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Fund for the future

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Under new strata laws, apartment buyers will be able to check whether big bills await.

A stitch in time saves nine goes the adage. It has never been more relevant than it is now to Sydney apartment owners.

The first buildings due to meet the new Strata Schemes Management Act requirement to have a 10-year sinking-fund plan, passed last year's deadline without major drama. But given that they are the youngest buildings in the staggered introduction of the law, the trouble-free start is not surprising.

The challenge will increase with age. Buildings due to face this year's July deadline date, built from 1985 to 1995, are likely to face more pressure, as are their older counterparts which need to comply by 2008 and 2009. Building owners who have let things run down will burn.

The new law requires apartment owners to come up with a plan to address and pay for - via their sinking fund - cyclic maintenance, such as painting and lift upgrades. It is called a 10-year sinking-fund forecast or plan. The idea is that, as maintenance can be predicted, owners should plan for it, put money aside for it and take action when required. The desired result is that Sydney's apartment stock be kept in good repair.

It's a lofty goal but one worth pursuing, the professionals say.

The pay-off for owners is that by giving timely attention to maintenance, more serious and costly problems are less likely to arise. For example, take a small 1940s building on the coast. If it has been painted regularly, its timber windows should not need to be replaced. But if it hasn't been painted and salt has seeped in, owners may face the hefty cost - tens of thousands of dollars - of replacing the windows and perhaps the steel lintels.

Another pay-off for owners is that, by building up their cash resources slowly, they will be able to attend to major maintenance without special levies.

The other big benefit is for apartment buyers. In the future, they will be able to look at strata records and assess a building's progress in adhering to the new legislation - in particular, whether owners have been preparing for the inevitable big-ticket maintenance items.



Outside Epica ... resident Gerald Chia.
Photo: *Quentin Jones*

The owners' corporation will have either done a dodgy job or made an honest attempt. In the first instance, there are likely to be some huge, hidden costs ahead. In the latter, the levies this year may well be higher but at least you will know what costs you will be up for in coming years. Theoretically, too, your apartment will be increasing in value because well-funded buildings also tend to be well-maintained.

How to do it right

Strata managers are generally fans of the new legislation and see it as an invaluable tool for managing buildings. "It is commonsense," says Glen Ettridge of Insite Asset Specialists (www.insite.com.au or 1300 302 708). "People need to put money aside for future expenses, otherwise you leave the problems to future generations. It's a community issue."

Gus Kernot, principal of O'Connors Property Reports (www.opr.com.au or 9420 9011), whose job is to assess the state of buildings, agrees. "It forces people to do the right thing," he says. It's like a pink slip for an apartment building."

That said, the process is not necessarily straightforward or palatable. It can involve a significant initial outlay of effort and money, particularly in older buildings that have been neglected for years or even decades.

"It is a two-stage process for really rundown buildings," Ettridge says. "You will have a catch-up phase and then do the 10-year forecast. Once you are up to speed, when you see little things occur, you then have to spend money rather than letting it get worse."

There are three ways of doing a 10-year sinking-fund forecast and the one owners opt for will depend on the viewpoint of the corporation, the budget and the age and state of the building.

Do it yourself

It's the free, fast and least accurate option.

"Basically, you can walk around the building and make a list of about a dozen things. You'll come up with a bigger figure than a global \$10,000," Kernot says. "This is the traditional lackadaisical approach."

It's an approach the professionals advise against for a few reasons. First, the cost of items you identify as needing replacement or maintenance is hard to estimate correctly. (You could be more accurate by identifying items and then getting quotes from appropriate tradesmen.)

Second, theoretically, members of the executive committee leave themselves open to legal action.

Wally Patterson of Dynamic Property Services explains. "If you do it yourself and you miss something major, the owners' corporation could have to wear the cost. That is why people get \$10 million office-bearers' liability insurance."

(Quantity surveyors and engineers alike should have professional indemnity insurance as this covers them in case they miss something.)

Third, there are plenty of problems that aren't immediately obvious but are serious trouble. Among the issues requiring caution is that of magnesite, which was used in the 1960s as a floor-levelling compound laid on concrete slabs. "It is like a firm version of compounded cork," Kernot says. "It provides sound attenuation and is a great underlay, it softens the concrete."

The nasty drawback is that the magnesite was applied with a salt-based glue. "When the glue gets wet - it is water soluble - it leaches down into the concrete and causes the concrete members to rust," Kernot says.

This problem of concrete cancer caused by magnesite typically occurs near balcony and bathroom doors.

"It is often not reported by tenants because the initial warning sign is just a bit of lumpy carpet," he says. "It's a real sleeper. It can be localised, but it can be worse. If you aren't aware and don't manage it, you have a big [expense] coming up."

Hire a quantity surveyor

Quantity surveyors such as QS Solutions (9748 0250) or Leary & Partners (9902 7400) charge from about \$450 for a four-apartment block up to \$720 for a 20-unit building.

An advantage of using professionals is they do sinking-fund forecasts on a daily basis and bring a wealth of knowledge about the problems characteristic of buildings of different ages and construction.

David Leary says his company has been doing sinking-fund forecasts since in 1990. "We started in Queensland where the legislation was introduced in 1997. Because we knew it was coming, we had sold it to body corporates [ahead of the deadline] as a management tool," he says.

Leary and his fellow quantity surveyors walk around a building and record details about items that need to be repaired and maintained over time. "Painting is often the biggest," he says. Other everyday items on the list include door hardware, gutters, driveways, windows, air-conditioners and lifts. "Essentially, it is a life-cycle costing exercise."

Leary uses custom software to estimate what contribution owners will need to make to keep their sinking fund topped up to pay the bills.

Find an engineer

An engineer is a more costly option - from about \$1500 to \$3000 for a smallish building - but can have advantages as he or she will have a more intimate knowledge of the building process and can advise exactly how to fix it. For this reason, an engineer is the smarter choice for owners' corporations that must play catch-up or are concerned they might have some structural issues.

"If the building has done the catch-up already, a quantity surveyor should be OK. If not, an engineer is the better way to go," Ettridge says.

Building consultant Andrew Harrison of Strata Asset Management (9482 5300) says he will visit and examine a building, identify any immediate issues that need addressing, then look at the lifespan of the materials.

Some of the aspects an engineer will look at are immediately visible; others are not and require a solid working knowledge of how apartment buildings are constructed now and how they were built in earlier times.

The requirements

Owners' corporations must decide how they will do their sinking fund forecast by the dates below. They must then present a completed forecast to the next annual general meeting a year later for adoption or modification. The legislation is self-regulating, however, if the owners' corporation cannot show they have undertaken these initiatives or have underfunded long-term maintenance, they may be exposed to legal action from owners in future.

The timetable

Strata plan numbers **30,000** to **49,999**: by July 1, 2007

Strata plans **10,000** to **20,999**: by July 1, 2008

Strata plans **9999** and below: by July 1, 2009

Not rocket science

Gerald Chia learnt all about sinking funds during a three-month search for his home in a new block on the North Shore.

"I spent three months looking at apartment buildings," he says. "Most I saw were around the 30-year-old mark and were in very poor condition. I quickly formed the opinion that a healthy sinking fund was integral to the future welfare of a building."

When he bought in the Mirvac-built block Epica - strata-titled in 2005 - he joined the nascent owners' corporation as secretary.

For the first year, the building was covered by warranty but after that it was the owners' responsibility. The strata manager recommended that the committee set the second-year sinking fund budget at \$45,000, a figure that rang alarm bells for Chia and his committee colleagues. "You didn't have to be a rocket scientist to realise it was ridiculously low," Chia says.

The 31-storey building has more than 200 apartments, a building manager, five lifts, air-conditioning, a gym, pool and the latest security.

The committee decided to commission a sinking-fund forecast from Leary & Partners in October 2005. The report recommended they raise \$333,000 a year for their sinking fund.

"I asked our strata manager. He said, 'Well you don't need to worry about it till the second annual general meeting,' and hung up."

The committee let that strata manager's contract lapse and hired Dynamic Property Services, a company experienced in managing high-rises. "They advised that the Leary assessment would be realistic," Chia says.

Wally Patterson, principal of Dynamic Property Services, is aware that if money is not put aside early on, special levies will need to be raised later.

At Epica, there was some initial dissent among the executive committee but the majority was supportive. "I put out an email before the AGM explaining [to owners] why we needed to have such a large increase and that it was in everyone's interest to have a well-maintained building, that it was an investment in the future," Chia says.

Chia now pays \$880 a quarter for his sinking fund levy, a 71 per cent increase.

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