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Condo Connection

Wilson, Blanchard Management Inc. – *Your Solution to Property Management*
www.wilsonblanchard.com

Insurance & Taxes

By Karen Reynolds & Jeff Lack, Co-Editors

Inside This Issue

Welcome to our 2nd edition of the WB Condo Connection, a newsletter intended to highlight Ontario condominium related articles and educational items that may be of interest to Boards of Directors and condo owners.

As promised, this edition features an article summarizing many of the common Insurance aspects that pertain to condominium living. In addition, two important recent tax changes affecting condos are outlined in this issue – the Home Renovation Tax Credit and the *proposed* Harmonized Sales Tax.

Currently, our newsletter is published online and available for download on our website (www.wilsonblanchard.com) as well as in hard copy format to the President of each of our Boards of Directors.

As always, we hope you enjoy this edition and we welcome your comments. Please direct any comments, suggestions or article topic requests by email to newsletter.editor@wilsonblanchard.com or by mail to:

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Property Insurance & the Condominium

By Karen Reynolds, ACCI, FCCI, R.C.M., A.I.H.M.

Simply put, any individual owning or living in a condominium must carry liability and property insurance. Liability coverage is quite straight forward however property insurance is probably one of the most confusing subjects regarding condominium lifestyle. What does the corporation insure, what does the owner insure, what does the tenant insure and what happens when a claim is filed? The intent of this summary is to discuss property insurance only and the following should provide basic answers to these questions and hopefully clarify the insurance responsibilities.

A standard condominium corporation is comprised of the units, common elements and exclusive use common elements the boundaries of which are provided in each corporation's documents and in every standard condominium it is the corporation's duty to insure all three components for the full

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replacement value. Exclusive use common elements are those areas of the corporation of which unit owners have sole use such as a driveway, or rear yard in a townhouse or a balcony in a high-rise building. If the unit boundaries extend to the curb at the front of your unit and the fence line at the rear of your unit and have no vertical boundaries, then everything in between is considered "unit" and therefore insured by the corporation's policy excluding improvements.

In that same scenario it is unlikely there would be any "exclusive use" common elements as the remainder of the corporation would be common elements so all would be covered under the corporation's policy for major perils such as fire, lightning, smoke, windstorm, hailstorm, explosion, water escape, vandalism or malicious acts, to name a few.

With respect to property, the owner is responsible for insuring any betterments to the unit, including those installed by a previous owner, and any personal belongings. If the developer has not turned over a standard unit definition at the turnover meeting, the Act includes a provision which allows the corporation, with majority consent of the unit owners, to modify the standard unit by passing a "Standard Unit By-law". Betterments or improvements are defined within the "Standard Unit By-law" which can eliminate specific aspects such as floor coverings or counter tops or can limit the standard of those features to, for example, builder's grade. It is important to familiarize yourself with the corporation's standard unit by-law and provide a copy to your insurance broker to eliminate the possibility of any gaps in your coverage.

"When damage occurs…it does not matter what caused the damage or where the cause originated but who is paying for the insurance coverage."

If you are not an owner but reside in a condominium unit, a tenant's package is sufficient as you are responsible for carrying coverage on your personal belongings and public liability. As an absentee owner, if you have made improvements to your unit and lease your unit you are still required to insure those betterments.

To determine what the "full replacement value" of the property might be, it is necessary to enlist the services of a reputable insurance appraiser and have an appraisal conducted. Many declarations include a provision to this extent spelling out the frequency with which the appraisals should be undertaken.

It is when damage occurs that the water seems to get muddied and many managers, boards and owners have difficulty understanding whose insurance will respond and who will pay the deductible. The easiest way to remember how insurance works in a condominium is that it does not matter what caused the damage or where the cause originated but who is paying for the insurance coverage on the damaged property. If the unit or common elements are damaged, then the corporation's insurance will respond however if it is personal property or an improvement to the unit then a claim against the homeowner's policy will be made.

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Deductibles also present some confusion because if damage is a result of an act of negligence or omission on the part of the owner and contained within their unit, the corporation can charge back an amount up to an amount equivalent to the deductible. Owners may obtain insurance to cover the amount of the deductible through their homeowners policy. With the majority consent of the owners, these circumstances can be expanded by passing a by-law which would make the owner of a damaged unit responsible for the deductible for damage that neither they nor the corporation caused to their unit, another owner's unit or the common elements. Otherwise, if a damage claim is processed, the condominium corporation is responsible for the deductible.

This summary addresses property insurance only in a very basic and brief manner and in no way is intended to provide a comprehensive review. It is also important to note that we have addressed only standard condominiums. If you own a vacant land or common elements condominium unit, the obligation to insure any structure on the unit is the owners. Your assigned property manager will be able to provide additional, more detailed information with respect to other insurance coverage owners and corporations require, the Standard Unit By-Law and also with interpreting your Declaration, and Description to determine unit boundaries and common elements.

Insurance Appraisal

As noted above, in a standard condominium corporation the corporation must insure the units and common elements for their full replacement value. How do you, as members of the Board, know what that value might be? Many rely on the increases implemented by their insurance carriers each year when the policy renews. This is not a recommended practice. If a major catastrophe occurs where property is substantially damaged and the insurance coverage is inadequate, where do the funds come from to repair and/or replace the damage? That's right, the owners. It is well worth the fees charged by a reputable company to have an appraisal undertaken and values adjusted accordingly. Many condominium declarations include a provision which stipulates the frequency with which the appraisals must be done, for example, prior to each renewal of the insurance policy.

Insurance Trustee

Many condominium declarations provide that the corporation shall retain an insurance trustee. The purpose for this provision is primarily to protect the interests of mortgage lenders as well as the owners. In the event of a large claim (typically in excess of $25,000.00), the cheque is issued to the insurance trustee to prevent the funds from being deposited in the corporation's bank account where, at the discretion of the Board, it may be used for other purposes rather than repairing any damage or worse yet, becoming a temptation for fraud.

Set-up fees and annual costs to a trust company can be expensive and therefore unattractive to a corporation who is trying to keep maintenance

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fees as low as possible but corporations may find that potential purchasers may experience difficulty obtaining mortgage funds for properties where an insurance trust agreement is not in place. As a more reasonable alternative, many professional firms such as lawyers and/or accountants will provide the corporation with written confirmation that, in the event a trustee is required, they will act in that capacity. This documentation is kept on file for the corporation and provided either with the status certificate or upon request.

What About Volunteers/Committees?

We are often asked about the liability exposure to a corporation that utilizes volunteers or committees to tackle projects within the corporation in an effort to keep costs down. Depending on the level of risk involved with the tasks they undertake, it can be as simple as providing your insurance broker with confirmation of the committee and their anticipated role. Providing the volunteers are not endangering themselves or other residents it is not a problem and they can be covered under the corporation's policy for a nominal, if any, amount. We have even arranged for coverage in a corporation where one owner agreed to use his snow blower to remove the snow from all interior walkways. Contact your insurance provider for specific details to determine whether your situation qualifies for additions to your coverage and/or premium to cover the volunteers within your community.

What Does Management Do in the Event of Insured Property Damage?

When water escape or penetration is causing damage to a unit the obvious first action is to locate the cause and shut the water off or have the problem repaired. The manager will then arrange to have a reputable contractor visit the unit to extract any surface water and take all necessary steps to avoid any contamination of the area as a result of grey water or the possibility of mould. The manager will work with the corporation, the owner, service providers and insurance adjuster to ensure the unit is restored as quickly as possible.

Assuming that emergency personnel have already been contacted, in the event of a fire, smoke, windstorm or explosion the first concern of the manager is the safety of all occupants of the unit and any neighbouring units. It is not the manager's responsibility to provide lodging for unit owners who may be displaced. Unit owners and tenants should ensure they have sufficient coverage within their condominium package or tenant's package to cover the costs should they be forced to lodge outside of their home for an extended period of time. Again, once the cause of the damage has been ascertained, the manager will work with the Board, the owners, service providers and insurance adjuster to ensure the unit is returned to a livable condition as quickly as possible.

Harmonized Sales Tax

By Jeff Lack, BAcc, CGA

It appears that the new single Harmonized Sales Tax (HST) will replace the current dual tax system of GST and PST in Ontario beginning July 1, 2010. Although not yet officially passed by the provincial government, there is no indication that the government will backtrack on this proposed change. While many of the details have yet to be announced (as is usually the case with proposed tax changes) the total tax rate will remain the same (13% for the HST versus 5% + 8% for the GST + PST). However, the list of "exempt" items will be reduced drastically which will have a significant effect on condominiums.

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In general, items that were previously GST exempt (federally), such as insurance, will remain so and will be charged at the current PST-only rate of 8%. However, there are very few items that fall into this category.

On the other hand, items that were previously PST exempt (provincially in Ontario) under the old system will ***not*** be exempt from the full HST. As a result, there exists a significant list of services that will now be taxed at 13% rather than 5%. This results in an automatic 8% increase in the cost of many expenses that directly affect condos (for a partial list of expenses that are currently PST exempt but will ***not*** be HST exempt, see below).

While much of the literature released by the government suggests that condo fees will remain 100% tax exempt (which is technically true), this is, at best, misleading. Condo fees have always been and will continue to be tax exempt. However, condo fees are derived from the total shared expenses of the corporation. As many of those expenses will rise by 8% under the new HST, individual condo fees must rise accordingly in order to cover the increased costs.

Budgeting

Upcoming condo budgets (at the time this article is being written) for July and later year-ends will be immediately affected by the new HST, despite the tax not taking effect until July 1, 2010. If your corporation has a July year-end, expenses for items that are currently PST exempt will be taxed at 5% (GST only) for the first 11 months of your new fiscal year, but 13% (HST) for the last month (July 2010). Likewise, an August year-end budget must take into affect 2 months of expenses at the new HST rate (July & August 2010) and so on.

It is likely that the new tax rate will be applied based on invoice dates, as has been the case with previous tax rate changes. As such, annual items (such as the Audit) will be effectively taxed at 13% for the entire fiscal year. For example, the audit for a July, 2010 year-end is not completed (and invoiced) until September, 2010. At that time, the new tax system will be in place, therefore the audit fee for the entire period August 1, 2009 to July 31, 2010 will be taxed at the HST rate of 13%.

Effect on Reserve Fund Studies

Furthermore, the change in tax rate may have a devastating effect on current reserve fund studies. Most reserve fund items are quoted and invoiced on a contract basis which in the past has been subject to GST only. As such, engineers have estimated future costs for many reserve items based on 5% GST. Condos have saved for future repairs and replacement based on these estimates. However, beginning July 1, 2010 the total cost of these major projects will now include the 13% HST. This may result in a significant shortfall of reserve funds for future major expenses.

As a very simplified example, imagine a highrise condo that is preparing for a major window replacement program. The cost is estimated to be $500,000 + tax. The condo has been saving,

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through their reserve fund, for this project for many years and expects to have the required $525,000 (including 5% GST) saved by June 30, 2010. However, on July 1, 2010, the cost of this project will increase to $565,000 (including 13% HST) overnight, resulting in a $40,000 shortfall. Whether the project is delayed (if possible) until further funds are saved or a special assessment is levied to raise the additional funds, the money will eventually come from the same source - the owners. This worst case scenario may not apply to all reserve items as every situation is unique and some projects may already include current PST on materials. In fact, one significant engineering firm in the Ontario condo industry recently estimated that the average reserve fund study would be hit with a 6% shortfall (reflecting the fact that some items in the study already took in to account the current PST) rather than the full 8% increase of the new HST.

When reserve fund studies are updated, which is required every 3 years, engineers will have to revise their estimates of future costs to take into effect the increase in taxes. This will result in significant increases in the level of savings for future reserve fund items, and may include a significant "catch up" amount for past savings (i.e. for the $40,000 shortfall in the example above that has been generated overnight by the tax increase). This again will result in an increase in condo fees to cover the new reserve fund requirements.

Non-Exempt Costs

The following is a partial list of condo-related items that are currently PST exempt in Ontario and are therefore charged 5% GST only. As of July 1, 2010 these items will be taxed at the new HST rate of 13%.

- Hydro
- Gas (both natural gas & gasoline)
- Professional services (audit fees, legal fees, management fees, engineers etc.)
- Internet, phone, cell phones, pagers
- Cable & Satellite TV
- Contracted services (landscaping, maintenance contracts, security services etc.)
- Repair services (plumbers, electricians, handymen etc.)
- Major project contracts (reserve repair & replacement contracts)

Home Renovation Tax Credit

By Jeff Lack, BAcc, CGA

Many questions have been raised with respect to the 2009 Home Renovations Tax Credit (HRTC) introduced by the Federal Government as part of the 2009 Budget. Both the Canadian Condominium Institute (CCI) and a significant coalition of Ontario lawyers have petitioned the Canada Revenue Agency (CRA) for clarification with regards to how the HRTC will affect condominiums and renovations to common elements. To date, no reply has been received from CRA. We do know however that the credit does apply to an owners' share of the costs associated with renovations made to the common elements of a condominium. As such, please find below a brief summary outlining how the HRTC will apply. Wilson, Blanchard Management will track HRTC eligible expenses during the eligible period

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and report these expenses to the owners in March, 2010 as information for their 2009 Personal Income Tax return. In the event there is a change in unit ownership during the year, it is the responsibility of the seller and purchaser to come to an agreement regarding how to split the potential tax credit.

It is important to note that this is a non-refundable tax credit eligible to be claimed on 2009 Personal Income Tax returns. This is not a direct tax rebate or cash refund.

HRTC SUMMARY

Based on our current understanding and the limited information that has been released by the Federal Government, the HRTC will work as follows:

1. A maximum non-refundable tax credit of $1,350 is available for home renovations in 2009. The credit is calculated as 15% of expenditures over $1,000 but less than $10,000 ($9,000 x 15% = $1,350).
2. Expenditures must be made after January 27, 2009 and before February 1, 2010. Expenditures in that period that are made pursuant to an agreement entered into before January 28, 2009 are ***not*** eligible.
3. Credit can only be claimed for dwellings that are eligible as a principal residence under existing tax law. As such, this does not apply to commercial condos.
4. The credit is available for eligible expenditures to renovate an individuals' own unit as well as the owners' share of eligible expenditures incurred in respect of common elements. The aggregate total of the expenditures may be claimed, not exceeding $10,000.

"The HRTC does apply to an owners' share of the costs…made to common elements."

5. Expenditures will be eligible provided the renovation is of an enduring nature ***and*** is integral to the dwelling. Expenditures for routine repairs and maintenance normally performed on an annual or more frequent basis are ***not*** eligible.

For additional information, including examples of what expenditures will and will not qualify for the HRTC, please visit the CRA website at http://www.cra-arc.gc.ca/hrtc/.

DISCLAIMER: Wilson, Blanchard Management is unable to provide personal tax advice to individual owners. Our responsibility is to manage your corporation and in accordance we will provide relevant information to the owners about the activities of their corporation. As every individual tax situation differs, it is the responsibility of each individual owner to decide how to use the information that is provided to them for their own personal tax situation. For all personal tax issues, owners should seek advice from a designated professional accountant.

We will continue to seek clarification from CRA through both our lawyers and the CCI with respect to the effect of the HRTC on condominium corporations and their common elements.

Wilson, Blanchard in the Community

Each year, Wilson, Blanchard Management contributes to worthwhile causes within our community and beyond, both financially and through volunteer activities. So far this year, our Staff Fund, corporate donations and volunteer hours have assisted:

- CNIB
- Casey House
- ALS Society of Canada
- Hamilton / Burlington SPCA
- McMaster Children's Hospital
- Freedom Village Canada
- Scott Mission
- Daily Bread Food Bank
- Hamilton Food Share
- World Vision
- Canadian Cancer Society – Relay for Life
- Ancaster Community Services
- James Fund for Neuroblastoma Research at SickKids Hospital

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