Sinking Fund in High-rise Properties: Nature, Scope and Challenges

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ARTICLE INFO
Article history:
Received 25 April 2014
Received in revised form 8 May 2014
Accepted 20 May 2014
Available online 17 June 2014

Keywords:
strata, sinking fund, joint management body, Management Corporation, maintenance fund, recovery of debt.

ABSTRACT
Maintenance of strata properties is unique as it requires common contribution from all strata purchasers. The contributions which sometimes referred as charges, levies or fee receive mixed reactions from the purchasers or owners for many various reasons. Some of the issues relate to ignorance on the term ‘Charges’ and how the money is used. Sometimes, an owner chooses not to pay to protest against any dissatisfaction over services rendered by the management or their agent. While some may agree to the Charges, others ignore the important of having to pay for future capital expenses. Some of the owners argue that the Charges are sufficient to cover whatever cost required in the maintenance of the building thus additional contribution is not necessary. This paper analyses the laws relating to strata as to how sinking fund is defined and managed in order to provide a basis to regulate sinking fund in Malaysia. This study adopts a qualitative content analysis approach in which legal provisions, case laws and other secondary data are analysed in understanding legal framework and policy on sinking fund. The result shows that there are specific purposes for which sinking fund may be spent or utilized by the developers, Joint Management Body or the Management Corporation (MC). The laws also provide the mode for determining the amount of the contribution, make it compulsory for an account to be opened for the collection as well as making it an offence if the management fails to comply with the laws. It is observed that there are considerable improvements in the newly introduced Strata Management Act 2013. Nevertheless, enhancements are still necessary to create awareness among the strata owners to contribute to sinking fund. No doubt, community living requires cooperation and sense of belonging from all especially the owners of the properties.

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INTRODUCTION
All buildings mature and sooner or later become dilapidated properties. The cost for maintenance such building increases as the buildings aging. In the maintenance of buildings, there are circumstances which are unexpected and beyond the projection of the management. Sometimes buildings need to be refurbished to maintain substantial value of the properties. In this situation, the collection from the maintenance fee may be insufficient. Realizing the need to have a separate account for this unexpected maintenance cost, most strata laws in many jurisdictions provide for collection of sinking fund. This study adopts a qualitative content analysis approach in which legal provisions, case laws and other secondary data are analysed in understanding legal framework and policy on sinking fund. As such, this paper traces the provisions of laws dealing with management of strata mainly the Strata Titles Act 1985 (STA 2013) which provides for the application of subdivision of a building and the management of the building after the titles are issued, the Strata Management Act 2013 (SMA 2013) which fills in the gap in the management of strata properties before the establishment of the management corporation the Housing Development Act 1966 (HDA) and the Housing Developers Regulation 1989 (HD Regulation) which deal with the management of subdivided building before the strata titles are issued and before the establishment of the Joint Management Body as well as the Building and Common Property (Maintenance and Management) Act 2007 (BCPMMA 2007) which focuses mainly on the management of property before the establishment of the management corporation. As there are transition period of implementation of the Strata Management Act 2013 (SMA 2013) and the BCPMMA 2007, this paper will refer to all the laws relating to strata properties in Malaysia.

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What is “sinking fund”?

The phrase “sinking fund” is not used in the STA 1985. Nevertheless, the law provides for a “special account” to be opened by the MC where the contribution shall be used for the purposes which are similar to the purposes described under the SMA 2013. It means, even though no “sinking fund” is provided under the STA 1985, there is a “special account” established (deleted in STA 2013) for the “purposes” which are retained by the SMA 2013. Minor amendment was made to the “purposes” in the SMA 2013 to widen the scope of sinking fund. Section 2 of the SMA Act 2013 defines “sinking fund account” as an account required to be opened and maintained by a developer, Joint Management Body(JMB) or Management Corporation (MC) or subsidiary MC under sections 11, 24, 51, 61, as the case may be. This definition which uses the word “account” supports the requirement for a special account for sinking fund under the STA 1985 with an improvement with the name “sinking fund”. These sections reading with sections 10, 23, 50, 60 illustrate that sinking fund is different from the “maintenance fund” thus the term “Charges” as explained under section 2 as any money deposited into the maintenance account should be excluded from the definition of sinking fund. This position is different from the definition of “charges” under the BCPMMA 2007 which means any money collected by the owner, developer, Body or managing agent from the purchaser for the maintenance and management of building or land intended for subdivision into parcels and common property. The unclear position of “Charges” and ‘contribution’ has been settled in the SMA 2013 where the word “Charges” used to refer to any payment made for Maintenance Account while “contribution” is used to refer to “sinking fund”. The term “maintenance fund” was deleted under the STA 2013 and SMA 2013.

Section 2 of the BCPMMA 2007 defines ‘sinking fund” as a special fund opened and maintained under section 24 which provides that Joint Management Body (JMB) has a duty to open and maintain sinking fund where a portion of it shall be paid as a contribution to the Building Maintenance Fund. The amount shall be determined by the JMB for the purposes of meeting its actual or expected liabilities in respect of the painting or repainting of any part of the common property; the acquisition of any movable property for use in relation to the common property; the renewal or replacement of any fixture or fitting comprised in any common property; or any other expenditure as the JMB deems necessary.

Section 46 of the STA 1985 and Schedule H of the Housing Developers (Control and Licensing) Regulations 1989 (amended in 2002) stipulate that the sinking fund (called "special fund" in the STA 1985) can be used to meet major liabilities of the strata properties. In addition, Regulation 20 (1) of Schedule H of the Housing Development (Control and Licensing) Regulations also allows the vendor, upon the date the purchaser takes vacant possession of the said parcel, open and maintain separate sinking fund for the purposes of meeting the actual or expected liabilities in respect of the following matters- such as the painting and repainting of any part of the common property; the acquisition of any movable property for use in relation to the common property; or the renewal or replacement of any fixture or fitting comprised in the common property. The amendment to the Housing Developers Regulation that was made in 2001 requires the developer to open an account for “sinking fund” without the need to form the MC which would delay the process of collection of special fund for specific maintenance purposes.

Under Housing Development Clause 20(2) the purchaser shall, on the date he takes vacant possession of the said parcel contributes to the sinking fund an amount equivalent to ten (10) per centum (10%) of the service charges. The contribution shall be payable monthly in advance. This provision has been adopted in the new STA 2013 thus making it clearer and standardized.

In Australia, sinking fund that is put under the control of the Owners Corporation is essentially a large capital expenditure fund that pays for expected (long term) and unexpected replacement, repairs and maintenance. Some things, such as carpet replacement in stairwells, common property painting and the like are easy to budget for, but other things like 'concrete cancer' or 'structural damage due to subsidence or an accident' are very difficult to predict and budget for. Thus, it is advisable to have an account for the 'unexpected emergencies' that may crop up from time to time.

In Malaysia, some developers collect this fund by way of governing documents, such as a Deed of Mutual Covenants, prior to the establishment of a MC for the development, while others rely on the provisions of the Schedule H. In whatever methods, the collection of sinking fund should not be confused with service charges, which are meant for the general maintenance and management of the common property and for the other services the developer has agreed to provide.

Establishment of Sinking Fund:

The duty to establish sinking fund takes place at all levels of management; during the development and before the vacant possession of the property are handed over, the period from the vacant possession and strata title being issued and the period during the MC has been established. Under the STA 1985, the developer or the original proprietor during the first annual general meeting shall decide on the portion of contribution to the management fund to be paid from the special account as provided under S 46 of the Act. Basically, the MC is required to establish two types of fund; the management fund and the sinking fund in which the contribution for
sinking fund is determined by the MC at a general meeting. In Australia, unit owners in a strata development must contribute to sinking fund, which is kept as a reserve fund to meet major replacement of parts of the common property. The fund is used to cover expenses for painting common property, obtaining property for owners corporation such as mowers or washing machine; renewing or replacing any fixtures on the common property and any other property owned by the owners corporation, replacing, repairing or making good the common property, to cover debt which not covered by the administrative fund as well as other capital expenses (S 75(2) Strata Schemes Management Act 1966).

In Malaysia, the MC through a special resolution under para (ba) of sub-section (5) of section 41 of the STA 1985 shall determine the portion of sinking fund that is payable to the management fund. Under the SMA 2013, it is the duty of the developer to open sinking fund account in respect of each development area effective from the date of the Act if the vacant possession of a parcel was delivered before the commencement of the Act or at any time before the delivery of vacant possession if vacant possession of a parcel is delivered after the commencement of this Act (S 11 of the SMA 2013) The developer is also required to continue maintaining the account until the expiry of the developer’s management period (S 11(2). A similar obligation is imposed on the developer in the case of development area of which no JMB is established (S 51(1) with additional scope of duties that the sinking fund shall be used to replace or renew any movable property vested in the MC and the upgrading and refurbishment of the common property (S 51 (2)(c) and (d).

Looking further, the Australian government has introduced a 10 year plan for sinking fund. From July 2009, all strata schemes are required by law to have a 10-year sinking fund plan in place (S 75A of the Strata Schemes Management Act 1996). This means that owner’s corporations must plan how they will repair and maintain common property and raise sufficient funds to cover the costs. The amount required for the 10-year plan will vary between schemes, for instance, newer schemes may require relatively less money than the plans for older schemes with more repair work due. Each sinking fund plan should reflect the individual needs of its scheme. The 10-year plan must be approved by owners at an annual general meeting (AGM) and must be reviewed and adjusted, if required, in the first five years. While there are no penalties in the legislation for owner’s corporations who do not develop a 10-year plan, any owner can apply to the Consumer, Trader and Tenancy Tribunal for an order instructing an owner’s corporation to meet its obligations to develop a plan. Such move is not adopted in the SMA 2013. Perhaps, the needs are yet to be seen in the Malaysian strata properties.

**How much is the Charges?**

Before the existence of the MC, the purchasers contribute to sinking fund an amount equivalent to 10 per cent of the service charges from the date he takes vacant possession (S 12 (4) of the SMA 2013). In addition, the buyers pay one (1) month’s deposit and three (3) months in advance in respect of the service charges to the sinking fund; any payment thereafter is payable monthly in advance. The provisions under the STA 1985 are silent as the amount to be contributed and this position is retained under the BCPMMA 2007. Nevertheless, section 41A of the STA states that any amount determined as contribution to the Management Fund in the first AGM of a MC must be approved by the Director of Land and Mines.

In Australia, the Owners Corporation must determine what both the administrative and sinking fund levies will be for the scheme on an annual basis. The amounts decided upon must be supported by a budget which must be presented at each Annual General Meeting. All the owners can then vote to either accept or reject the proposed budget which must take into account the actual and expected expenditure as well as the existing financial situation of the Owners Corporation. The levy amount set is payable by every owner based on unit entitlement of each lot. Basically the larger unit entitlement of a lot, the greater the portion of the levy are to be paid by the respective owner. Levies are usually payable quarterly and a levy notice is issued by the treasurer of the Owners Corporation or by the Strata Manager, if one has been engaged to look after the scheme (Strata Living, NSW Fair Trading). As a general guideline for determining the portion of sinking funds, the MC should review their budget and finances for both in the short and long term, make reference to the warranty period, life cycle and maintenance cost to work out the estimated budget for the various facilities and amenities within their development and seek the advice of a managing agent on such matters. Furthermore, before a contribution amount is adopted, the MC must table a proposal at a general meeting and obtain a consensus from the majority of the subsidiary proprietors present (Lim Chong Yong, BCA, 2012)

**Method of Calculation:**

There is no specific amount determined for the sinking fund charges under the STA 1985, BCPMMA 2007 as well as the Housing Development Act. The STA 1985 merely provides that the special account which is taken from the Management Fund must be enough to cover the future capital needs including the painting of the common property, acquisition of the moveable property, renewing or replacing fixtures, renewing and repairing common property, debts other than amount covered by the Management Fund and other capital expenses (S 46 STA 1985). During the initial period, the original proprietor or the developer has a duty to convene the first annual general meeting in which among others the agenda is to determine the portion of the management fund to
be paid into special account (S 41 (1)(ba) and to decide whether to vary or confirm the amount as contribution to the management. Whatever is the amount, the law provides that a portion of it shall go into the special account.

The BCPMMA 2007 specifies that the amount of contribution for sinking fund is to be determined by the JMB for the purposes of meeting its actual or expected liabilities in respect of the painting and repainting of any part of the common properties, acquisition of moveable property for the use in relation to common property, renewal or replacement of any fixture or fitting comprised in any common property or any other expenditure as the Committee deems necessary. Section 22(4) of the same Act provides that in any case where the JMB is yet to be established, references to ‘Body’ shall be construed as “developer”. It means that the same law and procedures are applicable to both JMB and developer as the case may be. Nevertheless, the SMA 2013 has identified an amount of 10 percent of the Maintenance charges to be contributed by the purchasers (S 11) and proprietors (S 52(1) to sinking fund (S 12 (4)).

Any purchaser is dissatisfied with the sums determined by the developer may apply to the Commissioner of Building (COB) for a review (S 12 (7) SMA. In this respect, the COB may determine the sum or instruct the developer to appoint, at the developer’s own cost and expense, a registered property manager to recommend the sum payable as the Charges, or contribution to the sinking fund and submit to the COB. Upon receiving the report from the appointed registered property manager, the COB shall determine the sum payable as he thinks just and reasonable as the sinking fund charges (S 12 (8).

Restriction in Dealings with Sinking Fund:

The SMA 2013 put some restrictions on the fund. All monies in the sinking fund shall not form part of the property of the developer (S 11 (4) SMA Act 2013) unless provided to the contrary. Furthermore, the developer shall not collect sinking fund before the opening of a sinking fund account; and vacant possession of the parcel purchased has been delivered to the purchaser (S 13(1)(a)(b) SMA Act). It is an offence for those who fail to open the account and shall be to a fine not exceeding two hundred and fifty thousand ringgit or to imprisonment for a term not exceeding 3 years or to both (S 14 (1) SMA Act). More importantly, the law is drafted to convey a message that sinking fund is a trust which ethically and legally creates a huge responsibility on all parties handling the fund (S 11(4).

How Sinking Fund is Claimed and Managed:

Current legislations do not provide much guidance on the method of collection and use of sinking fund. As unfair practices and unintended results are emerging especially from strata owners, there are efforts by the authorities to improve via legal policies including amendments made to the existing laws. The Malaysian government has addressed most of the issues raised in the SMA 2013. The Malaysian Housing Buyers Association (HBA) believes that collection of sinking fund must be guided by its intent; so that equity and fairness is preserved and transparent management and accountability to the people contributing to the fund can be practiced.(www.hba.org)

In emphasizing that the STA 1985 is silent as to “sinking fund” and used “special account” (deleted under the amendment 2007 via A1450) for the very same purpose, this, to a certain extent, has resulted in some developers collected sinking fund by way of governing documents such as deed of mutual covenants, prior to the establishment of a MC for the development. Nevertheless, Schedule H of the Housing Development Act 1966 provides for the establishment of sinking fund. Furthermore, section 18 of the BCPMMA 2007 provides that the developer shall deposit all moneys received from the purchasers for the purpose of the maintenance and management of a building into the Building Maintenance Account within two working days of receiving the moneys. Clause 20 of Schedule H stipulates that the money accumulated in the sinking fund is to be held by the developer in trust for all purchasers until a MC or JMB as the case may be is established. The developer or his agent shall be obliged to provide purchasers with a copy of the annual audited accounts for services paid for with sinking fund.

Section 44 of the BCPMMA 2007 provides that on the coming into operation of the BCPMMA 2007 Act in a local authority area or part of a local authority area or in any other area, the provisions of any written law, contracts and deeds relating to the maintenance and management of buildings and common property in as far as they are contrary to the provisions of this Act shall cease to have effect within the local authority area or that other area. This has been discussed in Woon Brothers Construction SdnBhd v MewahRembangSdnBhd (2009). In this case, a sinking fund was collected based on a Deed of Mutual Covenants which was entered together with the Sale and Purchase Agreement. It is not disputed that the Sale and Purchase Agreement is in the form and substance prescribed by Schedule H of the Housing Development (Control and Licensing) Regulations 1989, in particular Regulation 11 (1). Section 11 (2) provides that no housing developer shall collect any payments by whatever name it is called except as prescribed by the contract of sale and there is no provisions in the Sale and Purchase Agreement for the payment towards a sinking fund. After examining the Deeds of Mutual Covenants, the judge was in the opinion that the Deed was an attempt to contract out of the prescribed agreement and cannot be allowed to be stood. If the provisions of the Deeds are inconsistent with the Sale and
Purchase Agreement, the provisions become illegal and unenforceable against the purchaser. Furthermore, the BCPMMA clearly emphasizes that no agreement, contract or arrangement, whether orally or in writing, entered after the commencement of the Act shall operate to annul, vary or exclude any of the provisions of this Act.(S 44 BCPMMA). It is observed that the STA does not have clear provision that provides for failure to contribute for special account by the purchaser or failure to open a special account by the developer or the original proprietor. The STA 2013 has clearly stated that any developer who fails to comply to all procedures and requirement for the setting up of a sinking fund account commits an offence, on conviction shall be liable to a fine not exceeding RM250,000 or imprisonment for a term not exceeding 3 years or to both.

New Approach under the Strata Management Act 2013:

The approach under the new SMA 2013 is clearer. The provisions are divided into three periods i.e. the period where the development area is solely under the management of the developer or the original proprietor, the period where the handing over of the management to the JMB and the period where the MC has been established. In all the three periods, the law specifically mentions the need to establish sinking fund account (s 11, s. 24, s. 51, s. 61, s 67) and the penalties for failure to do as required (s 10(7), s 11 (7)). It is also stated that any moneys remaining in the sinking fund account after all payments have been made under the Act shall be transferred to the sinking fund account in the name of the JMB (s 11(6)).

It is noted that section 32(1) BCPMMA 2007 gives power to the JMB to recover from the purchaser any maintenance charges which become due by serving on the purchaser a written notice requesting payment of the sum due within a period which shall not be less than 14 days from the date of service of notice. If the sum remains unpaid, a further 14 days’ notice demanding for payment of the sum failure which, the JMB may institute proceedings in any curt of competent jurisdiction or alternatively, the JMB may also resort to issue warrant of attachment (Section 33 BCPMMA 2007). Under the SMA 2013, any parcel owners who fail to pay any charges and/or contribution to sinking fund shall be issued with a notice from the JMB or the developer to pay within 14 days from the date of the notice. Upon expiry of the 14 days and the charges remains unpaid, the JMB or the developer may file a summon or claim in court of competent jurisdiction (s 77) or make a claim to the Tribunal of Strata Management (s 34 of the SMA 2013). In Ong Tee Thong v Jaguh Tulin SdnBhd [2010] the High Court has rejected the plaintiff’s application to be declared as a registered strata owner of one condominium parcel as he failed to pay the maintenance charges and charges for other services provided by the vendor. It was held by the Ladyship that the MC or where applicable the vendor shall have a lien on any unpaid parcel. As an alternative to the earlier mentioned debt recovery mechanisms, the Commissioner is also given power to issue warrant of attachment in Form A of the Third Schedule based on sworn application by the developer or the JMC which authorises for the attachment of any moveable property belonging to the default parcel owner which may be found within the building or any part of the State (s 35 (1) SMA 2013). The procedures indicate effort to improve the power of the JMB as well as the Commissioner of Building in carrying out their duties in the strata management.

Conclusion:

The amendment to strata related laws and the introduction of the new SMA 2013 have made the legal framework on sinking fund significantly clearer. No doubt that there are issues and challenges faced by many quarters in raising the fund; partly due to lack of awareness on the importance of having the fund and lack of guidance helping as such. It is necessary that strata proprietors understand thus appreciate the importance of sinking fund since the management of strata properties are not only a trust in the hands of the developers but for a major part of the tenure of the building will be in the hands of the owners. Having mentioned the importance of sinking fund as manifested in the law for failure to pay as such, it is timely and appropriate for the Malaysian government to look into the possibility of making the preparation of 10 years sinking fund plan compulsory. Australia has pioneered the effort and Malaysia is moving a step forward when making this requirement as part of strata report.

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www.strataman.com.au