Deep in uncharted waters

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APARTMENT living is touted as a low-maintenance lifestyle but each year billions of dollars are needed to keep buildings up to scratch.

Decisions about when to fix leaky pipes, blocked drains, and flaky paint are the responsibility of the body corporate, however not all owners are passionate about this type of housekeeping and rather than low maintenance it can actually cause extra work and stress.

Often it's only when a lift breaks down or the air-conditioning packs up that major repairs are needed, sometimes costing millions of dollars.

Now, for large buildings that ad hoc approach to maintenance is about to change.

Under new legislation some owners corporation (the new name for a large body corporate) will need a 10-year plan for major capital works and a special fund to pay for them.

It sounds easy in theory but it's not just a case of collecting fees from owners and stashing it in the bank.

Owners corporations will have to become specialised money managers to keep up with the spiralling cost of building works and managing these large amounts of money.

Exactly how they do that is set to be one of the biggest challenges to come out of the new law.

THE LEGISLATION

The Owners Corporations Act 2006 takes effect later this year and requires a "prescribed" owners corporation to set up a 10-year plan and a maintenance fund - known as sinking funds in most other states.

What constitutes a "prescribed" owners corporation however is still under consideration and everyone is still in the dark despite the looming new law.

Institute of Body Corporate Managers (Victoria) general manager Rob Beck suggests rather than just large buildings, properties with 13 units or more, or with a budget greater than $50,000, should be classified a prescribed owners corporation and need to set up the new fund.

It's the smaller buildings that often have maintenance issues, but little provision to replace major items and protect owners assets, Mr Beck says.

Using this guideline about 50 per cent of all units (or lots) and 10 per cent of all existing owners corporations would be included in the new law.

However, Consumer Affairs Victoria has a different preferred option.

It suggests properties with more than 100 lots, or a budget over $200,000, should be considered prescribed owners corporations - about 27 per cent of all units or about 1.2 per cent of existing corporations.

Whatever the outcome, the cost of apartment maintenance will become a top priority for those included in the final definition.

WHAT IS REQUIRED

The maintenance plan must state the major capital items that will need repair and replacement within the next 10 years. This usually means things such as lifts, air-conditioning or a heating plant.

The maintenance fund, often called sinking funds, is made up of contributions levied against the owners, at a rate or amount in line to meet the requirements of the 10-year plan.

The main aim of the fund is to provide a reserve for expensive capital works so owners don't get hit with large, one-off or unexpected levies.

Maintenance funds can be used for most repairs or replacement of common property including fencing, carpets, roofing, guttering or painting.

Overall it appears to be a fairer, more equitable way to accumulate and pay maintenance costs.

"In the past, I might have owned an apartment for eight years and put nothing in and then a new owner comes in and has to pay for painting," Mr Beck says.

And it spreads the pain. It is often difficult for most people to come up with a big lump sum of money to meet the costs of a special levy to cover a major repair.

"Maintaining an asset over its life is a more cost-effective way than ignoring it until it breaks down," Mr Beck says.

PROTECTION

Consumer Affairs Victoria says prospective apartment and lot buyers will also be better informed under the new legislation, which requires an owners corporation to keep records of its activities and undertakings and make them available to incoming owners.

When selling a property in an owners corporation, a copy of the certificate with information about proposed fees, repairs and liabilities will have to be attached to the vendors' statement.

As an ongoing measure, owners corporations must also prepare financial statements and larger owners corporations must have them audited at the end of the financial year.

They must also obtain five-year valuations of common property for insurance purposes.

Victoria Body Corporate Services managing director Herman Klein says the legislation will increase the cost of living in or owning an apartment.

"It will put in place greater consumer protection, which will ultimately create more work for committee members of the body corporate, managers and secretaries," Mr Klein says.

Because of the complexity of the legislation, however, there will probably need to be a deal more reliance on professionals such as building consultants, quantity surveyors, engineers and risk assessors.

While people can self-manage their owners corporation, and there is a lot of information available from Consumer Affairs, it will soon be out of reach for the average person.

However, the increased cost and workload is expected to pay dividends.

Mr Beck says a building with a good maintenance plan and a healthy fund will appeal to buyers.

"Lots in owners corporations, which have properly planned for the future will be at a premium, benefiting from improved capital growth and gaining higher prices than those that have not made sufficient provision for future maintenance," he says.

PLANNING

The biggest challenge for a prescribed owners corporation will be the financial planning of the sinking fund money.

The Act allows the corporation to invest this money but it does not advocate how or where the maintenance money should be invested, Mr Beck says.

Owners corporations have to determine the most appropriate return and risk and in some cases the people who manage the corporation will not have the expertise or knowledge of how to best do this.

"One would expect that lot owners would seek financial advice and make prudent investments to protect the fund, while allowing for growth to cover increases in costs for repair and replacement of major capital items in the future," he says.

Department of Justice adviser Amy Carmichael says the legislative framework requires lot owners to be responsible for managing their money, including the new sinking funds.

In particular, if they borrow money, lot owners and consumers should be careful when signing a finance agreement to make sure they are able to service and repay the debt, Ms Carmichael says.

Owners corporations can invest money, and establish and operate bank accounts and any interest earned from the money must be paid back into the fund.

They cannot mortgage or "charge" common property and because of the greater risk of financial loss to large owners corporations, their financial statements must be audited at the end of each year.

As an added precaution professional managers will have to be registered and carry professional indemnity insurance.

EXPLORE THE OPTIONS

Building a successful maintenance fund is harder said than done.

In New South Wales and Queensland, where sinking funds are already in place, many do not have enough money.

A study by finance company Lannock Strata Finance shows the average sinking fund has only $247 per unit, despite billions of dollars estimated to be needed to repair concrete cancer, fire ordinances, blocked sewers and broken lifts.

Lannock Strata Finance managing director Paul Morton says owners don't like putting large amounts of money into sinking funds.

He believes strata funding needs to undergo a major shift in thinking and that owners should consider borrowing options to fund maintenance.

Mr Morton says an analysis of 150 strata schemes in NSW and Queensland shows borrowing can be cheaper than a sinking fund in about 75 per cent of cases. Special levies can also be cheaper than sinking funds in almost 50 per cent of cases.

"Sinking funds offer very poor investment returns, are taxed, subject to inflation and, in many cases, aren't properly valued on sale or purchase price posing a major problem for owners."

He says a big drawback is the time it takes to collect the money. "While you wait, the cost of the repair grows."

Another problem occurs where owners, who contribute to the fund over a number of years, sell before they get any benefit.

There is also the "lost opportunity" for owners who could be using their money for other purposes.

Mr Morton says there is no best form of strata title funding.

"It will always depend on the dynamics of each individual situation."

Mr Morton suggests:

- Separating the decision about the work you should do from the decision about the best way to fund the work. They are different issues and should be considered separately.

- Using return on investment as the measure to determine which work should be done.

- Regularly reviewing the capital works that are required and the means of funding.

- If borrowing, calculate the total cost of funds, including facility fees, line fees, approval fees, application and monthly fees.

- Consider capital works as an investment, not an expense. The infrastructure between the front gate and the front door is valuable.