



FEATURES THIS MONTH

1. VCS Is Required By Law
2. Insurance Confusion
3. Marching Orders
4. What To Do With That Operating Surplus?

NEED GOOD SITES FOR STRATA CORPORATION INFORMATION?

Here are some sites you can access:

Strata U. - Continuing Education Department web site links of interest:

- Canadian Condominium Institute: <http://www.cci.ca>
- Condominium Home Owners Association: <http://www.choa.bc.ca/index.html>
- Clark, Wilson, Barristers & Solicitors: <http://www.cwilson.com/stratafaq>
- *Strata Property Act* information web site: http://www.qp.gov.bc.ca/statreg/stat/S/98043_01.htm
- Vancouver Condominium Services: <http://www.vancondo.com>

1. VCS Is Required By Law

As you know, VCS is licensed and governed by the Real Estate Council of B.C. Further, we are bound by the *Real Estate Services Act* (RESA). As such, there are certain standards we must meet. For example, note some extracts of Section 3-3 of the RESA, as follows:

Duties to clients

- 3-3 (1) Subject to subsection (2), if a client engages a brokerage to provide real estate services to or on behalf of the client, the brokerage and its related licensees must do all of the following:
- (a) act in the best interests of the client;
 - (b) act in accordance with the lawful instructions of the client;
 - (c) act only within the scope of the authority given by the client;
 - (d) advise the client to seek independent professional advice on matters outside of the expertise of the licensee;
 - (e) maintain the confidentiality of information respecting the client;
 - (f) take reasonable steps to avoid any conflict of interest;
 - (g) without limiting the requirements of Division 2 [*Disclosures*] of Part 5 [*Relationships with Principals and Parties*], if a conflict of interest does exist, promptly and fully disclose the conflict to the client.

Although you, as council members, are not directly bound by these provisions, we do ask you to be aware of, and remember, them when you are directing the VCS agent to undertake certain tasks.

2. Insurance Confusion

Of the 170 strata corporations managed by VCS, over 100 have insurance policies which expire on December 31st. The remaining policies expire at varying times during the calendar year (mostly January to May).

For the December renewal just gone by, VCS requested quotations from the leading brokers in strata corporation insurance policies/programs. These firms were BFL Canada, CMW Insurance and Coastal Insurance. VCS did not request a quotation from the Co-Operator's Insurance although that firm is often viewed as a provider of strata corporation insurance policies.

In addition to the above-noted firms, VCS has a few clients who choose brokers known to council members but not known to VCS - the rationale being that such insurance programs can be obtained at lower premiums. More about this further in this article.

As it turned out, the only firm that provided quotations for the recent renewal was BFL Canada. Coastal Insurance and CMW Insurance, although invited, declined to offer quotations.

One of our clients requested CMW Insurance to reconsider its earlier position and provide a quotation. CMW did so, and offered a premium lower than BFL and with better deductibles. VCS was somewhat surprised and requested CMW to offer an explanation. The response is instructive. It reads:

We share markets with one of the incumbent brokers and may not have been able to place coverage for all properties. In fact, at times, it can hinder a broker's ability to place coverage if there are too many brokers out in the insurance marketplace.

In recent months, two expressions are emerging in respect of insurance programs. One is "capacity" and the other is "cherry-picking".

'Capacity' is the supply of insurance and reinsurance available to meet demand and it depends on the insurance industry's financial ability to accept risk. For an individual insurer, the maximum amount of risk it can underwrite is based on its financial condition and the reinsurance it

purchases. A property insurer must maintain a certain level of capital and policyholder surplus to underwrite risks and this capital together with its reinsurance arrangements is known as capacity. As the amount of capacity that each insurer has is limited, they also decide where they will get the best return. Strata corporation insurance with its high frequency of water damage claims is not necessarily the first choice for their limited capacity. Also when the industry is hit by high losses, such as recent global disasters and the trend of increasing water damage claims, capacity is diminished and insurers simply cannot take on more risk.

Cherry-picking, a perfectly legal procedure, is a process by which a broker can decline to quote on a large portfolio of accounts (such as the VCS portfolio worth about \$3 billion in asset value) but instead quote selectively on just some of the properties within the management company's portfolio. This process can sometimes be successful for the broker but it is not always the case. For example, in another client situation, the strata council requested VCS to obtain a quotation from the Co-Operators. In this case, the Co-Op was not able to better the premium and terms offered by BFL.

While strata councils may rightfully think that "playing the field" is beneficial and certainly worth trying, there is a downside to this approach, particularly if the strata corporation has a bad track record (i.e. claims experience) and, in our experience, even a strata corporation that is loss free for a number of years can have a run of bad luck. Long range stability and relationship with a broker/underwriters should be viewed as a highly desirable goal by strata councils which will ensure security of renewal at reasonable premiums and deductibles in years to come. To put it in the reverse, there is a big danger in jumping around from broker to broker on an annual basis. At some point, there is risk that no broker will be enthusiastic about offering terms as they could be unable to secure coverage.

Now a word about those "council-chosen" brokers. While VCS does not purport to be experts in assessing the quality of the programs of BFL, Coastal and CMW, we have worked with these agencies over a number of years and we can attest to the fact that these brokers offer good wordings, excellent general services and very good claims processing. Conversely, when a strata council instructs VCS to insure the strata corporation through some broker known to a council member who uses the broker for his cottage, boat or car insurance, it must be understood that VCS has no way of knowing, and accepting responsibility, as to whether or not that broker's and

underwriter's program is of sound value. Councils generally believe that "insurance is insurance" so why not just go with the firm with the lowest premium? We wish this were the case - life would be so easy. In reality, every insurance program wording is different and just going with the lowest premium may be, in fact, the most expensive route if a claim is not covered. Strata councils insisting on using their local "good guy" are at great risk when indulging in this practice. In respect of the recent December renewal, two council-chosen brokers were contacted by VCS in early December for renewal quotations. Neither of the brokers returned our repeated calls. Only through intervention by the council members were we able to obtain last minute quotes. Just how much comfort does that give you in relying on such agencies to insure your strata corporation? Does anyone on those councils have any knowledge as to whether or not the coverages/wordings come even close to the coverages/wordings offered by BFL, Coastal and CMW? Our advice, therefore, is to avoid such options.

We hope this article has shed some light on "insurance confusion". We welcome your feedback or questions.

3. **Marching Orders**

In the September 2010 Bulletin, there was an article regarding eligibility for council related to Section 28 of *The Strata Property Act (SPA)*. This article discussed the specific persons that may be council members and how the strata corporation bylaws may be amended to allow other classes of persons. As we are currently in the midst of the busiest AGM season of the year (typically stretching from late November to the end of February) and you as strata council members may have recently been elected (some for the first time), a closer look will be given to the two sections that bookend Section 28.

The election of the incoming strata council is most often the final order of business at the AGM. Once elected, the strata council is given direction not only as legislated by *SPA*, but also via the specific strata corporation bylaws - particularly if they have been amended to further define the powers and duties. This capacity is detailed in Section 27 as follows and clearly allows for the strata corporation to further define the scope of the strata council's authority by a majority vote

at a general meeting without interfering with the strata council's discretion when bylaw related issues need to be considered and addressed:

27 (1) *The strata corporation may direct or restrict the council in its exercise of powers and performance of duties by a resolution passed by a majority vote at an annual or special general meeting.*

(2) *The strata corporation may not direct or restrict the council under subsection (1) if the direction or restriction*

(a) is contrary to this Act, the regulations or the bylaws, or

(b) interferes with the council's discretion to determine, based on the facts of a particular case,

(i) whether a person has contravened a bylaw or rule,

(ii) whether a person should be fined, and the amount of the fine,

(iii) whether a person should be denied access to a recreational facility,

(iv) whether a person should be required under section 133 (2) to pay the reasonable costs of remedying a contravention of the bylaws or rules, or

(v) whether an owner should be exempted under section 144 from a bylaw that prohibits or limits rentals.

(Note: Section 144 addresses what is commonly referred to as 'hardship rentals')

And Section 29 addresses membership on council specifically related to the number of persons on council as follows:

29 (1) *The number of persons on council is determined by the bylaws.*

(2) *If a strata lot is owned by more than one person, only one owner of the strata lot may be a council member at any one time with respect to that lot, unless all the owners are on the council.*

(3) *If a strata lot is owned by a corporation, only one representative of the corporation may be a council member at any one time with respect to that lot.*

(4) *If all the owners are on the council, each strata lot has one vote at council meetings.*

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4. What To Do With That Operating Surplus

Budgeting for your strata corporation is supposed to be a zero sum game. All budgets should be prepared so that they are balanced - that is, there should be no surplus or deficit at the end of the fiscal year. That being said, because most costs are somewhat out of the control of the strata council, and budgeting is often a “best guess” scenario, it is unheard of for a budget to finish at \$0. We have previously covered what the *Strata Property Act* requires when ending the fiscal year in a deficit position (the deficit must be recovered via either the Operating Budget or a Special Levy). The purpose of this article is to advise you of the options your strata corporation has when finishing the year with a surplus.

First, let’s take a look at what the *Act* says about the subject:

105 (1) *Subject to section 14, contributions to the operating fund which are not required to meet operating expenses accruing during the fiscal year to which the budget relates must be dealt with in one or more of the following ways, unless the strata corporation determines otherwise by a resolution passed by a 3/4 vote at an annual or special general meeting:*

- (a) *transferred into the contingency reserve fund;*
- (b) *carried forward as part of the operating fund, as a surplus;*
- (c) *used to reduce the total contribution to the next fiscal year's operating fund.*

Now let's cover each option individually, working backwards:

Option (C) allows strata corporations to carry forward a portion (or the entirety) of the surplus as part of their operating budget to reduce the required revenue for the next fiscal year. The mechanism you would see in your budget to reflect this is a "Surplus Forward". If there is a significant surplus projected and a projected increase in expenses for the next fiscal year, a portion of the "Probable" surplus may be used as a carry forward to offset an otherwise necessary increase in strata fees.

An important rule applies here: throughout the budgeting process the numbers are imprecise and will not be known for certain until after the end of the fiscal year. For this reason, we highly recommend that only a conservative portion of any projected surplus be carried forward. If the actual surplus is lower than what was projected and you've budgeted to use the entire projected amount, you will effectively be carrying forward money which does not exist and putting the strata corporation immediately into a deficit situation at the beginning of the next fiscal year.

There is another important, nuanced consideration: If the strata corporation is going to have a surplus, but has prior-year unrecovered deficits, the surplus should first be applied to those instead of used as part of the next year's budget. This is a complicated subject and one better suited to its own article, but it does make a nice segue into the second option for the operating surplus.

Option (B), to carry the surplus forward as part of the Operating Fund, is usually fairly straight forward. If the amount in question isn't large (especially when unaudited) you may opt to simply leave the money in the Operating Fund. This gives the strata corporation a "cushion" of cash in the bank to meet any operating expenses which may not necessarily be funded yet by revenue. Remember, assuming a balanced budget, at the beginning of your fiscal year (the first month) you may have \$50,000 in expenses but may have only received \$40,000 in revenue. Leaving some cushion in your Operating Fund negates the needs to loan money between funds. If the amount in your Operating Fund ever becomes significant, you can also use it by way of a $\frac{3}{4}$ Vote of the Owners to fund projects.

Option (A) is to transfer the amount into the Contingency Reserve Fund. Though SPA does not specify that this requires a vote of the owners, many of the strata corporations VCS manages have



done this habitually to ensure transparency and that the owners are aware of the decision. Typically this flows through the operating budget (ie. a Contingency Reserve Fund allocation in the operating budget of at least the Surplus Forward revenue line item). The same caution applies with this decision as with the decision to carry it forward to offset Strata Fees. The numbers presented to the Owners at an AGM are usually based on Probable figures so it is suggested to only transfer a portion of the projected surplus to the CRF in order to avoid any unfunded transfers which might arise out of post year-end adjustments. If you are planning on transferring the surplus into the CRF perhaps the wisest decision would be to announce the decision to the owners (or even prepare a simple majority vote) without specifying the amount and then wait for your strata corporations audit and/or final year-end adjustments before deciding the actual amount to transfer.

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