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Fogler, Rubinoff LLP, Barristers & Solicitors

CONDO COMMENTARY

Fogler, Rubinoff LLP

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UNDERSTANDING CONSTRUCTION LIENS—A REFRESHER

By Carol A. Dirks, B.A., LL.B.

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It's that time of year again! Improvement projects are underway to the common elements. Invariably, problems can arise with those improvements and the relationship between the condominium corporation and the contractor. Before you know it, a unit owner who is either selling or refinancing reports to the management office that there is a construction lien registered on title to their condominium unit.

Under the *Construction Lien Act*, there is no requirement for a lien claimant, whether it be the general contractor or a subcontractor or other supplier, to give the condominium corporation prior written notice of an intention to register a construction lien. Similarly, the lien claimant is not required to give notice to the condominium corporation that it has even registered a construction lien. This may seem surprising. The first notice often arises when the condominium corporation is served with a Statement of Claim, some forty five days later.

Even though the improvement work was performed to the common elements (and not the individual units), there is no separate common elements index in Land Registry. In order to lien the common elements, the contractor must register a Claim for Lien against each individual condominium unit as each holds a percentage interest in the common elements.

Section 23(5) of the *Condominium Act, 1998* provides that a condominium corporation may be sued in respect of any matter relating to the common elements or assets of the corporation. Consequently, a judgment against a condominium corporation for the payment of money is also a judgment against each owner for a portion of the judgment as determined by the proportions specified in the Declaration.

Unless the construction lien was registered before the creation of the condominium, there is no means by which an owner can insist on discharging the unit's proportionate share of the lien. Aside from the condominium corporation's own direct issues, the additional impact on an individual owner also weighs significantly on the corporation itself. If a mortgagee advances funds when a construction lien is registered on title to a unit, the mortgage will lose priority for any and all liens arising; not just the one which has been registered. As a result, the mortgage company will refuse to advance or refinance until such time as the lien has been cleared. The result is often irate owners, and threats of legal action. The condominium corporation is also frustrated, especially where the construction lien arises not from any conduct on the part of the corporation, but rather a general contractor who has failed to pay its subcontractors and/or suppliers.

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Liability Imposed on the Condominium Corporation as the Land "Owner"

The Construction Lien Act can impose significant liability on owners (such as a condominium corporation) who fail to comply with its requirements. This liability can extend to directors of a corporation.

Section 14 of the *Construction Lien Act*, R.S.O. 1990 provides that:

> "*every person who supplies services or materials to an improvement for an owner, contractor or subcontractor, has a lien upon the interest of the owner in the premises for the price of those services or materials*".

The claimant will be secured only for the actual value of the work done. Can anyone who performs a service for a condominium corporation register a lien claim? The answer is no. The services or materials supplied must relate to an improvement.

The term "*improvement*" includes any alteration, addition or repair to the property, or any construction, erection or installation (or demolition) on any land. Amendments to the *Construction Lien Act* proclaimed in 2011 has expanded the definition of improvement to now cover "*industrial, mechanical, electrical or other equipment on the land where the equipment is essential to the normal or intended use of the land*". The fact that the equipment can be dismantled and removed from the property is no longer a barrier to registering a construction lien. However, "*improvement*" does not include basic maintenance services.

So, for example, a landscaper providing services under a maintenance contract for cutting the grass, weeding the flower beds, or watering the plants, would not be entitled to a lien claim as these would not be considered to be improvements. However, the installation of new shrubbery and trees by a landscaping contractor would apply for lien rights.

The contractor or subcontractor who supplies the services or materials to a property is entitled to a lien on the first day those services are provided. However, these lien rights expire unless certain steps are taken by the contractor or subcontractor under the *Construction Lien Act*. These steps are 1) registering a Claim for Lien within 45 days of the earliest of (i) the date it last supplied services or materials to the property (ii) the date a certificate of substantial performance is published and (iii) the date a certificate of completion is issued for the contract. This is typically referred to as the "Lien Period". 2) perfecting the Claim for Lien by issuing an action in the Superior Court of Justice within the next 45 days.

Mandatory Holdback Requirements

During that Lien Period, the condominium corporation (as the "owner") is required to retain a holdback fund. This holdback fund consists of ten (10) percent of each payment advanced. The holdback monies are there for the benefit of subcontractors or other persons who have supplied services or materials but who have not been paid by the general contractor.

If the contractor fails to pay its subcontractors or suppliers, then those persons can look to the corporation for payment from the holdback monies. The condominium corporation will be liable to pay the subcontractors the holdback monies, whether it has actually held back the monies or not. This means that a condominium corporation could end up paying the holdback monies twice if it had prematurely released those monies to the general contractor.

Before each monetary advance to the general contractor, as a practice the condominium corporation should ensure that it has received a sworn statutory declaration from the general contractor confirming that all subcontractors, labour and accounts for materials and equipment supplied to the property have been paid except for any holdback requirements. While this will not stop a construction lien from being registered, it will assist to protect the corporation from liability for the release of the holdback monies, and for breach of trust as discussed below.

Even though a subcontractor may have registered a Claim for Lien against a condominium corporation for the full price of the services or materials supplied, the condominium corporation's liability will in most cases be limited to the amount of its holdback obligations. The condominium corporation does not have a right of set-off against the holdback fund for any damages which it may have sustained.

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Trust Fund

The *Construction Lien Act* also imposes separate trust obligations on an "owner" for the benefit of a person who has supplied services or materials to the condominium property. These trust obligations are separate and distinct from the ability of a supplier to register a construction lien.

All monies set aside by a condominium corporation for payment to a contractor on account of a contract price are considered to be a "trust fund" for the benefit of subcontractors, and other persons who have supplied services or materials to the improvement. This trust only becomes discharged where the condominium corporation pays the contractor all amounts owing under the contract. If a condominium corporation has only advanced part of the designated contract monies to the general contractor, then the remaining unpaid portion remains as trust funds for the benefit of subcontractor and other suppliers.

Where a subcontractor has given notice to a condominium corporation and/or its representatives that the general contractor has failed to make payment, no additional monies should be advanced to the general contractor until the issue is addressed. The condominium corporation should seek legal advice as to the appropriate course of action.

Payment of Subcontractors Directly

Also under the *Construction Lien Act*, a condominium corporation can issue payment directly to a subcontractor who has not been paid by the general contractor, and deduct it from any debt owing to the contractor, so long as the corporation provides to the contractor written notice of the actual payment or intention to pay. In most cases, this is not recommended unless the general contractor specifically authorized it because the general contractor may have withheld payment from the subcontractor for reasons of the work being defective or incomplete. An exception would be if the general contractor had effectively abandoned the work.

Responding to the Claim for Lien

Once a condominium corporation is aware that a construction lien has been registered, legal advice should be immediately sought. The corporation will need to ascertain whether the Claim for Lien (or resulting Statement of Claim and Certificate of Action registered) has been preserved within the proper time periods. The corporation may have a basis to challenge the registration of the Claim for Lien, or any resulting action, as being invalid for a number of reasons including, time, value of the services or materials, and whether it is an improvement.

In certain cases, the condominium corporation may need to consider bringing a motion to the Superior Court of Justice for an Order vacating the Claim for Lien (and Certificate of Action if preserved) from title to the condominium property. This essentially involves paying money into Court as security so that the Claim for Lien can be removed from title, and owners can refinance or sell their units.

Extreme caution and restraint must be exercised by the condominium corporation from issuing payments to any contractor, subcontractor or supplier without first obtaining the appropriate advice. Failure to comply with the statutory requirements can result in the corporation being unknowingly liable to a number of parties.

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CONSIDERATIONS FOR NEW CONDOMINIUMS

By David Thiel, B.A., LL.B.

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Condominium boards face many challenges and certainly have a difficult job at the best of times. This is especially so for the first homeowner board after turnover from the Declarant. The first years for a condominium corporation in many instances can pose a number of difficult scenarios for new homeowner boards to address, and by extension, the property managers who assist throughout the process.

Tarion Claims

One of the most important tasks for the homeowner board of a new condominium with Tarion warranty coverage is to ensure that all warranty claims are filed with Tarion within the required deadlines. The *Condominium Act, 1998* (the "Act") requires that condominium corporations with at least one residential unit and common elements condominium corporations retain a qualified individual (usually an engineer) to conduct a "Performance Audit". The Performance Audit must be completed within six and ten months following registration of the condominium.

The person conducting the Performance Audit must submit a written report containing details of the inspection and findings in the course of conducting the Performance audit, as well as other documentation required by the Act and Regulations, to both the homeowner board and to Tarion before the end of the 11th month following registration.

The homeowner board will then have to deal with the Declarant and Tarion to address the deficiencies as reported in the Performance Audit. Often, dealing with the deficiencies can result in protracted discussions and attempts to obtain the cooperation of the Declarant to correct the deficiencies. Tarion has attempted to streamline the process and post a timeline for resolution of these issues in order to ensure that they do not drag on for many years as was often the case in the past. Tarion's Builder Bulletin No. 49, which applies to all condominiums with Tarion coverage registered on or after July 1, 2010, should assist homeowner boards, builders and Tarion in dealing with claims in a more timely manner than has been the case in the past.

First Year Budget Deficiency

The homeowner board also has a duty to collect any first year budget deficiency (the "Budget Deficiency") from the Declarant. The Budget Deficiency is the amount by which the total actual amount of common expenses incurred for the first year of operation of the condominium corporation exceeds the amount as provided in the Declarant's budget statement disclosed to the unit owners prior to purchase.

The board should ensure that the condominium corporation's auditor prepares the audit for the first year of operations to determine if there is a Budget Deficiency and, if applicable, determine the amount of same.

The board, within 30 days of receiving the audited financial statements with respect to the first year of operations, is required to give written notice to the Declarant of any Budget Deficiency. The Declarant has 30 days from the date it receives the aforesaid notice to pay the amount of the Budget Deficiency to the condominium corporation.

Often, the claim for a Budget Deficiency results in protracted discussions with the Declarant and arguments, for example, of whether or not certain decisions made by the homeowner board during the first year concerning expenditures should be the responsibility of the Declarant. The homeowner board should receive legal advice concerning same if such issues arise.

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Reserve Fund Study

Another important task for new homeowner boards is to arrange for a reserve fund study within 12 months following registration, as required by the Act. While this may seem routine, as reserve fund studies must be conducted by any homeowner board periodically every three years, the first reserve fund study can present certain challenges.

In particular, the first budget prepared by the Declarant typically budgets 10% of the overall budget towards contributions for the reserve fund. Unfortunately, this is often inadequate for the long-term planning of the major repair and replacement of the common elements. As a result, once the first reserve fund study is obtained, the board must propose a plan for future funding of the reserve fund and the budget in the second year and beyond may need to be increased, in some cases in the neighbourhood of 20% to 50%, to incorporate increased reserve fund contributions.

This is a problem because the Declarant must pay the first year Budget Deficiency (as discussed above) to the condominium corporation, however, this requirement to pay the Budget Deficiency does not apply in years two and beyond of the condominium corporation. Hopefully this apparent problem with the legislation can be addressed in any future update to the Act.

Homeowner boards should also be aware that, especially with some of the more complex mixed-use projects which may also have shared cost agreements with neighbouring properties, the scope and costs of the components to be included in the reserve fund study are not always immediately obvious. For example, shared cost agreements with neighbouring properties may affect the budgeting toward reserve fund components, and unit boundaries may not always be the typical boundaries as every development is different. It is a good idea to have the Corporation's solicitor review a draft of the first reserve fund study to ensure that the components are consistent for example with the Declaration's unit boundaries and with any shared cost agreements.

Also worth noting is the requirement that, before any part of the reserve fund accounts are invested, the board is required to develop an investment plan based on the anticipated cash requirements of the reserve fund study.

Termination of Certain Agreements

Of particular importance for the new board is the consideration of termination of certain agreements entered into by the condominium corporation, prior to the election of the homeowner board.

Section 112 of the Act permits condominium corporations, within 12 months following the turnover meeting, to terminate on 60 days notice various agreements entered into by the corporation before the election of the first homeowner board including agreements for the provision of goods, services on a continuing basis and agreements for the provision of facilities to the corporation on other than a non-profit basis.

For example, a new homeowner board may determine that an agreement with a landscaper is not favourable and decide to terminate same.

Of even more substantial concern is that there has been a trend in recent years for Declarant-controlled boards to enter into long term leases or other agreements relating to building components, for example, HVAC systems or 'green' energy systems. Even if these agreements were disclosed properly in the disclosure documentation provided by the Declarant to purchasers, there is still an opportunity to terminate these agreements. The costs to the homeowners associated with these agreements is often very substantial in relation to the corporation's overall budget and should be reviewed. The homeowner board should seek legal advice concerning termination of any agreement under Section 112 of the Act, and especially so for these more substantial commitments as there are a number of other related legal issues to consider in making a decision to terminate.

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It is important for the homeowner board to start reviewing existing agreements early in its mandate to determine whether Section 112 of the Act applies, whether there are business reasons to terminate any of the agreements, seek legal advice and to perhaps negotiate changes to agreements where thought fit.

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The foregoing of course is not an exhaustive list of issues for the first homeowner board to address. As always, legal advice should be obtained where appropriate as discussed above.

Older Condos: Be Careful What You Wish For?

By Lou Natale, B.A., LL.B.

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The old saying "be careful for what you wish for" is very applicable when it comes to condominium ownership and management. You may be disappointed when you realize the unintended results of what you "wished" for. A case in point with condominiums is the tunnel vision approach too often implemented by some board of directors (and managers) in trying to keep monthly common expenses as low as possible at the expense of proper maintenance and repairs, stable long term financial planning and enhanced property values. Of course, virtually every condominium unit owner and board member "wishes" to have low common expense fees or a zero budget increase year after year. But reality shows us that this is not possible and particularly with respect to older condominiums and their aging common element infrastructure.

It is estimated that there are over 6,700 residential condominium corporations in Ontario or about 500,000 units, with thousands more now under construction in the Greater Toronto Area. More and more people are calling condominiums their homes. Although there have been many condominiums built in Ontario over the last decade, the first wave of "new" condominium buildings were constructed in the 1970's.

Living in (and managing) an older condominium comes with some unique struggles and challenges. Too often, current boards of directors and managers come to realize that previous boards for many years have neglected to properly maintain and repair the common elements (ie. roof, garage structure, building envelope, etc.) and have failed to properly set aside money in the reserve accounts because of their well-intended but short-sighted desire to keep common expense fees low and to avoid increases when possible. This type of decision making (or lack thereof) becomes extremely expensive when the current boards and managers receive news from the consultants that the long overdue repairs and replacements are now double or triple the cost today as compared to when the work should have been completed. This ultimately creates a financial dilemma and the need for strong leadership from both the board and management. Whether the repair costs are paid through a loan to the corporation or by way of a special assessment or large increases to the reserve fund, boards must inform and educate the unit owners regarding the situation and how they got into this position. It is sometime easier for board members to procrastinate and continue to "kick the can along the road" when it comes to dealing with large, expensive repair work. But that is not leadership. The *Condominium Act, 1998* (the "Act") requires a condominium corporation to maintain and repair the common elements and it is the duty of the board of directors to ensure that this happens.

Recently, the Joint Legislative Committee for ACMO and CCI submitted a legislative brief (the "Brief") to the Provincial Government outlining a number of proposed changes to the Act. There are, in my view, several proposed changes which can directly impact and benefit aging condominiums to avoid situations where perpetual poor decisions of past boards have resulted in decaying infrastructure and financial mismanagement. Here are just a few examples:

1. Education is key to proper decision making. Without the proper knowledge or understanding of the requirements of the Act, there is a greater

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possibility of poor decision-making and lack of planning. The Brief proposes that directors' qualifications include a requirement that each newly-elected director attend an introductory directors' condominium course, within two years of being elected and at the cost of the condominium, which course will provide the basic knowledge of the directors' duties and responsibilities.

2. Boards spending reserve fund money on things that are not properly considered major repairs and replacement can, over time, severely deplete a reserve fund account. For instance, there are situations where boards choose to spend reserve fund money on "changes" made to the common elements even though such expenditures are not permitted to be paid through the reserve fund as per Section 93 of the Act. As well, boards sometimes spend reserve fund money on matters which are obviously minor, routine repairs and maintenance. To address these types of possible violations of the Act, the Brief proposes to add new sub-sections 93(8) and (9) to the Act which will clearly state that no reserve fund money can be spent on "changes" to the common elements unless those changes relates to a government ordered change or an energy conservation initiative (as will be further discussed below) or a "change" where the material being used is reasonably close in quality to the original as is appropriate in accordance with current technology and construction standards. As well, the Brief proposes that the phrase "major repair" be defined to include a monetary minimum to be considered "major" so as to avoid small routine expenses being paid through the reserve fund.

3. Boards of directors are sometimes faced with a situation where they have components in the building, such as the boiler, air intake system and lighting fixtures, which are not energy efficient and are costing the corporation large sums of money on higher energy costs. Currently, in order to change or replace these inefficient systems and equipment (before their useful lifespan has expired) the Act does not permit the Board to use the reserve fund which usually means that energy saving initiatives get delayed or shelved due to the lack of available money or the board's unwillingness to obtain a loan to finance the work. As indicated above, the Brief proposes that money in the reserve fund be permitted to be used for these types of energy conservation projects which will in turn will help condominiums spend less money on utilities and perhaps more money on needed repairs and maintenance.

Another initiative which will no doubt help condominiums generally in dealing with management issues is the requirement to license and regulate property managers in Ontario. Boards of directors made up of volunteers, who often know little about building infrastructure and reserve fund requirements, should expect to receive guidance and direction from property managers who have the proper knowledge and credentials. Managers are dealing with budgets worth thousands and even millions of dollars and their knowledge about building components, reserve funds and other requirements of the Act are essential in guiding corporations in the right direction as they age. Both ACMO and CCI, as well as other industry stakeholders, support the need to license and regulate property managers. How and when such licensing and regulations are implemented is now up to the Provincial Government. Stay tuned.

Lou Natale is a senior member and partner of the Real Estate and Condo Law Group at Fogler Rubinoff LLP which services the condominium industry throughout the Greater Toronto Area, the Golden Horseshoe, Barrie and surrounding regions.Lou can be reached at 416-941-8804 or lnatale@foglers.com.

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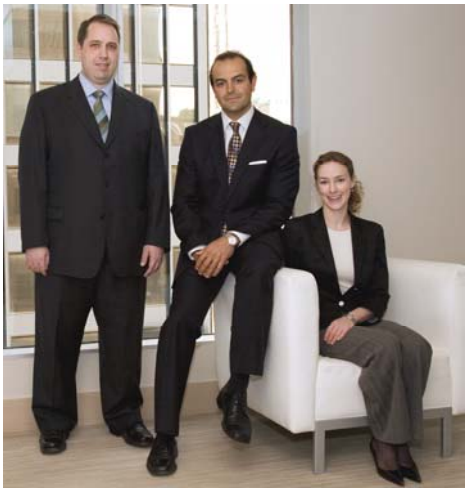

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News & Notes

- "Save the Date" - reminder that the ACMO/CCI National Conference will be held on November 2nd and 3rd, 2012 at the Toronto Convention Centre. Lou Natale will be moderating the session entitled "The Perfect AGM".