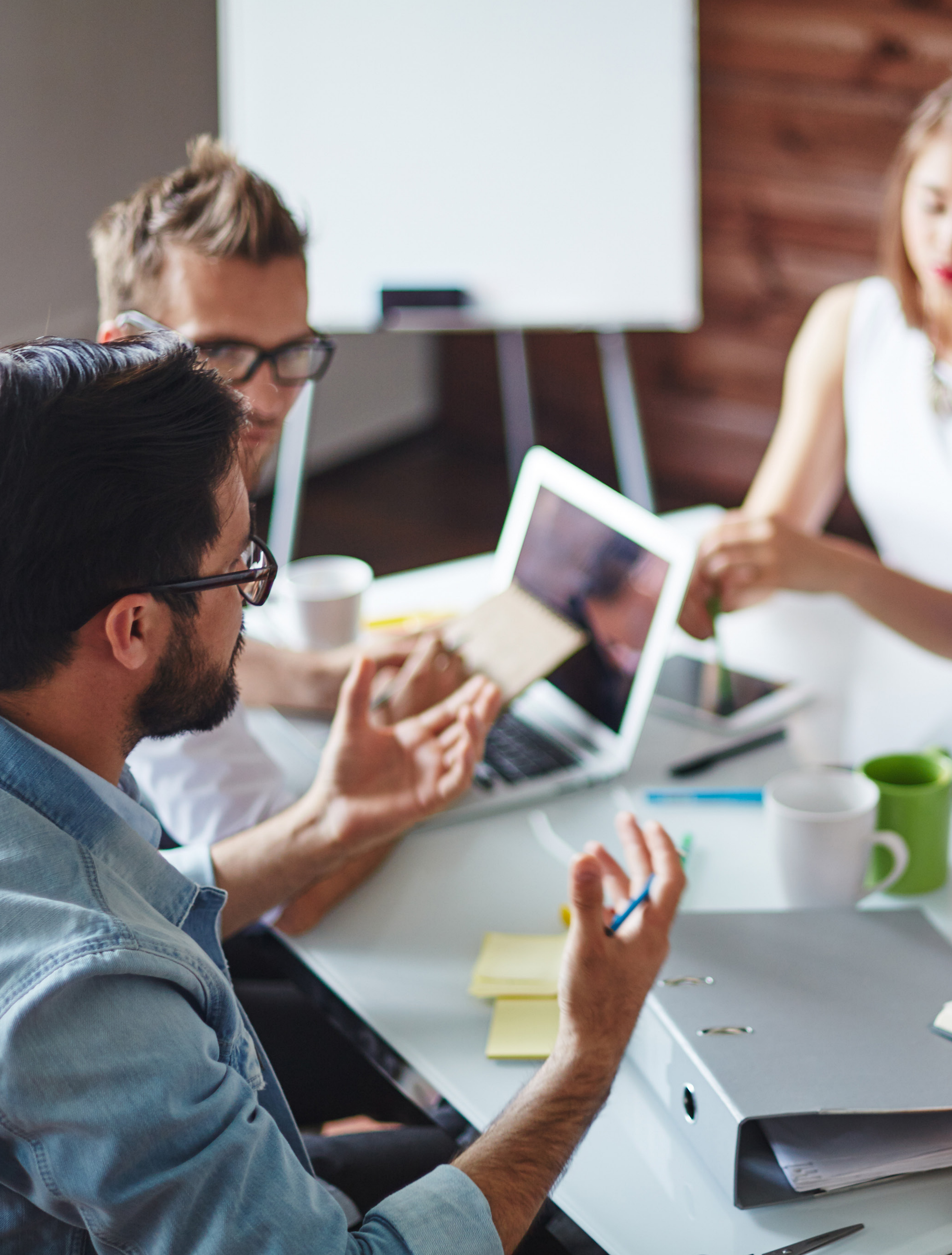

It may seem like a daunting task, but there are workable solutions to help a corporation recover from an operating deficit.

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Recovering from **Operating Deficits**

Many condominium corporations have faced financial difficulty. Cash shortages arise for various reasons and create challenges in managing the day-to-day expenses. Property managers and boards must work hard to keep fees as low as possible, while maintaining the expected property standards for the owners. If this balance is not achieved, then appropriate routine maintenance can't be performed, owners struggle to pay their fees, and unit values depreciate.

Let's look at three condominiums with varying degrees of operating deficits and cash flow concerns. What lessons can we learn from their experiences?

Special Assessment

A 550-unit highrise appeared to be in a healthy financial position at their fiscal year end. The budget had been approved at a 3.11% increase. Unrelated to their finances, the corporation was changing management service providers.

Their unaudited financials showed a surplus of $220K. Following transition to the new management company, a utility provider issued notice they had been under-billing for several years. The total unpaid charges were $217K. In addition, a large volume of unpaid invoices were discovered during the management transition. The corporation also had an existing mortgage bearing 7% interest on their superintendent suite approaching renewal.

Their true financial position was a deficit of $111K.

Management and the board worked to identify how much money had to be recovered. Three options were considered:

1. Collect $509K. This amount included the utility chargeback, an amount estimated as required to be adequate for utility consumption in the current year, paid the mortgage on the superintendent suite, and allowed funds to achieve a healthy operating surplus.
2. Collect $380K. This option eliminated the mortgage payout. The board considered continuing to pay 7% interest on the existing financing of the superintendent suite.
3. Collect $297K. The board considered re-financing the superintendent suite to full market value. The budget would be adjusted in the upcoming year to meet the increased mortgage payments.

Ultimately, the board decided that option 1 would be the best solution as it provided full funding and allowed savings in the upcoming budget with the elimination of the mortgage. This was ideal as the board was aware that the utility budget needed to be increased substantially because the under-billed utility would now be billed at full rates.

The board needed to decide if revising their budget or a special assessment

was the right option. The main consideration in their decision to levy a special assessment was to avoid increasing maintenance fees for the future to deal with past events. The decision caused some tension in the community and a town hall meeting was called to review the reasons for the special assessment.

One note of importance in this case is that the board did ensure that the amounts due were charged appropriately. They obtained legal advice and consulted utility experts in advance of their funding decisions.

Revised Budget

A 42-unit stacked townhome received bad news via their audited financials. The operating bank was in overdraft, and their reserve fund contributions had not been made.

The manager recommended a special assessment, but the board was hesitant. The assessment did not account for the current budgetary shortfall, and their reserve fund study was being updated. They were aware that several major repairs were required to the building, and their current funding plan did not account for this. They knew more increases were coming.

The board changed management services providers to get fresh perspective on their finances. At that point, their deficit totalled $12K and they owed $7K to the reserve fund.

In this case, the board decided to revise the budget for the remaining seven months of the year. They brought the fees up to a level that would prevent future deficits, and allowed for a two-year deficit recovery. Wish list items were deferred, with a plan to include those amounts once their surplus was at a healthy level. In doing so future increases were controlled – as the deficit recovery was removed from the budget, the improvements would be re-added.

The main consideration in this case was the uncertainty of the reserve fund study update. The board was opposed to levying a special assessment for the operating account, when an additional assessment for the reserve fund remained a possibility.

The financial position of the corporation was reviewed at the AGM with the owners and the reasons were clearly outlined. The owners generally supported the board's decision to revise the budget and they are now on target to a healthy operating surplus.

Other Options

A 103-unit townhome had done an excellent job of budgeting to meet their obligations. They kept within their budget so well that in the past they had only maintained a small surplus.

Two unit owners failed to pay their fees and were in power of sale. So, while the surplus totalled $11K, their bank account was in overdraft $5K.

In this case, the board did not elect to assess additional amounts to resolve the problem. The main consideration was that all owners should not be penalized due to the non-payment by two. Instead, the board elected to pay a modest fee to their insurer to spread their premiums monthly – keeping that cash available through the year. This allowed more time to collect the unpaid amounts.

With the next budget, in case they faced unpaid common expenses in the future, the board elected to increase the fees to allow for a slightly larger operating surplus.

Tips to Consider:

1. Look at the overall financial picture to ensure a healthy financial future – try not to focus only on the specific event causing cash shortages.
2. Review several options. Can fees be increased in the upcoming budget, or is it necessary to quickly assemble the necessary funds?
3. Manage your cash flow! Consider reviewing payment options for major annual expenditures – such as insurance – to minimize large one-time payments.
4. Communicate with owners. Ensure that the reasons for the deficit are clear and the options explored are reviewed. This helps to show the owners that a proactive approach was taken to resolve the problem and future planning was considered. ■

Lyndsey McNally, RCM has worked in the condominium field since 2002 in a variety of roles including administration, finance and property manager. She currently works as Malvern's Team Leader, with a focus on quality assurance and operational oversight.

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