Sectional title shake-up a step closer

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Sectional title owners and trustees will have to raise their game significantly if draft regulations released on October 2 under the Community Schemes Ombud Service Act (CSOSA) and the Sectional Titles Schemes Management Act (STSMA) take effect in their current form.

The Community Schemes Ombud Service provided for in the CSOSA will enable residents of community schemes – including sectional title schemes and homeowners' associations – to take their disputes to a statutory dispute-resolution service instead of a private arbitrator or the courts. The cost of arbitration or litigation has, to some extent, fostered a culture of impunity in sectional title schemes, because trustees, owners, tenants and even managing agents know they are unlikely to be called to account if they ignore the Sectional Titles Act.

The ombud service will be funded only in part by taxpayers' money; community schemes will have to pay an annual levy to the service, and people who seek the ombud service's intervention will have to pay an application fee and possibly an adjudication fee.

President Jacob Zuma signed both the CSOSA and the STSMA into law in June 2011, but, four years later, neither law has been proclaimed. The Acts are "twinned": the STSMA assumes that the CSOSA is operational.

The STSMA repeals and replaces sections 37 to 48 of the Sectional Titles Act, which govern how a body corporate must manage a scheme and conduct its affairs. The Sectional Titles Act will continue to prescribe how a sectional title scheme must be established.

Many of the provisions of the STSMA replicate those of the Sectional Titles Act. However, the STSMA does introduce some significant changes – for example, making it compulsory to establish a reserve fund and limiting to two the number of proxy votes that can be given to a person who represents an owner who is entitled to vote at a general meeting of the body corporate.

On October 2, Minister of Human Settlements Lindiwe Sisulu published in the Government Gazette draft regulations that flesh out how the STSMA and the CSOSA will be applied.

Mandatory reserve fund

Some sectional title schemes budget for future expenditure by saving – usually in a bank's money market fund – a percentage of the levies they collect annually from owners. Although the Sectional Titles Act requires a body corporate to take account of future expenditure when budgeting, current legislation does not prescribe a minimum amount that must be set aside specifically to pay for future maintenance and repairs. In order to keep levies low, some schemes make no or little provision in their annual budgets for future expenditure; instead, they raise special levies whenever they are faced with a major expense.

The STSMA requires a body corporate to establish two funds: an administrative fund and a reserve fund. Contributions (levies) collected from owners must be paid into the administrative fund and used only to fund operating expenses in the current financial year. A portion of the contributions must also be allocated to the reserve fund and used to pay for future expenditure determined by a maintenance, repair and replacement plan, which the body corporate is required to draw up.

The draft regulations released last week prescribe the formula that a body corporate must use to determine the minimum allocation to the reserve fund when it draws up its annual budget.

The formula is based on the amount in the reserve fund at the end of a financial year and the total contributions collected in that year.

In simple terms, the formula works as follows:

* If, at the end of the financial year, the money in the reserve fund is less than 25 percent of the total contributions to the administrative fund for that year, then, in the next financial year the minimum allocation to the reserve must be 15 percent of the contributions to the administrative fund.

* If, at the end of the financial year, the money in the reserve fund is equal to or more than 100 percent of the total contributions to the administrative fund for that year, the body corporate does not have to top up its reserve fund.

* If, at the end of the financial year, the money in the reserve fund is more than 25 percent, but less than 100 percent, of the total contributions to the administrative fund for that year, the contribution to the reserve fund must at least equal the amount the body corporate budgets to spend from the administrative fund on repairs and maintenance in the coming year.

New schemes do not have to use the formula when they present a budget at their first annual general meeting (AGM).

Maintenance plan

The draft management regulations require a body corporate to prepare a plan for the maintenance, repair and replacement of “major capital items” on the common property within the next 10 years.

The definition of “major capital items” includes electrical systems, plumbing, drainage, heating and cooling systems, lifts, carpeting and furnishings, roofing, painting, waterproofing, communication systems, paving and parking areas, security systems and any recreational facilities.

The plan must set out the current condition or state of repair of each capital item; when each item, or component of those items, will have to be maintained, repaired or replaced; what this will cost; and the expected life-span of those items, or components, once they have been maintained, repaired or replaced.

The draft regulations prescribe a formula that a body corporate must use to determine the annual contribution to the reserve fund to maintain, repair or replace a capital item. The formula is based on the estimated cost of maintaining, repairing or replacing the item, less any previous contributions made for that purpose, divided by the item’s expected life-span.

Although trustees will still be allowed to raise special levies, it is clear from the wording of the draft regulations that the reserve fund is intended to cover expenditure that many bodies corporate are funding via special levies. This expenditure includes repairs that could not have been reasonably foreseen when the maintenance plan was drawn up or urgent repairs and maintenance required to prevent damage to property or to ensure people’s safety.

The maintenance plan must be approved by the body corporate at the AGM, and, at each AGM, the trustees must report to the body corporate the extent to which the plan has been implemented.

Fidelity insurance

The draft CSOSA regulations make it compulsory for all community schemes to take out fidelity insurance against the risk of money being lost as a result of fraud of dishonesty by an “insurable person”, which means anyone who has access to or control over the money belong to a scheme.

The regulations prescribe the minimum amount of fidelity insurance that must be taken out, and state that the policy must pay out without the scheme having to pursue criminal or civil proceedings to recover the stolen money.

However, schemes will not have to take out fidelity insurance for an insurable person if such a person – a managing agent, for example – can prove that he or she has taken out cover that complies with the regulations. The insurer that provides this cover must note the scheme's interest in the proceeds of the policy and agree not to cancel it without giving the scheme at least 30 days' notice.

Currently, it is compulsory only for trustees of sectional title schemes to give members of the body corporate the option of deciding, at a general meeting, whether or not they want to take out any fidelity insurance. A body corporate can decide not to take out any cover. In terms of the draft STSMA regulations, fidelity insurance will be a compulsory item on the agenda of every AGM.

The draft regulations also make it compulsory for public liability insurance to be on the agenda at each AGM. This type of insurance is to cover a body corporate's liability if it must pay compensation because of injury, death, damage to, or loss of, property sustained in connection with the common property. The draft regulations state that the minimum amount of liability cover must be R10 million.

The draft regulations require a body corporate to have the buildings and any improvements to the common property valued at least every three years and for the valuation to be presented at the AGM.

PROPOSED CAP ON PENALTY INTEREST 'IS BAD NEWS'

A draft management rule that will cap the interest that bodies corporate can charge owners who default on their levies has been sharply criticised by sectional title specialists.

The draft regulation, issued under the Sectional Titles Schemes Management Act, states that the rate may not exceed the maximum rate of interest a year under the Prescribed Rate of Interest Act, compounded monthly in arrears. If the regulation were introduced now, the cap would restrict the trustees to imposing penalty interest of nine percent. Currently, a body corporate can decide on the rate of interest.

Sectional title attorneys Tertius Maree and Marina Constas say the interest-rate limit protects debtors, without taking into account that non-payment by some owners shifts the financial burden to others.

“A low interest rate will encourage the non-payment of levies. It is the most easily obtainable and cheapest form of credit available, and the other owners, who may also experience financial pressures, are obliged to extend it to the defaulter. If the body corporate is compelled, due to non-payment, to obtain a loan, this will have to be done at a much higher rate of interest, again mostly serviced by the diligent payers,” Maree says.

Charles Coetzee, the chief executive officer of Stilus, which provides levy insurance, says about 20 percent of the 800 000 owners of sectional title property do not pay their levies on time.

The only way for a body corporate to recover money from persistent non-payers is to obtain a sequestration order, which can take up to four years. He says the courts are reluctant to grant sequestration orders when the amount the claimants want to recover is relatively small, which means that owners who don’t pay their levies can freeload for a number of years.

Removing the incentive – in the form of meaningful penalty interest – for owners to pay their levies will have a negative effect on the sectional title property market, Coetzee says.

Sectional title attorney and educator Professor Graham Paddock says the regulated reserve fund and maintenance plan will provide people who are considering buying into a sectional title scheme with a far more accurate idea of the scheme’s true financial situation. Currently, it is difficult for prospective buyers to ascertain exactly what liabilities they could incur, and whether the body corporate has made adequate provision to maintain the scheme’s common property.

Paddock, whose law firm is advising both the Department of Human Settlements and the Community Schemes Ombud Service, says owners in schemes that have not built up savings will probably experience financial hardship in the short term, because levies will have to be increased sharply to meet the required reserves.

However, he says the current situation, where owners are hit by special levies whenever major repairs must be undertaken, or where an owner who knows that a special levy is about to be imposed sells his or her unit, passing the liability onto the purchaser, is unfair.

The reserve fund and maintenance plan are intended to ensure that owners pay while they derive the benefits of a common property that is properly maintained, Paddock says.

Constas and Maree welcomed the moves to combat the practice of schemes using “revolving” special levies to finance maintenance and repairs. They say owners tend to take a conservative approach when the budget, on which their levies are based, is discussed and approved at annual general meetings.

Constas says the requirements for drawing up a maintenance plan are quite onerous and most trustees will need expert help. This is likely to create opportunities for people with experience or qualifications in construction and property maintenance to provide services, including software, specifically to advise trustees.

Paddock says the cost to schemes of funding the Community Schemes Ombud Service should be seen in the context of how the service will benefit owners and residents when they encounter disputes and problems.

He says the ombud service and the new management rules have significant implications, and it is important that owners in community schemes use the opportunity to study and comment on the draft regulations.

TO COMMENT ON THE REGULATIONS

Comments on the draft regulations issued under the Community Schemes Ombud Service Act and the Sectional Titles Schemes Management Act must be submitted to the Department of Human Settlements by November 1.

The regulations can be downloaded from the ombud service’s website, www.csos.org.za. Click the “Draft regulations” link.

http://www.iol.co.za/business/personal-finance/sectional-title-shake-up-a-step-closer-1928392