to help guarantee payment and avoid owners going into default.

If a unit owner fails to pay the amount to be contributed on account of his or her unit when it is due, the unit is considered immediately to be in default and a lien arises against the unit in favour of the condominium corporation. The lien includes interest on the arrears and the reasonable expenses (including legal expenses) of collection or attempted collection of the amount due. The unit owner must pay all those amounts in order to discharge the lien.

The board is entitled to register a certificate of lien against title to the unit while the payment is in default anytime up to three months after the lien first arises (provided appropriate notice is first delivered to the unit owner). Registration of the certificate of lien protects the priority and rights of the condominium corporation in respect of the arrears and all other amounts covered by the lien.

In the event a unit owner is in arrears of common expenses, it is advisable that legal counsel be consulted as early as possible to help avoid losing such protection by missing the statutory deadlines.

## **ANNUAL BUDGET**

In relation to the charts above an "annual budget" for the condominium corporation is mentioned. However, even though there are some provisions of the Act that appear to depend upon there being one (for example, it is a requirement to include a copy of the budget with each status certificate), nowhere in the Act is the corporation specifically required to prepare such a budget.

Although this is the case, in our view it is essential that the corporation have a budget for each year's expenses. We would consider it difficult to state that a board has conducted itself with the care, diligence or skill of a reasonably prudent person if no budget for the condominium was made.

Budget planning for the next fiscal year should begin well before the conclusion of the current year. The budget should be set before the beginning of the year to which it applies.

The budget should cover all the regular costs of operating the condominium, including (for example only and not as an exhaustive list) such things as administrative costs and regular office expenses (phones, supplies, etc.), bank charges, meeting costs, management fees (if any), amounts to be paid under any service contracts (such as landscaping, snow removal, cleaning, maintenance and so forth), property and liability insurance, salaries and deductions if the corporation has any employees, and foreseeable legal and accounting/auditing fees.

A sufficient cushion should be built into the budget to help deal with unforeseen costs, such as unexpected maintenance and repairs that are not payable from the reserve

fund, or legal fees if there are disputes with unit owners or escalating enforcement issues.

Subject to what the by-laws may say, there does not appear to be any obligation to provide unit owners with a copy of the corporation's budget if they do not specifically ask for it. However, it is not unreasonable to give a copy to each owner annually along with the statement (that should be given annually) advising the owner of the amount he or she is required to contribute to the common expenses for the same fiscal period.

## **BANK ACCOUNTS AND RESERVE FUNDS**

The corporation is required to have at least two *separate* bank accounts: one for regular operating expenses, and one for the reserve fund.\*

All regular expenses of the corporation are to be paid from its operating account. The reserve fund account contains the monies that the corporation is required to collect and set aside in a separate account to be used exclusively for major repairs and replacements of the common elements and assets of the corporation.

The reserve fund monies must never be mingled with the other monies of the corporation or used for any purposes other than those specified for them in the Act.

Therefore, the common expense budget technically does not include expenses payable from the reserve fund, even though the reserve fund is in principle a type of common expense. However, contributions to the reserve fund are collected from unit owners in the same proportions as the regular common expenses (the proportions set out in the declaration, as discussed above)\*\* and it is typical for the contributions to the reserve fund to be collected at the same time and in the same manner as the regular common expense contributions.

It is technically contrary to the Act to deposit reserve funds into the operating account of the corporation. Section 115(4) states that the amounts collected for reserve funds must be deposited directly to the reserve fund account. Practically speaking, however, this is rarely if ever what is done. Instead the funds are usually collected in one lump, such as in a single cheque or fund transfer from a unit owner, and are deposited directly to the operating account of the corporation.

Where this is being done, the board should ensure that the reserve fund portion is accurately calculated and *immediately transferred* to the reserve fund account in order to help avoid any misuse or inadvertent depletion of such funds.

*In relation to the foregoing, also note that no part of the reserve fund monies may be "borrowed" to cover general operating costs. A notation in the records of the corporation*

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\* On a related point, sometimes where related condominiums share management the condominiums' respective bank accounts are pooled. A recent Ontario court case suggests that this also should not be done. *Larlyn Property Management Ltd. v. Waterloo North Condominium Corp. No. 71, et al.*, [2007] O.J. No. 1044 (Ontario Superior Court of Justice, Small Claims Court - Kitchener, Ontario).

\*\* For example, in the fictional 6-unit condominium described above, Unit 1, Level 1, pays 17.5% of the common expenses. The owner must also pay 17.5% of the annual reserve fund contributions.

that money is “owed” from the general account to the reserve fund account is in our view evidence of serious error and/or financial mismanagement.

The amount of money that should be contributed annually to the reserve fund is determined by reference to a reserve fund plan prepared by the board in accordance with a reserve fund study that is to be performed *at minimum* every three years (see section 94 of the Act). Then, as already noted, the unit owners are required to contribute to the reserve fund in the same proportions as they pay toward the other common expenses.

Failure to pay reserve fund contributions results in a lien against the unit, the same as with respect to any other default in the payment of common expenses.

### **SPECIAL ASSESSMENTS**

From time to time, there will be unanticipated (and therefore unbudgeted) expenses that the condominium corporation must pay. In such cases, subject to the by-laws of the corporation, the board may assess the owners for the amount of such unanticipated costs.

The proportion of such special assessment that a unit owner pays will be the same proportion that the owner would pay of the regular common expenses. For example, if the owner ordinarily pays 5% of the regular common expenses in accordance with the applicable schedule in the declaration of the condominium, his or her contribution toward the special assessment will likewise be 5% of the special assessment amount.

Although it could be that from time to time special assessments cannot be avoided, in our view for the most part they can and should be. The too frequent occurrence of special assessments may be a signal that a condominium corporation is not being properly or prudently managed.

### **BORROWING**

Borrowing is another way available to the corporation, other than special assessments, to obtain the funds needed for exceptional expenses.

Ideally, borrowing can be avoided by careful, prudent and conservative fiscal planning. However, at times borrowing may be factored into the budget or financial plan (including reserve fund plan) of the corporation. In our view, it is likely only the most unusual case where this is an advisable course of action. Other times circumstances arise that are unforeseen and create the need for borrowed funds. In either case, it is essential that there be a by-law of the corporation that authorizes such borrowing.

The necessity for a by-law necessitates thinking ahead. Generally, it takes at least one month to prepare, approve and register a by-law of any kind. Thus, there are no circumstances in which the board can simply, “all of a sudden” or “on a whim” enter into any kind of loan arrangement. There should always be time for the board to consider carefully its options before committing the corporation to a loan.

When negotiating a loan, the board or manager may wish to seek both legal and financial planning counsel. Although in our view condominiums are relatively secure

borrowers due to their powers to special assess and lien unit owners, not all lenders are very familiar with, or confident about lending to, condominiums. Usually, for condominiums, which typically own no suitable assets to use as collateral (remembering that the condominium corporation does not own the common elements), such security will be in the form of providing the lender the rights to use and benefit from the corporation's powers relating to special assessments and liens in order to ensure it will get paid. Legal counsel may be useful in negotiating such security as well as providing advice with respect to other terms of the loan.

Even where that kind of security is given, the corporation will usually be better off if the board will diligently use such powers itself to ensure that every owner contributes the amount required to pay the debt, rather than allowing the loan to fall into default.

### **OTHER (NON INVESTMENT) INCOME**

We will not dwell here at length on the issue of alternative income for condominium corporations (other than investing, which is discussed hereafter). Condominiums generally don't engage in any business enterprises, though we have encountered some which seek to do so. This topic could be complex and is something best left for serious consideration when a serious issue arises.

Having said this, there are a few means of making money that many condominiums already do engage in regularly. Primarily, such income comes from leases or licenses of the common elements. These can include such things as leasing spare parking spaces or locker rooms to residents, licensing use of a common activity or party room, or leasing the roof top (as in some apartment style condominiums) for telecommunications antennas.

Any condominium entering into any sort of enterprise where money will be earned over and above the regular contributions to the common expenses ought to seek advice from its financial professionals as to any possible tax consequences or other issues. The corporation should anticipate, for example and at the very least, that there might arise a necessity to collect and remit GST, and therefore also a need to file annual returns. To the extent contracts are involved when setting up such arrangements, the involvement of legal counsel is also advisable.

### **INVESTING FUNDS**

Quoted in part above in this memorandum, section 115(1) of the Act states:

*115. (1) A person who receives money on behalf of or for the benefit of the corporation, including money received from owners as contributions to the common expenses or the reserve fund, shall hold the money, together with interest and other proceeds earned from investing it, in trust for the performance by the corporation of its duties and obligations.*

Also, section 115(3) states:

*(3) Each of the accounts [of the corporation] shall be located in Ontario at a bank listed under Schedule I or II to the Bank Act (Canada), a trust corporation, a loan corporation, a credit union authorized by law to receive money on deposit or a Province of Ontario Savings Office.*

Accordingly, the corporation's funds – whether regular common expenses or reserve funds – simply cannot be regularly held by investment dealers or others who do not qualify under Section 115(3). However, this does not mean that portions of the corporation's monies cannot be invested at all.

The Act permits some investment of both the regular and reserve funds of a condominium. In either case, such funds may only be invested in "eligible securities". These are defined in section 115(5) of the Act as follows:

*(5) "eligible security" means a bond, debenture, guaranteed investment certificate, deposit receipt, deposit note, certificate of deposit, term deposit or other similar instrument that,*

*(a) is issued or guaranteed by the government of Canada or the government of any province of Canada,*

*(b) is issued by an institution located in Ontario insured by the Canada Deposit Insurance Corporation, or*

*(c) is a security of a prescribed class. [To date there are none prescribed.]*

Investment of the general operating funds of the condominium is further limited by section 115(6) which states:

*(6) The board may invest all or any part of the money in the corporation's general accounts in eligible securities if,*

*(a) they are convertible to cash within 90 days following a request by the board; and*

*(b) they are,*

*(i) registered in the name of the corporation, or*

*(ii) held in a segregated account under the name of the corporation by a member of the Investment Dealers Association of Canada and insured by the Canadian Investor Protection Fund.*

As for reserve fund monies, section 115(7) of the Act states:

*(7) Subject to subsection (8), the board may invest all or any part of the money in the corporation's reserve fund accounts in eligible securities if they are,*

*(a) registered in the name of the corporation; or*

*(b) held in a segregated account under the name of the corporation by a member of the Canadian Investment Dealers Association and insured by the Canadian Investor Protection Fund.*

Section 115(8) reads:

*(8) Before investing any part of the money in the corporation's reserve fund accounts, the board shall develop an investment plan based on the anticipated cash requirements of the reserve fund as set out in the most recent reserve fund study.*

Accordingly, it would appear that there can be no investment of monies from a reserve fund account until the condominium has conducted a reserve fund study under the Act. It should be supposed that, for practical purposes at least, the board also could not make its investment plan until it has first made its reserve fund plan based upon the study in accordance with section 94(8) of the Act.

While it is doubtful a Court would force a condominium to return its investments to the reserve fund account pending the completion of a reserve fund study, if the board has unwittingly invested such funds in the meantime, it would be advisable to seek to comply with the Act in respect of the investment of reserve funds, especially before making any further investments. Otherwise the corporation's auditors may be forced to make negative comment in the financial statements relating to the investment of reserve funds (i.e., that such investment is contrary to Section 115(8)). Furthermore, beyond the risk of an embarrassing note in the audit, the condominium runs the risk that some part of the reserve funds would be tied up in investments at the very time the study and plan would indicate such are needed to pay for repairs or replacements that should be able to be covered by the fund.

Given the specificity of the above quoted provisions of the Act, it is our advice that any condominium seeking to participate in investments obtain advice from a financial consultant who is experienced with and knowledgeable of those provisions to help ensure that none of the corporation's funds are ever put into improper investment vehicles.

## DOCUMENTATION AND AUDITS

In relation to all of the foregoing, it is important for the condominium board and/or manager to keep proper, detailed and accurate records of all financial transactions. Section 115(9) of the Act states:

*(9) A person who receives money under subsection (1) [quoted above in this memorandum] shall keep records relating to the receipt and disposition of all money under this section and shall, upon reasonable notice and at all reasonable times, make the records available for examination by the corporation, an owner or a mortgagee.*

Each condominium board should ensure that the records of their condominium are in compliance with these requirements. Such records will also greatly assist in the annual audit of the corporation's funds.

It is strongly recommended that condominiums be regularly audited. Even where a waiver of audit requirements is permitted by the Act, under section 60(5) of the Act, it is not recommended that this be done every year. Audits can contribute to the condominium board's and manager's education about how to handle funds, and, more importantly, provide some protection from fraud, serious error and other problems that could put such boards and managers on the wrong side of the law in regard to their very serious obligations relating to handling the condominium's funds.

Michael H. Clifton (August 2007)