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A free newsletter to the sectional title industry by Tertius Maree Associates

PERCENTILE LEVY ADJUSTMENTS:
A PERVASIVE PESTILENCE

It happened many years ago at the very first annual general meeting which I attended as an advisor, invited by the trustees. When it came to approval of the budget (with or without adjustments), no objections, suggestions, or comments whatsoever came from the floor and the budget was adopted by general consent, as is.

The chairman then announced the next item, (not appearing on the formal agenda) namely to decide what the levies for the ensuing financial year must be and the percentage by which the current levies should be adjusted. This caught me completely by surprise and I did not react but waited to see the members' response. A suitable percentage was debated, agreed upon and confirmed by general consent of the members. Dumbfounded, I then brought it to the chairman's attention that the procedure followed was not allowed and explained that the only function of the members at the AGM was to approve a budget, with or without amendments and that it was the trustees' function to calculate and fix the individual levies subsequently by applying the participation quotas to the approved budget, formalised by a trustees' resolution.

Despite my appeal, the chairman thanked me, mentioned that in future the prescribed procedure should rather be followed, but for now, the members' decision stood.

Since those early days I had assumed that this cowboy-style practice had ceased in the sectional title administration industry.

I was wrong.

Having recently been involved with assessments of levy procedures of numerous schemes countrywide, I was astounded at the widespread practice of allowing members at the AGM to conclusively fix levies by determining a percentage increase.

At an AGM it may start with an innocuous statement by the chairman that the proposed budget calls for, say, a 10% increase. This devolves into a discussion of what a suitable percentile adjustment should be, finally degenerating into a members' resolution purporting to fix the percentage by which the levies should be increased, for example at 7,5%.

This satisfies everyone: The managing agent who knows, or should know beter, raises no objection for fear of antagonizing the members and trustees, thereby compromising his commercial interests, and the trustees who want to remain popular but, incidentally, also have a financial interest, concurring with the members and the procedure followed.

Also not to be underestimated is the sweat factor: It is so much easier to take a shortcut by adopting a percentile adjustment rather than to go through the budget item by item and make adjustments where it may be justified. In that way everyone can go home earlier, content with a job well done.

What are the consequences of this practice, apart from the obvious fact that everyone has flaunted the law by mutual accord?

Firstly, it inevitably results in under-budgeting. By applying a general percentage adjustment, it must apply to each and every item in the budget, which is not achievable. Alternatively disbursements on some items will have to be reduced even further or completely excluded.

Following on the above, it also means that in practice there will be no provision for future maintenance expenses and contingencies, as required in terms of section 37(1)(a) of the Act.

The combined effect of the above will inevitably be the later need for a special levy to keep the body corporate afloat and to perform pressing maintenance tasks.

(I sometimes wonder whether owners are motivated at budget time to defer expenses for a later special levy when they may already have sold their units. In the long run this is a short-sighted approach which will eventually undermine market values in the scheme, as I shall attempt to explain).

Lastly, there is the serious, but generally ignored, result that under such procedure, the determination of levies is fatally flawed, resulting in levies not being recoverable in a court of law. The fact that most owners pay their levies and that eventually even defaulters usually pay their

arrears without objection, does not detract from the seriousness of the situation and the possible financial consequences for a body corporate.

One must not underestimate the effect of flawed governance (because that is what this is) upon market values of units. The fact that this is not immediately visible does not diminish the issue. Apart from the fact that purchasers are slowly but surely picking up what to look out for regarding management aspects when buying into a sectional title scheme, there is another factor which is due to change the entire scenario to the detriment of owners in schemes where such risky practices prevail, namely stepped-up requirements by mortgagee banks.

Banks have been slow to realise that their security for mortgage bonds in sectional title schemes does not vest only, or even primarily, in bricks and mortar, but also in the quality of governance. This is now changing at a rate that may catch owners, trustees and managing agents unprepared. Should banks commence stipulating minimum administrative standards before granting bond applications, I predict that many schemes will be found not to be in compliance as matters stand today.

Financial administration, including the way budgeting is done and levies are determined, are likely to be the first aspects looked at with a critical eye.

Tertius Maree

LEARNING TO COUNT

It is not unusual to be confused by the various counting requirements in respect of quorums and voting for ordinary, special and unanimous resolutions. Sometimes even the experts need a 'second take' and may even differ in their opinions.

One aspect about which the statutory provisions may be somewhat vague and could result in errors relates to special resolutions. The relevant portion of the definition of **'special resolution'** in the current act reads as follows:

> *. . a resolution passed by a majority of not less than three fourths of the votes (reckoned in value) and not less than three fourths of the votes (reckoned in number) of members of the body corporate . . . or a resolution agreed to in writing by at least 75% of all the members of a body corporate (reckoned in number) and at least 75% of all such members (reckoned in value) . . . .*

Where it states '*reckoned in number*' does it mean number of members or number of units held by such voting members? This could obviously make a considerable difference, for example where a scheme should consist of 10 units with a dominant member holding 8 units with a combined participation quota of 75% or more. If the requirement for a special resolution is 75% of PQ plus 75% of units, he can obviously pass any special resolution singlehandedly. If the 'number' relates to members (and not units) he is not able to do so.

From the wording of the definition this crucial distinction is not clear. 'Number' could relate to either a number of members or a number of units held by the voting members. In practice I suspect that the latter interpretation is applied in the majority of cases. However, if the purpose of the dual requirement was to maintain a balance between majority and minority interests, I lean towards an interpretation that, when counting 'numbers' it must relate to the number of voting members and not the number of units held by them.

It seems to me that Prof CG van der Merwe may also support this view from his brief comment in footnote 317 on page 14-54(6) of Sectional Titles, Share Blocks and Time-Sharing.

In the Sectional Titles Schemes Management Act No 8 of 2011, which is due to take effect, probably in September this year, the matter remains somewhat obscure although it seems to support the latter interpretation. My reasoning is as follows:

The more concise definition of **'special resolution'** now reads as follows:

> *'means a resolution –*
>
> *(a) passed by at least 75% calculated both in value and in number, of the votes of the members of a body corporate who are represented* (sic*) at a general meeting; or*
>
> *(b) agreed to in writing by members of a body corporate holding at least 75% calculated both in value and in number, of all the votes.*

The above should be read with section 6(7) which states that *'when votes are calculated in number, each member has one vote.'*

Accordingly, in terms of the new act, the 'number' used for counting votes for the purposes of a special resolution means the number of members, irrespective of how many units a particular member may hold.

The same arguments apply in respect of the calculation of a quorum for the purposes of a unanimous resolution.

Tertius Maree

RULES ARE RULES - OR ARE THEY?

Section 35(1) states:

> '*A scheme shall as from the date of establishment of the body corporate be controlled and managed, subject to the provisions of this Act, by means of rules*.'

Sounds simple, but could in fact 'hide' many administrative errors. The following are some of the underlying reasons for such errors:

Firstly, it should be understood that the provisions of the Act itself are always conclusive. Accordingly no rule may deviate from or contradict any statutory provision.

Secondly, rules are not just any old rules. To be valid and enforceable a rule must have been made according to the directives of section 35. Accordingly there is no such thing as 'house rules' or rules, guidelines, or edicts issued by trustees or by some other informal procedure even if these have been 'adopted' by the members.

Thirdly, section 35(3) requires that rules '*shall be reasonable, and shall apply equally to all owners of units put to substantially the same purpose*.' Accordingly, although it is possible to have different rules for different components within a scheme, rules relating to, for example, a residential component must apply equally to all residential units, in a broader sense. This is a difficult requirement to comply with when drafting rules.

Fourthly, section 35(5)(c) states that amended rules take effect on the date of filing thereof at the office of the Registrar of Deeds. This is where things may start to go wrong: Proper filing of an amended rule does not guarantee that the rule is valid and enforceable, in the sense of compliance with formalities, legality and reasonableness. Because rules filed at the Deeds Registry are not examined, it is possible to file any rule which may, for various reasons, not be enforceable.

Unfortunately the physical integrity of the rules filed at the Deeds Registry is also not guaranteed. Due to uncontrolled tampering many sets of rules filed at Deeds Registries have in the past been corrupted, and may even be completely lost.

The situation will certainly improve once both examination and custody of rules are entrusted to the Ombud, which will hopefully happen in the very near future. However, this will not resolve the issue of rules which may have been lost or corrupted previously.

A further problem relates to the fact that the legislature has, over the years, introduced numerous amendments to the model rules prescribed under Annexures 8 and 9 to the Act. This is not a problem for bodies corporate which have adopted the model rules without amendment, but could pose huge difficulties for bodies corporate which have adopted special rules. The trustees of such bodies corporate usually keep their own working copies consisting of a full set of rules.

Although the copy filed at the Deeds Registries is supposedly the conclusive copy, neither this nor the 'working copy' is automatically updated with amendments by the legislature, unless the trustees have diligently incorporated the applicable amendments as they were introduced. (A complicating factor is that not every amendment by the legislature would affect the rules of a scheme where special rules had been adopted).

The end result is that at many schemes rules may erroneously be applied without reference to amendments made by the legislature over time. The Ombud will not assist with this problem and the only solution would be a thorough audit of the rules, preferably before the Ombud takes over responsibility for the rules.

Tertius Maree

ARE FINES LAWFUL?

Recently some doubts have been expressed regarding the legality of fines raised against transgressors in sectional title schemes. One of the arguments in support of the view that they are unlawful is based on section 1(3)(c) of the Act which states in respect of a unanimous resolution that -

> '*where the resolution in question adversely affects the proprietary rights or powers of any member as owner, the resolution shall not be regarded as having been passed unless such member consents in writing thereto'*.

If the latter provision should be applicable to a penalty provision in the rules, it would of course be very difficult to adopt a management rule to provide for the imposition of fines.

In my view the proviso in question relates only to instances where a member's proprietary rights as owner of a section (or holder of a right of exclusive use), or his powers flowing from such ownership, namely his power to vote, are affected. When reading the Afrikaans text (signed by the State President at the time, it is clear that the word '*proprietary*' relates to and qualifies both '*rights*' and '*powers*.'

It cannot be said that the imposition of a penalty adversely affects the proprietary rights or powers arising from a member's position as a registered owner. If that should be true, it would be equally true that the management rules cannot be amended to impose an alternative levies regime whereby some owners are required to contribute proportionally more than before.

The other counter-argument is of course the fact that the proviso referred to relates to unanimous resolutions only, whereas there is nothing to prevent a penalty

provision from being included in the conduct rules, requiring only a special resolution.

But that does not mean that fines may be imposed without further ado or that just any old rule will suffice to authorise fines. Before any fines may be imposed, a properly drafted rule, complying with the provisions of the Promotion of Administrative Justice Act, must be adopted. Equally important, when the trustees seek to impose a penalty on an owner, the procedures set out in such rule must be followed to the letter.

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WHO HAS JURISDICTION?

Uncertainties arising from new act need to be removed

In Issue 40 of MCS Courier I expressed an opinion that when the Sectional Titles Schemes Management Act and Community Schemes Ombud Service Act become effective, Magistrates' Courts will no longer have jurisdiction in respect of the recovery of arrear levies. Some colleagues disagree with this view based on the use of the word '*may'* in section 3(3) and 3(4). Their argument is that when interpreting a statute the word '*may'* is regarded as permissive rather than directory.

> '*The word '*may' *in its natural meaning is permissive and imports a discretion and must be construed as discretionary unless there is anything in the subject-matter to which it is applied or in any other part of the statute to show that it was meant to be imperative'*.

In normal circumstances that would be the correct interpretation.

Accordingly, so the argument goes, the trustees have a discretion to refer the matter to the ombud service but the option remains to pursue the matter in a court of law with appropriate jurisdiction.

I have two problems with this conclusion.

Firstly, the reference to an '*action in any court (including any magistrates' court) of competent jurisdiction*' as it now appears in section 37(2) of the current act has been removed in the 2011 act. Such removal should be regarded as having certain consequences. In my view the removal indicates an intention to remove actions for recovery of levies from the jurisdiction of the courts.

Should the provision have been removed from the wording of the current legislation and replaced with a reference to an ombudsman, assuming that one had been appointed, the reasonably clear inference would have been that the courts no longer had jurisdiction. I do not see that it should be different with the new act.

Secondly, the word '*may*' is also used in the current section 37(2) and has been since its inception. The only meaning that can be ascribed to it in the current context is that the body corporate '*must*' follow the court route if recovery is to be enforced. That means that if the trustees were unable to obtain payment by informal means, a court action was the only alternative, (which it in fact was, before the standard management rules were amended in October 1997 to make provision for arbitration, and as clarified by the Greenacres decision in 2006).

If the use of '*may*' in section 37(2) had the meaning of '*shall*' or '*must*' as I believe it did at the time when the 1986 act was first promulgated, it should in my view have the same meaning in the corresponding provision of 2011 act.

Whatever the case may be, it appears to be incumbent upon the legislature to clarify the situation in order to avoid a spate of exceptions in our courts.

Tertius Maree

FOOTNOTE

In issue 39 it was pointed out that upon change of ownership no provision is currently made for a new owner to continue paying special levies which are payable in instalments. This has caused some alarm in the industry and managing agents and trustees had to revert quickly to the 'old' method of using a tripartite agreement to ensure continuation of payments. It should be noted that the 2011 Sectional Titles Schemes Management Act will eliminate this omission, when it comes into effect.

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ABOUT TERTIUS MAREE ASSOCIATES

Tertius Maree Associates is a firm of attorneys based at Stellenbosch, specialising in the legal aspects related to the management and administration of sectional title schemes, home owners' associations, retirement and share block schemes, and similar structures.

At Tertius Maree Associates we consult with and advise trustees, owners, managing agents, developers and attorneys, draft amendments and develop rules and constitutions, and have been doing so since 1994.

We also specialise in the recovery of arrear levies.

Tertius is the author of three books and approximately 900 articles on sectional title matters. He obtained a master's degree in law (*cum laude*) focusing on sectional title law, at the University of Stellenbosch in 1999 and has served as part-time lecturer in sectional title law at several institutions. He is also a proud honorary member of NAMA and member of the development team of the STILUS levy insurance product for bodies corporate.

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