

**FINANCIAL STRATEGIES FROM
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There is more to Condos than a Beautiful View

In the last ten years, condominiums or “condos” have taken over the real estate landscape in Canada. In cities like Toronto and Vancouver, the entire downtown landscape and in particular the waterfront have been redesigned to fit in as many new condominium towers as possible – and the building continues this very minute.

Every Saturday, entire sections of the local newspapers are full of beautiful pictures of upcoming condominium towers to be developed, claiming beautiful views overlooking the city and selling the benefits of never having to shovel snow again, accessing in-building gyms and pools, concierge services, English gardens, underground parking and party rooms. Each tower is given a fantasy sounding name and it is hard to find an ad that doesn’t have the word “prestigious” in it.

In my opinion, too many Canadians are being seduced by the pretty pictures and stories of easy lifestyle and they end up buying into a building that is a time bomb of costs that could render this lifestyle unaffordable over time. As a condo owner or potential condo owner, do you really know what you are buying?

Who is Condo Marketing Targeted At?

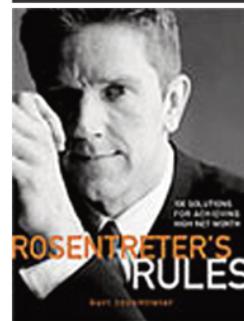
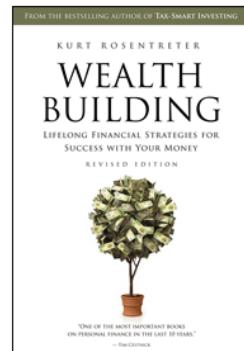
As I see it, there are three primary types of Canadians that are targets for condo marketing:

1. Retired Canadians – People seeking simplified retirement lifestyles – having someone else take care of every aspect of maintenance is attractive as you age. Elevators replacing stairs can be helpful to someone with advanced health issues. Buying a condo near a subway or hospital makes it easy to get to the doctor or to the grocery store. Condos look like the ideal way to retire for a couple or for a widow / widower who doesn’t want to stay in a big house after their spouse dies.
2. Young professionals – 28 to 33 years old, a high paying career, perhaps single and liking the idea of a short walk to work downtown, means a condo is a desirable purchase for these young executives. Most of them view the property as a stepping stone to build some equity before buying a home in the suburbs in a few years when they get married and have a family.
3. Established investor – Aged 45 to 65, often male, seeking to diversify his investments and so he decides to purchase a condo with the intent of renting it out and making a profit year after year.

Big Picture Condo Economics

First and foremost, let’s remember what you are buying when you buy a condominium unit: you, and 300 strangers who want to have nothing to do with you, are co-purchasing a \$80 Million+ dollar building and all the maintenance costs associated with running it – forever. That’s a mighty big purchase to contemplate if you are a retiree on a fixed pension or a young professional trying to get ahead. But there is more – a lot more:

Kurt's National Best Selling Books



Social and Emotional Challenges of a Condo

- Tom and Mary, living in a condo in central Toronto, complain about the smell of food in the hallways from the neighbour's cooking – "Kurt, everyday it smells different – it is really hard to get used to it".
- Pez, living in a condo in mid-town Toronto, complained to me about the guy who walks the hallway every evening on his cell phone talking loudly. She doesn't understand why he won't take the call in his suite – and she is too scared to make a comment to him fearing retaliation – after all they are floor mates.
- Bob, a retiree living in a retirement condo community with separate homes in a gated community in Calgary is fed up being on the condo board. When he originally asked / volunteered to be on the board, he thought it would be for a year only. Now six years later, he can't find anyone to replace him on the board. Most of the retirees in the community head to the US for five months each winter, leaving him behind to ensure maintenance of the grounds is completed.
- Fred, a lawyer, decided to overthrow his condo board, feeling they were incompetent and in disarray. After an investigation they determined that one individual was inappropriately spending money.
- Liz, a condo resident in Etobicoke, complains of the residents of the condo who live above her and their late night walking on the floor. At the same time, she claims the condo neighbor beside her smokes on the balcony and she can not escape the smell.
- Gary and his family, downtown Toronto condo owners, find the enjoyment of their balcony interrupted by the collection of their upper neighbour's "dog's duty" on the balcony above theirs.



Being a Condo Landlord to Tons of Renters

Rumour has it one third of condos being built in Toronto are owned by investors planning to rent them or flip the property for a quick gain. These types of owners may not offer a lot of stability to the building overall, and fill the building with a regular amount of transient, rental clientele.

But are condos a good rental property investment?

On one level, buying the property for X dollars today and selling it for Y dollars in a year is possible – all it takes is a hot real estate market. These types of gains may be fleeting however and unless your timing is excellent you could be just as likely to end up with a significant loss as a gain. In major cities like Toronto, space for detached homes on your own lot is limited, guaranteeing a rising demand with a limited supply that will only see prices move higher on homes permanently over time – in these big cities, the only space left for new homes is to build vertically, up in the air, with a condo tower. This space is unlimited however and this is where a supply glut can eventually occur. So many new towers, each offering hundreds and thousands of suites, can face harsh market corrections leading to steep drops in market prices for periods of time. One would think that a good old "bricks and mortar" home on the ground will hold its value with less variability over time than a condo will.

And then there is the matter of rental income from a condo that you rent out.

Canada Revenue Agency (CRA) has made it clear in recent years that if you purchase a rental property you need to have a business plan to generate profit over time. In the past, landlords thought it brilliant to claim rental losses year after year and deduct these losses against their regular income, reducing their income tax bill.

Not any more. Many a condo landlord have faced audits by CRA that led to disallowed losses – even losses in the past – as CRA forces the tax payer to prove whether or not they have a valid business. It is easy to see how many investors do not. Check out my example of a common investment in a rental condo:

Purchase price of the condo: \$400,000
Mortgage \$350,000 with a 6% interest rate
Annual interest cost of \$350,000 x 6% is \$21,000.
Gross rental income \$1,600 x 12 months equals \$19,200

The interest expense exceeds revenue! And we have not even factored in property taxes, utility costs, insurance, supplies, advertising and other costs of running the condo. It doesn't take a rocket scientist to see that unless you are putting down a very large deposit (leading to a small mortgage), that a rental condo should not be claimed as a tax loss.

In CRA's eyes, it is pretty hard to build a business case for profit today or down the road when the investment is leveraged to the hilt with debt.



If you are currently a landlord claiming the condo as a tax loss, seek the counsel of an experienced tax accountant or lawyer for guidance on how to fix your tax return filings. If you have not been audited yet, every year you stack more losses on, the likelihood may be increasing of a huge audit in the future.

In the end, you can keep the rental condo, just think twice about claiming tax losses. You are likely better to just eat the loss yourself and over time, as debt is paid down, hopefully create the permanently profitable position you want.

Seniors as Condo Owners and Rising Maintenance Fees

Seems like a great idea for someone in their 60's or 70's – sell their home and move to a condo to simplify their life.

While I'm sure the personal goals will be accomplished in doing this, I'm wondering how many people really take a good look at whether they can afford to live in a condo.

Forget about them being cheaper than living in a house – big city condos with views can cost more than a house. And even if they are cheaper, the property taxes and maintenance fees can take a big chunk out of your living costs each year.

"Kurt, my condo maintenance fees have risen 15% per year over the last five years, and now they total \$900 / month. They are as high as rent – I should just sell my condo, rent a suite for \$900 / month, get away from property taxes and pocket my original investment. I never thought these fees would rise like this." - Comments by a client, July 2009

Ladies and gentlemen, watch out. I have already had to move one client out of a beautiful new condo building. She bought it after her husband died, and living off her teacher's pension, CPP and OAS she thought she could easily handle the maintenance fees. For the first three years she moved in, the fees stayed the same. But after that the costs rose each year, as extra money was necessary to pay for broken valves on the pool, a raise for the security guard, re-sealing the huge parkade floors and a host of other costs of the mega-million dollar building. The maintenance fees rose so much, so fast, that it was eating up too much of her pension income. I told her she had to move out or face going broke. The uncontrollable costs were savaging her pension income. The beautiful features of the building (the view, underground parking, swimming pool, concierge, etc.) are huge growing costs that seem nice in the newspaper but are less attractive when you realize you are paying for it all.

Think an older condo building is better? One without all the fancy add-ons?

Think again. I have a client who received a special one-time assessment of \$12,500 as her share of the cost to fix a major crack in the underground parking ceiling. Fortunately she had the money, but how many other retirees would have to dip into their personal savings in this unexpected and large way? And what if you don't have any savings? Can you sell the condo to run from the big cost? No way, the cost is tacked on automatically to your selling price.

Retirees should really think twice about hitching their fixed level pensions to a rising array of costs for a host of equipment and supplies necessary to run a multi-million dollar building. And the tighter your finances are before you move in, the more closely you need to examine if this is the best type of retirement home for you. At a minimum, before you purchase, do some research to look at what others have experienced across Canada – there is a lot of information on the Internet or perhaps just visit a local condo building and interview some residents.

If you have already bought, surely you did that before you moved in – surely you interviewed existing tenants to see what they don't like about the building? After all, if you are about to sink \$400,000 or more into a new home in the sky, this basic "test drive" or "second opinion" from existing owners is downright essential common sense. And, last but not least, carefully review the condo's status certificate as a condition of purchase.



Property Managers, Lawyers, Accountants and More

A large condominium building that has 500 suites is as big as a small town. And like a small town, it requires some degree of "government" to make sure everything runs efficiently.

There is a condo board consisting usually of residents who volunteer to manage the property's finances on a not for profit basis. They will also accumulate and manage a reserve fund, the large pool of money put in place for forecasted major maintenance and repair costs that can arise. The reserve fund can be worth millions of dollars. The condo board will meet throughout the year and conduct business that can usually be viewed in their meeting minutes that summarize each meeting.

One of the roles of the board is to engage a lawyer and an accountant. The lawyer is required to oversee and provide advice on all legal matters governing ownership and running of the property. The accountant will maintain the books of the property, tracking condo fees collected, recording expenses, summarizing the reserve fund, paying taxes and generally all bookkeeping. A second accountant or accounting firm will be engaged each year to "audit" the books of the property. This is a degree of certification from the accounting firm that the books are in good order. Since the accounting firm is a neutral third party, they can be counted on for unbiased and objective advice.

A major player in the operation of a condominium building can be a property manager who brings expertise in running big projects like this. The property manager is often a stand-alone separate company that is hired by the condo board to manage the operation of the building. They handle all aspects of operations and management, freeing the condo board from doing this work. Of course they do all this for a fee.

Besides the condo board, the book keeper, the accounting firm, the lawyer and the property manager, the condo may also need to engage a small army of contractors on a regular basis to help keep the building running: the pool people, snow removal contractor, the landscapers, painters, plumbers, carpenters and electricians.

And then there is the regular staff: teams of janitors and the security staff at the front desk and superintendents: all on your payroll. You are paying for every one of them.

I spoke to an accountant recently who had been involved with condominium accounting and the Annual General Meeting that each condo property is required to hold once a year. She didn't hold back in her comments about what she had seen over the years: "management companies like to keep the board / occupants happy by keeping condo fees low – so to do so they may charge improper items to the reserve fund or underfund the reserve fund. Small condo boards tend to be completely reliant on the management company as board members don't have the skills or time to run the organization – this puts the management company in a position to abuse their power – I've seen misappropriation of funds, kick backs to management companies for maintenance or landscaping contracts or management companies

that are just not doing the job well (e.g. slow to collect condo fees from delinquent owners or failing to complete timely financial statements)."

The message about all the professionals that you engage to help run the condominium is this: if you are going to hand over a small fortune of money to invest in this home, and keep paying every month, get involved with the board. Make sure there is keen interest by all board members and they have the smarts to play a role. Get competitor price quotes on all work. Make sure the accounting books balance to the penny and ask the auditors to help put in strong internal controls around cash management and record keeping. If you are going to use a management company, look for conflicts of interest and ensure the price you pay for their work is reasonable.

There is a lot to think about as you take steps to run this small town.



What A Lifestyle for Young Professionals!

Living in Toronto I see it close up: 20 somethings and early 30 somethings who are working downtown and purchase a condo as a lifestyle choice.

They can walk to work.

They can live minutes from the lake.

Close to entertainment.

Very little upkeep equals maximum fun time.

Ahhhhh, what a lifestyle!

But perhaps these young, high income professionals are the easiest prey of all to be enticed into being a condo owner.

They love the roof-top pools and jogging track. The party room comes in handy.

"And besides Kurt we otherwise wouldn't have enough money to buy a home in downtown Toronto This keeps us from having to buy in the 905 region and commute long distances daily."

Many young professionals view their condo purchase as a stepping stone to owning a home later – buy a condo, build up some equity, and then buy a house in the suburbs later, often when they get married and have children. After all, who wants to raise a child in an apartment building right?

So they buy. Borrow money from mom and dad. Steal from their RRSPs using the terrible Home Buyer's Plan and effectively mortgage the property 100% although optically it doesn't look that way. Spend a fortune to buy a one bedroom that is a sliver of space. Move in was delayed a year due to contractor financing issues and building delays – I don't know what any of that was about but I'm sure it didn't matter! And having purchased the place based on a picture and a model – funny, I thought it would be bigger when I watched the video!

A lot of young professionals should not buy condos as their first home.

First, if their finances are wound so tight that they have to beg, borrow and steal to scrape up enough for the deposit, something is wrong here. Buy a home, any home, when you yourself have saved at least 10% down of real money – your own money, money in a short term savings account that you saved over time. You need wiggle room in your cash flow, a lot of it, to own a home and have a life too. And what if you lose your job? In 2009 that could occur and you may be out of luck trying to sell the condo in a recession. Without money coming in to pay the bills, this could quickly spiral downward into personal bankruptcy.

Second, do not count on being able to sell the condo when it is time to move up to your larger home in the suburbs when the baby comes along. It is quite possible that a market correction could sideswipe these plans, leaving you with a condo market value that is less than your mortgage. Worse, the sheer number of new condos being built almost guarantee that in a market correct the condos will fall faster and deeper than a townhouse or a detached home. This can make a condo a more volatile investment.

I tell all my young professional clients that they should not buy a condo unless they plan to own it for ten years and have solid, sustainable cash flow. Since almost none of them plan to stay this long, we tend to look at other options right from the start.

A Grab Bag of Other Condo Points

A few final quick thoughts on other planning points to explore long before you fork over money for a condo.



- Ontario is planning a move to harmonized sales tax that could add provincial sales tax to a host of new costs. It remains to be seen what impact this will have on various types of condo costs. Whether you are a buyer or a current owner, can you afford yet another raise in costs?
- How is your condo building affected by accessibility standards for peoples with disabilities? If your old condo building cannot accommodate a wheel chair, what does that mean to your pocketbook?
- If you serve on the board of your condominium property, what legal liability do you face if things go awry? Over time, in a building with hundreds of residents, it is not hard to see that disputes will occur between the board and residents. If you face a lawsuit, you may be indemnified by sections of the Condo Act or through private insurance, but even with this protection the stress may be very unpleasant for you. And then there are the high costs of legal fees.

Interesting Recent Media Headlines About Condos

“...condo hotels have turned out to be one of the worst investments in decades.” “The condo crash has wiped out the value of many units, and the hotel bust means the rooms are being rented only infrequently and at much lower rates than anticipated.” “These were not simple real estate purchases, said Jared Beck, an attorney working on dozens of lawsuits against condo-hotel developers.” Wall Street Journal, August 5, 2009.

“...Unfortunately the ONWHP (Ontario New Home Warranty Plan Act) scheme has many developer-friendly loopholes because ONWHP warranties have a number of exclusions (see Chapter 13A of Beyond the Condominium Act by J. Robert Gardiner) and Tarion is a developer controlled organization. Engineers and condo lawyers often note that Tarion building defect conciliations often result in lower net dollar recovery than litigation or the threat of litigation. Also ONWHP claims deadlines are tight.” Article “Tarion cuts Purchasers a Break” by J. Robert Gardiner and Warren Ragoonanan, The Condo Voice, Winter 2006.

“...Randy Bailey {a retired cop}, 56, pleaded guilty to defrauding Wilson, Blanchard Management Inc. of close to \$530,000 and to fabricating the minutes of meetings of condominium boards of directors and altering financial statements of their corporations in order to cover up his lying and swindling.” “The frauds came to light when an owner of one condominium unit complained to the management company about condo fees being raised despite the building falling into disrepair and no major work getting done.” “An internal investigation revealed Bailey, who managed 12 or 15 condo properties, had been submitting false invoices for maintenance and repair work. He also stored larger sums of cash from condo reserve funds”. “Ex Cop Sent to Jail for Fraud, Lying to Judge”, The Hamilton Spectator, July 28, 2009.

Want to read more about the issues that can arise through condo ownership? Google terms like “condo problems” and see what comes up. As well, get into the habit of reading the condo blog published by the law firm Gardiner Miller Arnold Law Firm at www.ontariocondolaw.com for a discussion of condo issues in Ontario.

Parting Words

As I drive around Toronto looking at all the condominium buildings that continue to be built, I wonder who the real winner is.

Clear, one winner is the developer, who builds the tower, sells the units and walks away. Just you and 300 of your co-tenants left to manage the skyscraper for the next 100 years. With people lining up to buy units based on nothing more than a picture, it is no wonder that builders are rushing to build more and more units as fast as possible.

A second winner is the real estate agent who sells you the property and makes a commission.

Another winner is the property management company, as they have built a successful business running condo buildings for owners who otherwise don't have a clue about property management. For the property manager, fees and naive clientele are a good thing!

And the newspapers are a winner of course. The millions they pocket from weekly condominium advertisements have ensured that you never see a critical article published on condo costs in their pages. That's alright – I don't mind being the voice of reason here.

That leaves you, the condo buyer/tenant/owner. Clearly you are a winner too as you have elevated your quality of life to exclude snow shoveling and home repairs by moving into a condo right? But on the financial front, as a financial planner and Chartered Accountant, I worry about you. I fear that your investment to buy the condo and the ongoing monthly costs and special assessments may become a cost monster that eats your life savings and leaves you with little other monthly money for other lifestyle costs. Real estate is often the largest purchase of our entire life. This is no time to take short cuts, rush into a purchase or stay in a building you cannot afford long term. Get proper financial planning advice first.

Condo living can truly be an exceptional quality of life for all types of Canadians in the end. Let's just make sure that you can afford it today and in twenty years. In the end, this article is about nothing more than being careful. The cost of being wrong and finding out too late can be financially devastating.

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