

Strata Living and the 10 year sinking fund plan

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In recent years, the Strata Schemes Management Act 1996 underwent two major reviews, in consultation with the public. The New South Wales Parliament consequently passed amendments in 2002 and again in 2004. The latter amendments in particular dealt with large schemes (100 lot plus), and the planning of the sinking fund.

However, the government further identified a number of other unresolved issues and again had sought comment from the public on twenty-three named issues, in connection with strata schemes and related matters.

This paper seeks to discuss and investigate the recent legislative reforms which deal only with the planning of the sinking fund in a strata scheme. The sinking fund primarily is used to cover expenses such as the painting of the building; driveway refurbishment; the replacement of fencing; common property items such as carpets, roof, and guttering; and the overhaul of the lift.

The research included empirical data in the form of surveys gathered from strata owners, whether it is owner-occupiers, or absentee-owners of strata title properties. In conclusion, the research findings considered the effectiveness of the new 10 year sinking fund plan requirements. The survey results indicated that strata owners were of the opinion that there was a need for the new 10 year sinking fund plan to be mandatory for all strata schemes, regardless of the lot numbers in the scheme.

Keywords: sinking fund, strata schemes, strata title

INTRODUCTION

The Office of Fair Trading (NSW), describes a *Strata Scheme* as “a building or collection of buildings, where individuals each own a small portion (a lot) but where there is also common property (eg. external walls, windows, roof, driveways etc) which every owner shares ownership over”. In other words, the strata lot consists of the air space within the boundary’s that are noted on the strata plan, and lodged with the Land and Property Information NSW.

The role of the owners’ corporation is to manage the business of the strata scheme whether it is the day-to day operations, or the long-term capital expenditure needs. Strata Levies are charged to each lot owner, and are based on the unit entitlement of each lot, and the budgeted forecast of the strata scheme. This budgeted forecast includes both the administration fund, i.e. the day-to-day operations, and the sinking fund, which is concerned with long-term capital expenditure.

Information from the Land and Property Information NSW indicates that there are currently approximately 65,000 strata schemes in New South Wales, and the size of the schemes ranges from two lots to seven hundred lots.

The first strata laws which were introduced in NSW, date back to the early 1960’s. There have been many changes since then, and in recent years, the Strata Schemes Management Act 1996 has undergone two major reviews, in consultation with the public. The New South Wales Parliament consequently passed amendments. New provisions, under The Strata Schemes Management Act 1996, require all new strata schemes coming into existence from 7th February 2005 and onwards to prepare a 10 year sinking fund plan. Furthermore, during April, 2006, additional gazetted regulations now require other strata schemes to comply with the 10 year sinking fund plan requirements. There are four phases, to introduce this requirement, which will depend on the strata scheme’s age, in other words, the strata plan number. The latter amendments in particular deal with large schemes (100 lot plus), and the planning of the sinking fund.

The government identified a number of unresolved issues, however this research paper focuses primarily on the recent legislative reforms which deal only with the planning of the sinking fund in a strata scheme.

BACKGROUND

In NSW, on the 1st July 1961, the first strata laws were introduced with the Conveyancing (Strata Titles) Act 1961. The purpose of this act was to give property owners the legal title (allocated lots), to air space within a building. Areas such as hallways and staircases were considered common property and for the use of all lot owners.

The 1961 Act was replaced with the introduction of the Strata Titles Act (1973) which commenced on 1st July 1974. The 1973 Act, facilitated and cleared the management and dispute resolution provisions for strata owners. Responsibilities such as administration, and the power and duties of the owners' corporation were also clarified.

In 1986, the Strata Titles (Leasehold Development) Act 1986 was introduced. This allowed strata schemes to exist on leased land, such as land leased above a railway line. The Community Schemes legislation (Community Land Development Act 1989) provided for the combination of various developments, such as buildings and recreational facilities, and open space areas.

In 1997, there were major changes to the strata title laws, with the introduction of the Strata Schemes Management Act 1996. One of the most significant changes, was the process for dispute resolution and mediation. The local court system was no longer required for dispute resolution and the Strata Adjudicators and Strata Tribunal was established. Additionally, the Strata Titles Act (1973) was renamed the Strata Schemes (Freehold Development Act) 1973 and its purpose was to deal only with the development and sub-division aspects of strata schemes.

During 2002, this dispute resolution and mediation process was merged under the Consumer Trader and Tenancy Tribunal Act 2001. During 2003 – 2006 various other changes have also occurred to the Strata Schemes Management Act 1996

Figure 1 below traces the historical changes with the legislation relating to Strata Title history in New South Wales:

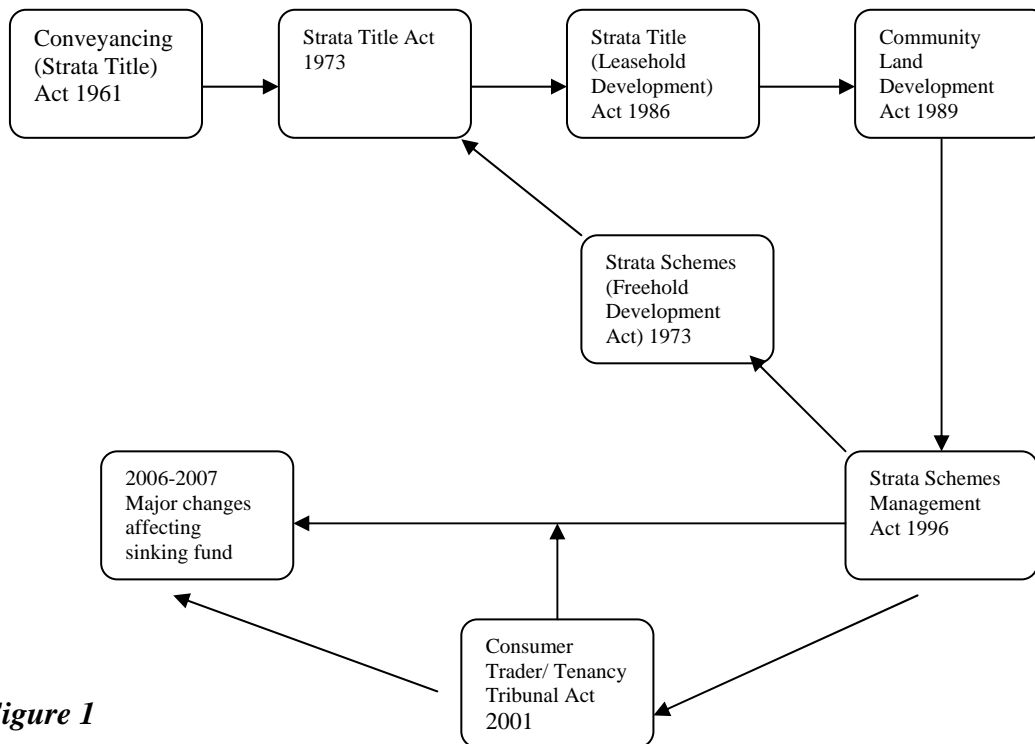


Figure 1

This historical information above, in *figure 1*, refers to the state of New South Wales. Each state and territory in Australia has individual legislation for Strata Title. The Office of Fair Trading in New South Wales administers the Consumer, Trader and Tenancy Act 2001 and the Strata Management Act 1996. The Strata Schemes (Freehold Development) Act 1973 is dealt with by the Department of Lands.

STRATA SCHEMES MANAGEMENT ACT 1996

In a discussion paper, written by the Property Council of Australia , in 2005, it was stated that a “level playing field for strata title schemes” was desirable. In other words all strata schemes, regardless of size, should be included in the mandatory 10 year sinking fund plan. The purpose being so “that sufficient reserves are able to meet future capital expenditure requirements”. The Property Council of Australia argued that it was “critical” to adequately provide for the buildings , because “cities, urban and regional areas could suffer from an ugly blight of under-maintained strata buildings into the future”.

The Strata Schemes Management Act 1996 sets out the framework for the management of the strata schemes and also defines the process for dispute resolution and mediation. In recent years, The 1996 Act has undergone two major reviews, in consultation with the public. One of the amendments in particular deals with large schemes (100 lot plus), and the planning of the sinking fund. With effect from 7th February 2005, and onwards, all new strata schemes must implement a 10 year sinking fund plan. Furthermore, the plan is to be reviewed and adjusted if required, no later than the fifth annual general meeting. The ten-year sinking fund plans are to be in place for the entire life of the strata scheme. It is also permitted to consult with outside experts, or for the owners' corporation to develop the plan.

Furthermore, on 28th April 2006, another regulation was gazetted which refers to strata schemes which are older than February 2005. Under this regulation there are four phases of implementation, which will depend on the strata schemes age. Listed below in *Figure 2*, is a summary of the four phases and the effective date for implementation of the 10 year sinking fund plan.

	Strata Plan Number	Implementation date for 10 year sinking fund provision
Phase 1	Strata Plan No. 50,000 and above (excluding those plans already required to do so from 7 th February 2005).	1 st July 2006
Phase 2	Strata Plan No. 30,000 to 49,999	1 st July 2007
Phase 3	Strata Plan No. 10,000 to 29,999	1 st July 2008
Phase 4	Strata Plan No. 1 to 9,999	1 st July 2009

Figure 2

Whilst in *Figure 2*, every Strata Plan number has been allocated an implementation time frame, there are some exemptions for 2-lot schemes.

SINKING FUNDS

The purpose of the sinking fund, is to provide sufficient funds for the owners corporation to adequately meet the capital expenditure of the common areas of the building. Sinking funds can be used for items such as the painting of the common areas of the building eg hallways and stairs; replacement of common property items eg carpets and roof; overhaul and replacement of the lift and hot water systems; landscaping upgrades, driveway upgrades etc.

In the past, when the owners' corporation required funds to pay for capital expenditure, if there were insufficient funds in the sinking fund, a special levy would be raised to cover the cost of the expenditure. This disadvantaged lot owners, who perhaps were not in a financial position to unexpectedly meet this financial contribution. The introduction of the 10 year sinking fund plan is to overcome the need to charge these huge "one-off" amounts to the lot owners. The aim of the 10 year sinking fund is to build up reserves for these future capital costs.

RESEARCH OBJECTIVE

This paper will focus on those issues relating to the strata owner who must contribute sinking fund levies, towards the reserve of a sinking fund plan. The research paper will examine the adequacy of the current legislation with the gazetted 4 phase stage to introduce this mandatory 10 year sinking fund plans for all strata schemes.

In conclusion, the research findings will consider the effectiveness of the new 10 year sinking fund plan requirements, in relation to the strata scheme and if in fact there is the need for the new 10 year sinking fund plan to be mandatory for all strata schemes, regardless of the lot numbers in the scheme.

RESEARCH METHODOLOGY AND LIMITATIONS

A survey of strata owners was undertaken and analysed. The questions asked in the survey focused on issues relating to the financial aspects of the current levies and the total lot numbers within the strata plan. Issues such as the lot owners' current

contribution towards their individual sinking fund and whether or not adequate provision had been implemented by the owners' corporation to provide for the 10 year sinking fund plan were also discussed. Comments were also invited from the strata owners on any special levies raised, and in conclusion the strata owners possible recommendations regarding the 10 year mandatory sinking fund plan.

The research was from the perspective of the strata owners, comprising a mixture of owner-occupiers and owners who leased out their strata unit. The type of strata units was randomly selected, and classified into residential, commercial, industrial and retail usage. A total of 125 surveys were distributed, yielding a response rate of 94.7%. The geographical area covered included the St George, Inner West and Eastern Suburbs of the Sydney Metropolitan area.

FINDINGS AND DISCUSSION

QUESTION ONE

a) Are you an owner-occupier of your strata unit, or an "absentee-owner"?

OWNER OCCUPIER	7%
ABSENTEE-OWNER	93%

b) Which category best describes your strata unit:

- *Residential*
- *Commercial*
- *Industrial*
- *Retail*

RESIDENTIAL	84%
COMMERCIAL	13%
INDUSTRIAL	1%
RETAIL	2%

This question sought to identify the strata owners who occupied their own strata unit, as opposed to strata owners who were investors, and therefore leasing out their unit. The purpose of seeking this clarification was for the later questions in this survey that

focused on issues with allowable deductions regarding the strata levies. Hence the purpose of part (b) of this question, which categorised the strata unit description.

QUESTION TWO

Has the owners' corporation raised any "special levies"?

YES	39%
NO	61%

The purpose of this question was to identify the frequency that the owners' corporation sought lump sum amounts from lot owners, as opposed to adequately providing for future funds in their current sinking fund.

QUESTION THREE

If you answered yes, to question two, how many times in the last five years has a special levy been raised?

ONE TIME	91%
TWO TIMES	7%
OVER TWO TIMES	2%

This purpose of this question was to obtain information on whether or not the current sinking fund adequately met the capital expenditure requirements that were arising during the later years of the life of the building.

The respondents were asked to indicate the number of times a special levy was raised, and they were also given the opportunity to give reasons for the frequency of the special levy raised. It appeared that those respondents who had a special levy raised on more than one occasion, cited either the age of the building, or inadequate funds provided into the sinking fund during the earlier years. One strata owner plan in particular appeared to have had no future planning in the early years of the strata scheme, resulting in constant special levies to pay for the capital expenditure items which were now inevitable.

QUESTION FOUR

If you are an absentee owner, are you aware that special levies are not an allowable tax deduction on your rental schedule when preparing your income tax return?

YES	8%
NO	92%

This question sought to identify from the investors, whether or not they were aware of the tax treatment of the special levies raised. The question also provided for feedback from the respondents, with a large number stating that they gave their accountants the information and they were never told that they could not claim this as an allowable deduction. Additional comments included questions on whether or not the quarterly strata levies were a tax deduction, and if they were, then why raise a special levy when it could not be claimed on the tax return.

QUESTION FIVE

Is your strata scheme in the process of implementing a 10 year sinking fund plan?; or does your strata scheme have in place a 10 year sinking fund plan? Or does your strata scheme have in place an itemised sinking fund plan.

10 year sinking fund Plan

YES	3%
NO	13%
DO NOT KNOW	84%

OR, if there is no current sinking fund requirement, does an itemised sinking fund plan exist:

YES	18%
NO	47%
DO NOT KNOW	35%

The purpose of this question was to ascertain the extent to which strata schemes were implementing and planning for their long-term capital expenditure commitments, regardless of whether or not there was a requirement to implement the 10 year sinking fund plan. Interestingly 84% of the respondents appeared to be unaware of the recent

sinking fund requirements, and 35% had no idea on whether or not there was any sinking fund plan implementation. Most respondents appeared to be unaware of the detail listed in their present sinking fund plan. However, additional comments from the respondents indicated a positive reaction to the purpose of introducing a 10 year sinking fund plan.

b) Do you agree with the government’s decision to introduce the 10 year sinking fund plan?

YES	89%
NO	11%

Once the respondents became aware of the purpose of the sinking fund plan, they appeared to be very positive towards the acceptance of the fund within their strata scheme.

QUESTION SIX

Do you regularly attend the meetings held for your strata plan.

OWNER OCCUPIERS

YES	83%
NO	17%

ABSENTEE OWNERS

YES	22%
NO	78%

This question sought to extrapolate from the respondents the extent of their involvement with the management of their strata building. It appeared that the majority of absentee owners do not regularly attend the meetings; and a high percentage of these owners, were also unaware of their 10 year sinking fund plan obligations.

Some of the respondents who did not regularly attend meetings cited work and family commitments as the reason for this. Two respondents commented that they had never attended any meetings, and had owned their units each for over 5 years. It also appeared that owner-occupiers were more inclined to be actively involved in the running of their strata scheme.

QUESTION SEVEN

How many lot owners are in your strata plan?

Lots	
1 – 5	14%
6 –10	6%
11-25	46%
26-50	22%
51-70	6%
71-100	4%
100 plus	2%

The purpose of this question was to determine the size of the strata scheme and to correlate the non compliance of the sinking fund requirements, with the 4 stage introduction process with the

SUMMARY OF FINDINGS

There were seven questions and listed below in *figure 3*, is an overview of the findings from the respondents to the survey.

TABLE OF FINDINGS - SUMMARY

NO.	QUESTION	RESPONDENTS
1	Ownership of strata unit	Owner-occupier 7% Absentee- owner 93%
2	Special levy raised	Yes 39% No 61%
3	Number of times special levy raised	Once 91% Twice 7% Over 2 times 2%
4	Awareness of special levy being not allowed as a tax deduction	Yes 8% No 92%
5	a) Implementation of 10 year sinking fund plan	Yes 3% No 13% Do not know 84%
	No requirement for a 10 year sinking fund plan	Yes 18% No 47% Do not know 35%
	b) Do you agree with the govt. decision to introduce the 10 year sinking fund plan	Yes 89% No 11%
6	Regularly attend meetings – owner occupiers	Yes 83% No 17%
	Regularly attend meetings – absentee owners	Yes 22%

		No	78%
7	Number of lot owners in strata scheme	1 to 5	14%
		6 to 10	6%
		11 to 25	46%
		26 to 50	22%
		51 to 70	6%
		71 to 100	4%
		100 plus	2%

Figure 3

Apart from the statistical responses as shown above in figure 3, some of the comments from the respondents were as follows:

- Concerns for residents with low income (particularly retirement village schemes) – how will they meet their future financial commitments for this additional levy required on the 10 year sinking fund plan.
- Good idea to implement the 10 year sinking fund plan – the older the building, the higher the need for long term planning – respondent purchased a strata unit which eventually required 3 special levies due to the inadequate provision of the sinking fund a decade earlier.
- Should have been done years ago when the building was new, and there was very little maintenance, where will we find the money now to build up the reserves required in the sinking fund.
- Prefer no 10 year sinking fund plan – raise special levies as needed – money sits in the sinking fund and is not growing.

CONCLUSION

The respondents were given seven questions in the survey, ranging from the type and size of the strata scheme, to the tax advantages of strata levies and special purpose levies, and whether they considered the 10 years sinking fund plan to be favourable for all strata schemes.

The respondents generally considered the implementation of the 10 year sinking fund plan to be a very good idea. However, there was also anger that they would now be caught up in this net of an additional financial commitment when in some cases they

had only owned the unit a relatively short time, in comparison to the age of the strata scheme. Some respondents commented that it should be compulsory for previous owners be asked to contribute towards the sinking fund as these previous owners had benefited on low strata levies at the beginning of the life of the strata scheme, and had enjoyed the use and ownership of the building.

There was surprise from many of the respondents that the special purpose levy was not an allowable deduction on their rental schedule when preparing their income tax return. Of the 92% who were unaware of this tax law, 79% comprised of absentee-owners. Also figure 3, indicates a large percentage of absentee-owners are not involved in the day to day running of the strata scheme, and many commented that they only attended the meetings if they had a problem with a strata matter that they wished to discuss. The respondents did acknowledge that whilst purchasing a strata unit was a sizeable investment package, they were just unable to allocate additional time to be involved in the strata management of the strata scheme.

The respondents also commented that as they had not previously owned a strata unit, they were unaware of their financial obligations with the strata levies, and were financial stressed when the levies were significantly increased, or when a special purpose levy was raised. Suggestions from the respondents to solve this issue ranged from availability of easy to read literature on this issue, and attending short courses to gain an insight into the issues of day-to- day strata living. The majority of respondents appeared to be unaware of the amount of money that should be accumulating in the sinking fund for long term capital projects.

As noted earlier in the research paper, the governments' purpose for the 10 year sinking fund plan implementation was to build up reserves for future capital costs. This would relieve the burden to strata owners being unexpectantly charged a special levy. Additionally, this long-term planning and forecasting would mitigate the cost of upkeep and maintenance of the building for the "future-generation owners" of the already existing strata schemes. The outcome of the government's purpose appears to be two-fold. Firstly, this will ensure that New South Wales's strata units are kept in top condition, well-maintained and the sinking fund has a solid financial reserve to

access. And secondly if a strata unit is well maintained, the strata owners will be rewarded with an increase in the value of their strata unit.

In conclusion 89% of the respondents agreed with the governments decision to introduce the 10 year sinking fund plan. Benefits such as a well-maintained building, easier to sell later, better for budgeting purposes were cited as additional reasons for their positive response.

Further research will continue, as the four phase plan is implemented, and the owners' corporation adjusts their strata levies to compensate for the new financial budgets for the 10 year sinking fund plan.

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