Loans to Bodies Corporate

How should they be accounted for?

Bodies corporate are increasingly borrowing money to fund major capital expenditure, such as the cost of upgrading fire safety facilities within an older building. The governing legislation in New South Wales and Queensland allows owners corporations and bodies corporate to borrow money, but how well does that legislation cater for the accounting and reporting of this type of transaction? This article examines that important question.

Queensland

The Queensland *Body Corporate and Community Management Act 1997* ("**BCCM Act**") actually works against this type of arrangement in that the relevant provisions of the various modules frustrate the arrangement. Take for example the *Body Corporate and Community Management (Standard Module) Regulation 1997* ("**Standard Module**"). Section 100(3) of the Standard Module requires a body corporate to pay the following amounts into its sinking fund:

- contributions raised to cover spending of a capital or non-recurrent nature (including the periodic renewal or replacement of major items of a capital nature and other spending that should reasonably be met from capital);
- amounts received under policies of insurance for destruction of items of a major capital nature; and
- interest from investment of the sinking fund.

Any amount that is not required to be paid into the sinking fund must be paid into the administrative fund (vide section 100(2) of the Standard Module). Section 101(1) of the Standard Module requires the sinking fund to be applied towards:

- spending of a capital or non-recurrent nature;
- the periodic replacement of major items of a capital nature; and
- other expenditure that should reasonably be met from capital.

All other expenditure of the body corporate must be met from the administrative fund (vide section 101(2) of the Standard Module).

This separation of the income and expenditure of the two funds is reinforced by section 100(7) of the Standard Module which prohibits funds being transferred between the administrative and sinking funds. Furthermore, when a body corporate manager administers the funds (as most body corporate managers would as a matter of normal practice) the manager commits an offence if there is a transfer between funds.

These provisions, strictly applied, result in the following situation:

1. Loan moneys received by a body corporate to fund a major item of capital expenditure must be paid into the administrative fund.
2. The capital expenditure itself must be paid from the sinking fund.
3. The principal and interest repayments on the loan must be paid from the administrative fund.
4. There can be no transfer of the loan moneys from the administrative fund to the sinking fund.
5. There is no point in a body corporate borrowing money to pay for capital expenditure items because it cannot use the borrowed money for that purpose.

It follows that if a loan is to be taken out to fund an item of major capital expenditure, then the Act and relevant module will need to be "manipulated" in order to achieve this. The following is suggested until such time as the Act and modules are adjusted to take account of this type of transaction:

(a) establish a special fund within the administrative fund (in exactly the same way you would to deal with facilities that are used by only some owners – such as a marina);
(b) pay the loan moneys into that special fund;
(c) pay the capital expenditure out of that special fund;
(d) pay the principal and interest payments from the administrative fund itself (which is where they should come from); and
(e) be aware that if what you are doing is challenged, there is a risk that the whole process will be voided.

While this solution is far from satisfactory, it is in our assessment the best currently available. It is also at least partly defensible by other provisions of the Queensland legislation. Both the Act and modules recognize the power of a body corporate to borrow amounts and give security for those borrowings (see section 150(2)(f) of the Act and section 102 of the Standard Module). Also, the modules clearly allow a body corporate to grant exclusive use rights that are subject to the recipient owner paying the body corporate an annual fee to cover maintenance and renewal expenses (see section 173 of the Act and section 123(2) of the Standard Module). Clearly, that fee is payable to the administrative fund whereas, in the absence of a sub-fund within the administrative fund, some of the expenditure would be required to be made from the sinking fund. The normal way to handle this type of payment and expenditure would be to have a special sub-fund within the administrative fund, similar to what has been suggested for the loan transaction.

New South Wales

The position in New South Wales is totally different. Section 67 of the *Strata Schemes Management Act 1996* ("**SSM Act**") requires an owners corporation to pay the following into its administrative fund:

- contributions levied to that fund;

- the proceeds of disposal of personal property of the owners corporation;
- fees for inspection of records and provision of information certificates; and
- amounts received by way of discharge of insurance claims.

Section 70 of the SSM Act requires an owners corporation to pay the following amounts into its sinking fund:

- contributions levied to that fund;
- amounts received by way of discharge of insurance claims, unless they are paid into the administrative fund; and
- any amount received by the owners corporation that is not required or permitted to be paid into the administrative fund.

Section 68 of the SSM Act prohibits an owners corporation from paying money from its administrative fund except for the purpose of:

- maintaining in good condition on a day-to-day basis the common property and any personal property owned by an owners corporation;
- insurance premiums;
- meeting other recurrent expenses;
- approved distributions of surplus funds;
- approved payments to a member of the executive committee; and
- other payments in connection with the carrying out of its functions under the SSM Act or the by-laws.

Section 71 of the SSM Act prohibits an owners corporation from paying money from its sinking fund except for the purpose of:

- painting or repainting any part of common property which is a building or other structure;
- acquiring personal property;
- renewing or replacing personal property;
- renewing or replacing fixtures and fittings that are part of the common property;
- replacing or repairing the common property;
- meeting other expenses of a capital nature; and
- approved distributions of surplus funds.

Inter-fund transfers are permitted provided the amount transferred is recouped into the source fund by special levy to that fund within 3 months of the transfer (vide section 71(2) and (3) of the SSM Act). For the purpose of borrowing funds these provisions are the equivalent of a prohibition against inter-fund transfers.

These provisions, strictly applied, result in the following situation:

1. Loan moneys received by an owners corporation to fund a major item of capital expenditure must be paid into the sinking fund.
2. The capital expenditure itself must be paid from the sinking fund.
3. The principal and interest repayments on the loan must be paid from the administrative fund.

This situation neatly accommodates the accounting treatment of loan moneys to and loan repayments from a New South Wales owners corporation. This is in direct contrast to the position in Queensland.

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