

AFTER THE DEPRECIATION REPORT WHAT COMES NEXT?

BY JAMIE A. BLEAY, BARRISTER & SOLICITOR

ACCESS LAW GROUP 1700 – 1185 W. GEORGIA STREET VANCOUVER, B.C. V6E 4E6

What Comes After The Depreciation Report?

The title to this presentation is "After The Depreciation Report - What Comes Next" so let's assume that everyone lives in a building that has obtained a depreciation report. You have gathered all necessary records and documents, such as budgets and financial statements, engineering reports, historical repair/replacement invoices, service/maintenance manuals and service contracts, insurance policies and appraisals; the strata plan, any existing as-built plans, agreements with strata lot owners regarding common property and limited common property alterations, limited common property designations, etc; and hired a "qualified person" who has prepared and presented to you what is now one of the most important documents that your strata corporation is required to obtain.

Now, pursuant to section 59 of the Strata Property Act, the depreciation report must be disclosed to any "owner, purchaser or a person authorized by an owner or purchaser" who makes a request for an Information Certificate. All of a sudden your strata corporation now has to disclose a detailed plan that identifies all that is good, bad or otherwise with the inventory/major items to potential purchasers into your building!

After the depreciation report comes the gnashing of teeth each time it is disclosed to any individual: purchasers, real estate agents, insurance companies and banks who will all likely place great importance on the accuracy of the contents of your depreciation report.

While the accuracy of the depreciation report is important, of equal or greater importance is having in place an accurate financial forecasting section (see section 6.2(3) of the regulations) that is to include at least 3 cash-flow models for the CRF relating to the maintenance, repair and replacement over 30 years (beginning with the current or previous fiscal year of your strata corporation) for all the items listed in your physical component and inventory section (see section 6.2(2) of the regulations.

Not much is said in the regulations about the funding models other than that the cash flow funding models can include:

- Balance of the CRF and anticipated contributions and withdrawals from the CRF [section 6.2(4) of the regulations]
- Funding from special levies;
- Funding from borrowing.

Leaving aside the new regulations regarding funding of the CRF, what you need to consider when looking at funding models is whether the minimum period of 30 years is preferable or is a longer period of time worth looking at. This will depend on the age and condition of your building. In addition, it is important to know the risk tolerance of the owners and how that impacts on the amount and timing of upcoming expenditures

required by the depreciation report. You will also need to consider the impact of interest rates and inflation on the CRF balance from year to year.

Generally speaking, any funding scenario will need to take into account all of the forecasted expenses, identify any "highs" and "lows" in the forecasted expenses, and attempt to identify the actual contributions required (for the models) to ensure that an unexpected deficit does not occur.

At a recent Canadian Condominium Institute seminar on depreciation reports one of the presenters (Kevin Grasty of Halsall Associates) recommended these funding models:

- 1. Fully funded/inflation matched (no special levies);
- 2. Current contribution approach and special levies; and
- 3. Alternate scenarios between scenario # 1 and scenario # 2 (phase-in contribution increase and smaller/less frequent levies.

Another consideration somewhat related to risk tolerance is the demographics of the ownership and the historical rate of ownership turnover within a strata corporation. The more stable the ownership, the more willing they may be to agree to a more aggressive funding model than in a building with a high amount of turnover. At the end of the day the funding model will need to be fair, balancing the interest of present and future owners, as well as take into account the upper limits of monthly contributions toward the CRF and the extent to which the owners will likely be able to pay for future special levies. It will also need to be flexible and consider, with the help of the qualified person who prepared the depreciation report, whether there are any options that might allow a strata corporation to keep CRF contribution increases stable. For example, if a major item is, according to the report, at the end of its service life but is still performing adequately, can the replacement of this item be deferred for a further period of time?

CRF contributions as a source of funding is inevitable; how much the CRF contributions will need to be, and whether or not some expenditures can be reduced, deferred, or avoided completely, will be the subject of a moving target which will be revisited every three years after the initial depreciation report is obtained, as the report must be updated every three years.

While the Act does not make it mandatory for strata corporations to implement the funding component of a depreciation report once they obtain the report, the funding is for all practical purposes the next logical step to take. Provided the plan is updated every three years and the repair/replacement programs are properly managed, implementation of the plan will (subject to possible funding issues) greatly assist the strata corporation in managing its common property and common assets.

How might depreciation reports (or lack thereof) impact on property values?

Unless a strata corporation is exempt from the requirements of a depreciation report (or annually waives the requirement), depreciation reports are now mandatory in B.C. In

order to be effective, depreciation reports will need to be accurate and thorough. Keeping in mind that a depreciation report now has to be disclosed pursuant to section 59 of the SPA, the existence of a good depreciation report will, more likely than not, have a positive impact on the value of strata lots, especially in a competitive real estate market.

A thorough and well-prepared depreciation report will identify the need for significant expenditures over the 30 (or 40 or 50) year period captured by the report and will include three cash-flow funding models that will identify and establish the manner in which the current and future repair and replacement costs will be funded. The report will take the guess work out of trying to determine the accuracy and transparency of strata council minutes and will identify all repair, maintenance, and replacement issues for the major items for a building. The report will, if properly implemented, give owners and potential purchasers comfort in knowing that there is an adequate funding plan in place and what their ongoing costs will be, regardless of how long they plan to own their strata lot. Without a report, future special assessments to pay for a significant repair of a major item or to replace a major item is unknown.

With a depreciation report in hand, a purchaser and his/her mortgage provider can see what the purchaser's costs of ownership will be, moving forward. Implementation of the report should help to extend the serviceable life of the major items through the maintenance plan in the report, and maintain or even improve the exterior and interior condition of the building and its components to create a kind of "street appeal" for purchasers, mortgage providers and insurance providers. This should provide a significant level of certainty that there will not be any "surprises" in the way of unforeseen special assessments. It will likely have a positive rather than a negative impact on a mortgage provider's decision to approve a mortgage. While the fear of increased monthly contributions and periodic special levies to fund the repair and replacement costs is real and may scare away some purchasers, over time strata corporations that have depreciation reports in hand and who have taken steps to fund the repair and replacement costs will be better served than those who have not. A good depreciation report should help sustain or even increase property values when it is evident that the strata corporation has a viable plan in place and is financially committed to the plan. Once owners buy into the idea of obtaining a depreciation report and agreeing to fund the repair/replacement plan, they will understand: consistent low fees are not a good thing!

Collection of contributions and special levies:

It's one thing to get 75% of the owners to buy into obtaining and paying for a depreciation report, and to get them to agree to pay more in monthly contributions and periodic special levies. It is another thing to successfully collect and recover those contributions to fund the plan. However, if arrears of these contributions are allowed to build up, several things come into play. Firstly, any strata corporation in this predicament will start to fall behind in funding the repair and replacement plan. Secondly, owners who are not in default in making their contributions will, if the funding plan is a critical stage, have to make additional contributions to make up for the

"shortfall". Finally, word may get out to realtors and mortgage providers that there are "money" problems and this could impact on the perceived value of the building.

So what does the Act say about monies due and owing to a strata corporation? The collection of money due and owing by an owner to a strata corporation is generally covered by Division 6 of the Act. Division 6 states:

Division 6 — **Money Owing to Strata Corporation**

Notice to owner or tenant of money owing to strata corporation

- 112 (1) Before suing or beginning arbitration to collect money from an owner or tenant, the strata corporation must give the owner or tenant at least 2 weeks' written notice demanding payment and indicating that action may be taken if payment is not made within that 2 week period.
- (2) Before the strata corporation registers a lien against an owner's strata lot under section 116, the strata corporation must give the owner at least 2 weeks' written notice demanding payment and indicating that a lien may be registered if payment is not made within that 2 week period.

Notice to mortgagee

- **113** If a mortgagee has given the strata corporation a Mortgagee's Request for Notification under section 60, the strata corporation
 - (a) may give the mortgagee written notice that the strata lot owner has failed to pay money owing to the strata corporation for more than 60 days, and
 - (b) must give the mortgagee a copy of any notice given to the owner under section 112.

Disputed debt

- **114** (1) If there is a dispute over whether an owner or tenant owes money to the strata corporation, the owner or tenant may pay the disputed amount
 - (a) into court if court proceedings have been started and the Rules of Court allow payment into court, or

- (b) to the strata corporation to hold in trust if the matter has been referred to arbitration or if court proceedings have been started.
- (2) On receipt of an amount under subsection (1) (b), the strata corporation holds the money and any interest on the money in trust for the parties to the dispute until the dispute is resolved.
- (3) After the dispute is resolved, the strata corporation must pay the amount to the party entitled to it as set out in the decision of the court or arbitrator.

Certificate of Payment

- 115 (1) Within one week of the request of an owner or purchaser, or a person authorized by an owner or purchaser, the strata corporation must give the person making the request a Certificate of Payment in the prescribed form if
 - (a) the owner does not owe money to the strata corporation, or
 - (b) the owner does owe money but
 - (i) the money claimed by the strata corporation has been paid into court, or to the strata corporation in trust, under section 114, or
 - (ii) arrangements satisfactory to the strata corporation have been made to pay the money owing.
- (2) The certificate is current for the purposes of section 256 for a period of 60 days from the date it is issued.
- (3) The strata corporation may charge a fee for the certificate, but the fee must not exceed the amount set out in the regulations.
- (4) In completing the certificate, the strata corporation may include money owing in respect of
 - (a) the matters set out in section 116, and

- (b) fines and the costs of remedying a contravention of a bylaw or rule charged against the owner or fines and costs for which the owner is responsible under section 131.
- (5) A certificate must not include claims of damages against an owner which have not been determined by a court or by arbitration.

Certificate of Lien

- 116 (1) The strata corporation may register a lien against an owner's strata lot by registering in the land title office a Certificate of Lien in the prescribed form if the owner fails to pay the strata corporation any of the following with respect to that strata lot:
 - (a) strata fees;
 - (b) a special levy;
 - (c) a reimbursement of the cost of work referred to in section 85;
 - (d) the strata lot's share of a judgment against the strata corporation;
 - (e) [Repealed 1999-21-25.]
- (2) The strata corporation may register a lien against any strata lot, but only one strata lot, owned by an owner as owner developer, by registering in the land title office a Certificate of Lien in the prescribed form if the owner developer fails to pay an amount payable to the strata corporation under section 14 (4) or (5), 17 (b) or 20 (3).
- (3) Subsections (1) and (2) do not apply if
 - (a) the amount owing has, under section 114, been paid into court or to the strata corporation in trust,
 - (b) arrangements satisfactory to the strata corporation have been made to pay the money owing, or

- (c) the amount owing is in respect of a fine or the costs of remedying a contravention.
- (4) On registration the certificate creates a lien against the owner's strata lot in favour of the strata corporation for the amount owing.
- (5) The strata corporation's lien ranks in priority to every other lien or registered charge except
 - (a) to the extent that the strata corporation's lien is for a strata lot's share of a judgment against the strata corporation,
 - (b) if the other lien or charge is in favour of the Crown and is not a mortgage of land, or
 - (c) if the other lien or charge is made under the *Builders Lien Act*.
- (6) On receiving the amount owing, the strata corporation must within one week remove the lien by registering in the land title office an Acknowledgment of Payment in the prescribed form.

Forced sale of owner's strata lot to collect money owing

- 117 (1) After the strata corporation has registered a Certificate of Lien against a strata lot, the strata corporation may apply to the Supreme Court for an order for the sale of the strata lot.
- (2) If the strata corporation has obtained a judgment for the amount owing, the court may, after considering all the circumstances, make an order for the sale of the strata lot.
- (3) If the strata corporation has not obtained a judgment for the amount owing, the court may try the issue and may
 - (a) order that judgment be entered against the owner in favour of the strata corporation for the amount of the lien or for an amount that the court, as a result of the trial, finds owing, and
 - (b) if judgment is entered against the owner, make an order for the sale of the strata lot after considering all the circumstances.

(4) An order for the sale of a strata lot must provide that, if the amount owing is not paid within the time period required by the order, the strata corporation may sell the strata lot at a price and on terms to be approved by the court.

Costs added to amount owing

118 The following costs of registering a lien against an owner's strata lot under section 116 or enforcing a lien under section 117 may be added to the amount owing to the strata corporation under a Certificate of Lien:

- (a) reasonable legal costs;
- (b) land title and court registry fees;
- (c) other reasonable disbursements.

What does this all mean to a strata council faced with mounting strata fees and/or special levies associated with the funding of a depreciation report? It means that there is a process akin to a "foreclosure" process that enables a strata council to pursue recalcitrant owners for monies due and owing, including interest (section 6.8 of the Regulations now permits a maximum interest rate of 10% to be charged on outstanding strata fees and special levies if provided for in a bylaw) and that these amounts, including the costs under section 118 of the Act, are "lienable" and rank in priority to most other financial charges.

As for process, the initial demand pursuant to section 112 of the Act may do the job. If not, you will likely need to retain the services of a lawyer to take the steps (once the lien if registered) to collect the amounts due and owing AND, if the matter proceeds to court, to obtain judgment for the amounts due and owing, including court costs, and an order for sale in the event the owner (or the owner's bank) does not "redeem" the property by paying the amount due and owing.

On rare occasions it is necessary for a strata council to engage a real estate agent and list the owner's property for sale pursuant to the order for sale, and go to court to have the sale approved, after which the strata corporation will ultimately recover the amounts it is owed from the net sale proceeds! Although many Judges refer to this entire collection process as "draconian", it is a very useful and effective way for strata corporations to recover strata fees and special levies so that the funding of a depreciation report can be maintained.