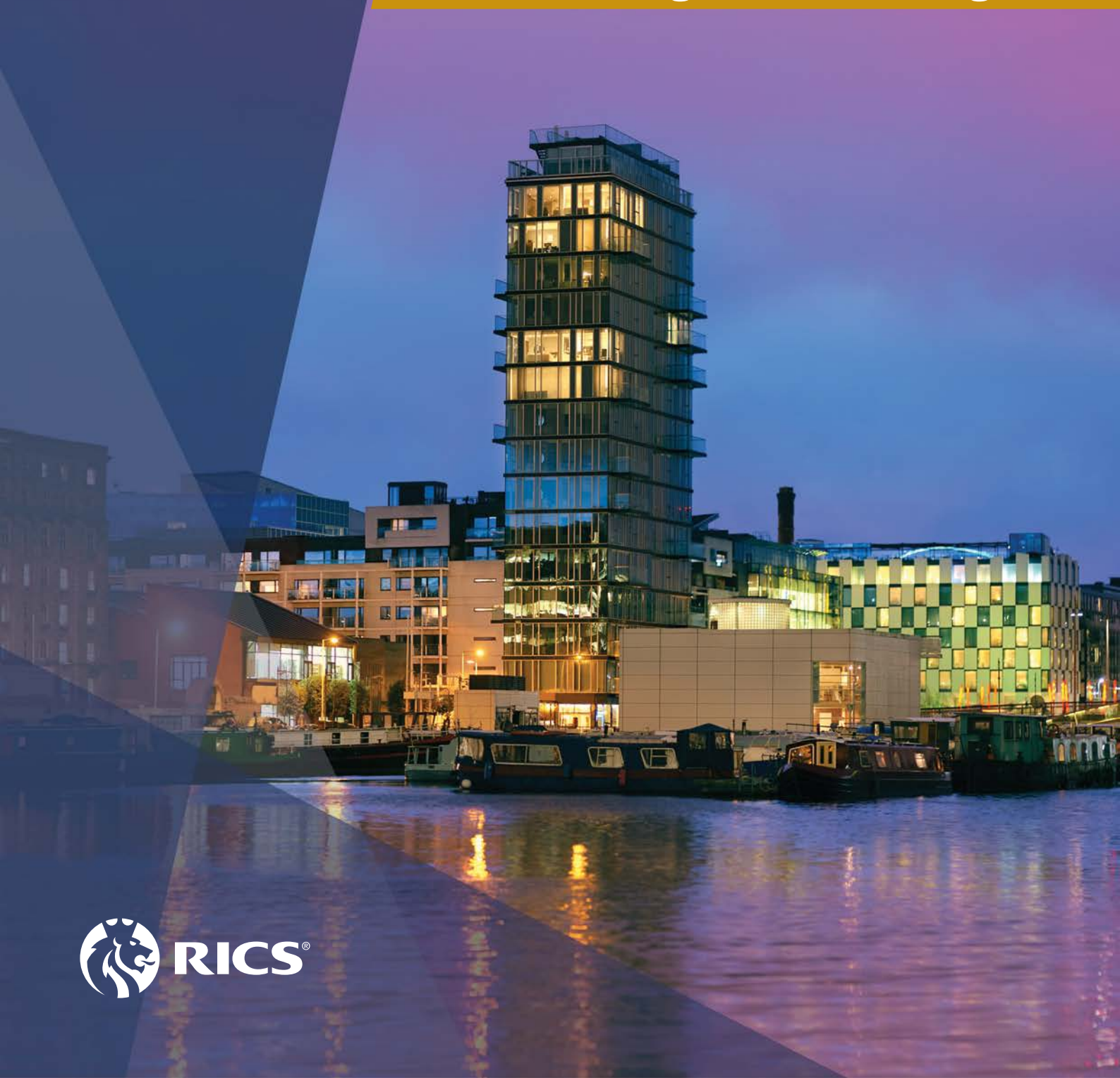


Sinking Funds in Apartments

Meeting the Challenge



About SCSI

Our key objectives are to provide impartial, independent and authoritative advice on key issues for consumers, business and policy makers, as well as advancing and maintaining standards for Chartered Surveyors working in the property, construction and land sectors. All aspects of the profession, from education through to qualification and the continuing maintenance of the highest professional standards are regulated and overseen through the partnership of the Society of Chartered Surveyors Ireland and Royal Institution of Chartered Surveyors, in the public interest.



Table of Contents

Executive Summary	6
Importance of Sinking Funds in Multi-Unit Developments	6
Research Findings and Conclusions	6
Recommendations to support adequate Sinking Funds	8
1. Multi-Unit Developments and Sinking Funds	10
1.1 What is a Multi-Unit Development?	10
1.2 Sinking Funds and the MUD Act	11
1.3 Annual Sinking Fund Contributions	11
1.4 Dealing with a Sinking Fund Shortfall	12
2. Building Investment Fund Reports	14
2.1 What is a Building Investment Fund Report?	14
2.2 Examples of Contribution Amounts Required in MUDs	16
3. Evidence on Current Sinking Fund Provision	18
3.1 Survey Data	18
3.2 Current Situation regarding Sinking Funds	19
3.3 Building Investment Fund Reports	20
4. Recommendations	22
4.1 Need for Change re Sinking Funds	22
4.2 Education	22
4.3 For New Multi-Unit Developments	23
4.4 For Owners' Management Companies in Existing MUDs	23
4.5 For Government	23
4.6 For Others	24
Annex: The MUD Act	26

Foreword

This report was prepared by SCSi Chartered Property Management Surveyors due to a concern on the part of professional Managing Agents in Ireland that many multi-unit developments (MUDs), and in particular apartment complexes, are not adequately budgeting for future building investment needs.

If MUDs, and the Owners' Management Companies (OMCs) responsible for them, do not budget for adequate 'Sinking Funds' over time, then there is a significant likelihood that property owners and OMCs will face significant financial challenges in the years ahead to address maintenance or other investment costs. There is also an additional risk of health and safety implications for residents if required works cannot be funded.

Original research for this report, based on information held in 2018 by leading Managing Agents in Ireland, shows these concerns are well grounded. To address these concerns, the report sets out recommendations under several headings, including recommendations for existing property owners and their OMCs, recommendations in relation to newly constructed MUDs and recommendations for policy makers.

As overall editor, I wish to thank all Committee members of the SCSi Residential Property Management Group for their input to the report. I would like to thank Patrick Hogan and Kevin Hollingsworth for their work on specific sections. I thank Neil Mac Dhonnagáin and Arthur Hanley of RF Property Management for their assistance with the data gathering and analysis. I thank Edward McAuley, Áine Myler and others in the SCSi for their assistance with the report. I also thank the Apartment Owners' Network for their very useful comments on a draft version of the report.

Go raibh maith agaibh go léir.

It is the hope of the SCSi that the report's findings and recommendations will contribute to a greater debate on Sinking Funds in MUDs in Ireland. Such a debate has the potential to underpin the stability of apartment living in the decades ahead. This in turn is important in relation to the future of urban centres in Ireland and finding long-term solutions to Ireland's housing crisis.

Finbar McDonnell MSCSI MRICS

Property & Facilities Management
Surveying Chairperson



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Executive Summary

Importance of Sinking Funds in Multi-Unit Developments

Apartment living in Ireland is increasing in popularity. Census 2016 identified 204,145 occupied apartments in Ireland, up by over 10% since 2011. Apartments are now the single most common dwelling type in the Dublin City Council area.

The growth of multi-unit developments (MUDs), which normally means apartment developments but which can include duplex units, houses and commercial units, has meant the emergence of Owners' Management Companies (OMCs) to manage them. In many cases, professional licensed Managing Agents manage the developments on a day-to-day basis on behalf of these OMCs. Their work includes collection of service charges and management of a wide range of services on site.

An important issue for MUDs is the need to budget for adequate Sinking Funds. As many MUDs in Ireland are fairly new, this has been a relatively neglected issue to date. Sinking Funds are crucial to ensure a development has sufficient financial resources over time to refurbish its common areas and to permit investment and upgrade projects, e.g. upgrades to lifts, roofs, pumps, electrical fittings, metalwork, fire alarm systems, carpets and so on. An inadequate Sinking Fund will mean problems in undertaking these projects. This will reduce the standard of the property, affect residents' living standards and could compromise health and safety.

The requirement for a MUD to establish a Sinking Fund was set out in the 2011 MUD Act. This contains a guideline contribution of €200 per unit per year although, as MUDs differ widely, this is purely a notional figure. For a specific MUD, assessment of the level of Sinking Fund required should mean 'starting at the end' in working out how much should

be in the fund and when funds will be required for particular projects. To obtain this information, an OMC should request a construction professional, such as a Chartered Building Surveyor, to prepare a long-term Building Investment Fund (BIF) report, e.g. over a 20-year period.

Research Findings and Conclusions

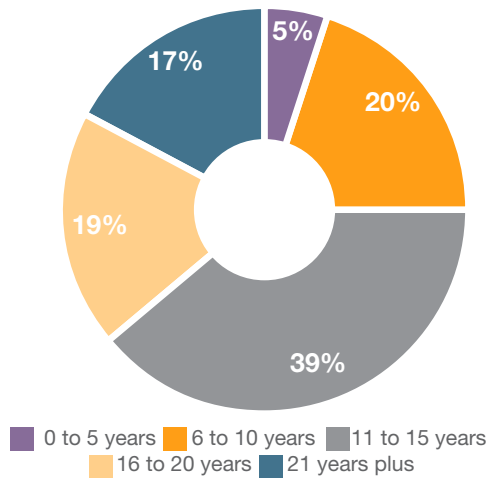
Consultations for this report with Chartered Property Managers/Managing Agents and Building Surveyors indicate that, in practice, the MUD Act reference to the €200 per property annual guideline is often considerably less than is required to budget for an adequate Sinking Fund commensurate with the needs of the MUD. This is based on analysis of actual Building Investment Fund reports prepared in Ireland in recent years.

The study involved the collection of data from an expert panel of nine large Managing Agent companies in Ireland. The expert panel provided data in relation to 632 MUDs which contain 52,600 individual properties. The age of these properties is shown below.

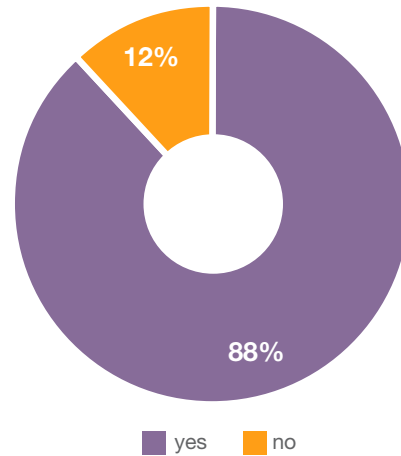
The age profile of the MUDs, together with the standard expected life spans of passenger lifts, certain roof types, carpets and other elements of a building, suggests that the issue of adequate Sinking Funds will come sharply into focus in Ireland in the decade ahead.

The study asked if MUDs in Ireland have established Sinking Funds. Almost all have and this is a positive outcome of the MUD Act. Furthermore, the vast majority hold the Fund in a separate bank account, as shown below.

Age of MUDs Surveyed



How many MUDs have Separate bank accounts for sinking funds?



The research found that:

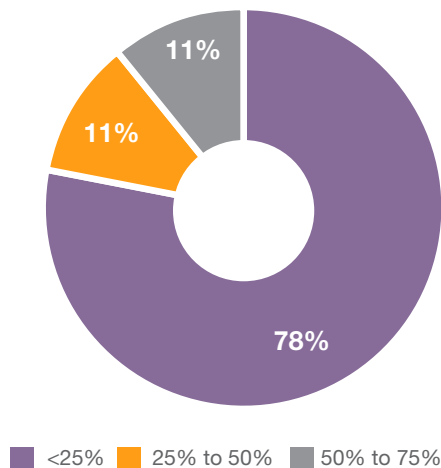
- One-third of the expert panel of agents and their MUDs vary their Sinking Fund contributions based on the age of the MUD. This is low as one might expect contributions to rise as MUDs get older and suggests that many MUDs have not yet faced up to the challenges ahead.
- Some 89% of the panel of agents reported that additional levies had been required in MUDs under their management. This can arise when there are inadequate Sinking Funds and urgent spending is required.

In relation to the adequacy of Sinking Funds, as shown below, over three-quarters of Managing Agents (78%) said that under 25% of the MUDs under their management have adequate levels of Sinking Funds.

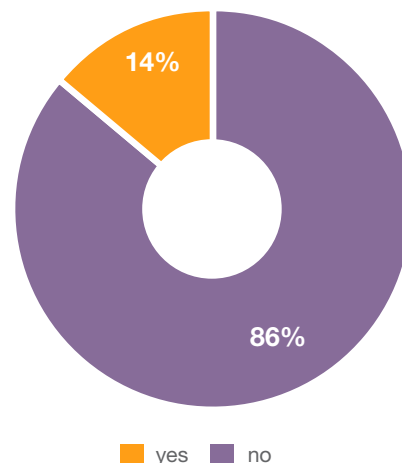
When asked their opinion on why so many MUDs have inadequate Sinking Funds, eight of the nine Agents said that many property owners do not wish to have increased service charges today in order to build a Sinking Fund for the future.

Related to this is the fact that six out of seven MUDs have not prepared a BIF report.

Percentage of Agents - Reporting adequacy levels of Sinking Funds



MUDs prepared a BIF Report



The research found that, even of those that have prepared a BIF report, only a minority are fully implementing its findings and building a Sinking Fund in accordance with its recommendations. The main reason cited by Agents as to why more OMCs had not undertaken BIF reports is that the OMCs believe the report is likely to recommend higher charges and they don't believe owners will want these charges.

Recommendations to support adequate Sinking Funds

The research findings and the existing knowledge of Chartered Property Managers/ Managing Agents lead to a number of suggestions. Key recommendations are below – a full list of recommendations with more details on some of them is contained in the full report.

For Policy Makers

1. An inability to put aside an adequate contribution to the Sinking Fund each year is in part due to wider challenges that OMCs face in collecting service charges from owners who refuse to pay them. Changes to make it easier for OMCs to collect service charge arrears would assist OMCs in this regard.
2. The MUD Act allows the Minister to make regulations prescribing “a class or classes of expenditure which may be incurred by a Sinking Fund; the matters to be taken into account in the settings of such contributions; and the arrangements for levying and payment of such contributions”. SCSl recommends that regulations are introduced to require OMCs to prepare / update / review a BIF every five years and that AGMs should take account of such reports in deciding on Sinking Fund annual contributions.
3. Any future amendment to the MUD Act should make it a requirement that a dedicated Sinking Fund be established in a development from year one. This should be held separate to any other OMC fund (in its own bank account) and should be shown as a separate account in the annual OMC financial statements.

4. Given that elements of MUDs such as different kinds of lifts, roofs etc. are reasonably standard, it may be that the Department of Housing, Planning and Local Government or the Housing Agency could prepare or sponsor preparation of a guide for OMCs on the standard ‘wasting assets’ in a MUD and the issues that arise with them. This would not replace the need for BIF reports in individual MUDs. SCSl is willing to participate in preparation of such a guide.
5. Given the public interest in MUDs having healthy Sinking Funds, the Government should consider ways to incentivise OMCs to put money aside for longer-term needs.
6. It is likely that some MUDs will face funding shortfalls in the coming decade for essential repairs and investment projects. As a generalisation, this is more likely to happen in areas that are less well off, especially in developments sold at the top of the property market in 2004-08. The Government, the Housing Agency, local authorities and other stakeholders need to consider if they will be willing to support investment projects in such MUDs, especially where health and safety issues are involved.

For New Multi-Unit Developments

7. Safety files passed to OMCs by developers should include information on the lifespan of all materials and maintenance processes during the life of the buildings. This builds on the provisions of Section 6 of the Sustainable Urban Housing: Design Standards for New Apartments – Guidelines for Planning Authorities (2018).
8. A Building Investment Fund (BIF) report should be prepared at the outset and provided to the OMC by the developer. This should be completed by a competent, independent construction professional.
9. Sinking Fund contributions should be included in annual charges to owners from the outset, informed by the BIF report.
10. A small proportion of the purchase price (e.g. 1% or 1.5%) of properties should be allocated to the Sinking Fund at the start of the development. This is in the long-term interest of all property owners.

Raising awareness

11. Property owners need to be better educated as to why budgeting for an adequate Sinking Fund is in their own interest and represents an investment, not a cost. Similar to personal pension provision, early and regular contributions are important to ensure an appropriate long-term fund is built up.
12. Estate Agents need to provide more information to purchasers in relation to the state of developments into which they are buying as regards Sinking Funds and whether a BIF report has been prepared.

For Owners' Management Companies in existing MUDs

13. The information provided each year by OMCs to property owners could provide more detail on the level of cash reserves of the OMC, the specific balance of the Sinking Fund account and whether a BIF report has been prepared and is being implemented.
14. The professional who completes a BIF Report should present the findings at AGM. This will help instil transparency and address owners' concerns.

For Others

15. The Law Society should review the list of questions posed by the solicitor for the purchaser of a second-hand property in a MUD as regards pre-contract enquiries. It may be that these can be expanded to include more questions on the Sinking Fund and whether a BIF report has been commissioned.

16. Local authorities and social housing associations own properties in many MUDs, or rent units on long-term leases. These organisations should use their influence (and votes at AGMs) to support the preparation of BIF reports and the development of strong Sinking Funds. The Irish Council for Social Housing could help to coordinate such an approach.
17. The Construction Industry Federation should work to educate its members in relation to the longer-term maintenance and renewal costs in relation to MUDs.
18. Insurance underwriting companies that provide block insurance policies could consider including issues to do with the Sinking Fund in the development (and a BIF report) as part of their wider risk assessment of a MUD.

It should be noted that the requirement for adequate Sinking Funds in MUDs is no different to the requirement for owners of regular houses (not in MUDs) to put money aside in a prudent way for long-run refurbishment works such as replacing boilers, replacing a flat roof, re-carpeting, re-surfacing their driveway and so on. However, the requirements of communal living and OMCs mean that building a Sinking Fund needs to be coordinated across many owners and the detail of the buildings and equipment is more complex.

This is why it is important that action is taken now to address what is a serious issue for apartment developments and other MUDs in Ireland. Such action will help to underpin and support apartment living as a normal, long-term residential choice in Ireland. The longer action is postponed, then the more drastic will be the need for that action in due course.



1.0

Multi-Unit Developments and Sinking Funds

1.1 What is a Multi-Unit Development?

A multi-unit development (or MUD) is a development with shared areas and facilities and at least five residential units. The 'units' are generally a mix of residential apartments and/or duplexes and the shared facilities generally include internal (and perhaps external) common areas and services. Housing estates can constitute MUDs where open spaces, roads, footpaths etc. are not taken in charge by the local authority. A MUD may include commercial units. The operation of MUDs in Ireland is governed by the Multi Unit Developments Act 2011 (MUD Act).

When a property owner buys into a MUD, he or she becomes a member of an Owners' Management Company (OMC), the legal structure under which the common areas are managed and maintained. All unit owners have voting rights within the OMC and,

for residential units, this is normally based on 'one unit, one vote'.

The OMC is a company under company law. It is administered by a Board of Directors, normally made up of OMC members elected at the company's AGM. Generally, day-to-day management is undertaken by a professional Managing Agent, who must be licensed by the Property Services Regulatory Authority. A minority of developments are 'self-managed' by owners.

Members of the OMC are required (under lease agreements they sign when purchasing their properties) to contribute to the costs of managing and maintaining the shared facilities. Annual service charges cover all expenses for the day-to-day running of the development, e.g. block insurance, refuse collection, electricity costs, grounds maintenance, maintenance of fire safety

equipment and so on. In addition to service charges for ongoing expenditure, there is a separate requirement for owners to establish a Building Investment Fund or “Sinking Fund”.

1.2 Sinking Funds and the MUD Act

A Sinking Fund (also known as a Building Investment Fund) is established to fund the gradual replacement of wasting / depreciating assets in the development. In an OMC, this means future capital expenses relating to the common areas (see examples in Table 1).

Each MUD will have different required Sinking Fund expenditure, e.g. some developments do not have lifts, some do not have underground car parks and so on. Housing estates will likely have lower requirements than apartment developments. Required spending over time also depends on quality of original installation, standard of ongoing maintenance and changes in technology or legislation.

Section 19 of the MUD Act (see Annex) sets out OMC obligations in relation to Sinking Funds. It states that an OMC must establish a Sinking Fund within three years of the first sale of a unit in the MUD. It sets out guidelines on the use of Sinking Fund monies, with spending limited to:

- The refurbishment of the multi-unit development;
- The improvement of the multi-unit development;
- Maintenance of a non-recurring nature;
- Advice from a suitably qualified person relating to the above items.

In relation to what maintenance is ‘non-recurring’, the Act says that any such expenditure needs to be so certified by the OMC Board and approved by a meeting of OMC members.

The MUD Act does not set down a mandatory figure that should be contributed each year to the Sinking Fund and, given the wide variation in MUDs, it would not be possible to do so at national level. As such, this is a matter for each OMC to decide each year for its own development. However, the Act does mention a figure of €200 per unit per annum purely as a guidance figure.

The MUD Act sought to ringfence Sinking Fund monies by requiring that funds collected for the Sinking Fund ‘be held in a separate account and in a manner that identifies these funds as belonging to the Sinking Fund’.

1.3 Annual Sinking Fund Contributions

While the MUD Act sets out the obligation to make an annual contribution to a Sinking Fund, it does not provide guidelines to OMCs as to how the contribution should be calculated. Rather than setting an arbitrary amount (e.g. an average of €200 or €300 per unit), good practice would require that an OMC ‘start at the end’ in the sense of calculating what funding is required in its particular MUD over a 20-year or longer time period, and when those amounts will be required. This in turn should drive the annual contributions.

Table 1: Areas in which Sinking Fund Expenditure may be required in a MUD

Life systems, including fire alarm systems, emergency lights and vents	Roofs, including copings and cappings, fall arrest systems etc.
Mechanical Plant, including lifts and pumps	Electrical fittings, including light fittings
External common areas, including perimeter walls, pedestrian gates etc.	Windows / window frames of common areas and perhaps individual units
Building façade, including external walls and renders	Interior common areas, including carpeting, painting, joinery etc.
Roads and car parks, including gates	Re-tiling
Landscaping	Ironwork and metalwork

Distinction between Total Net Assets, Cash Reserves and Sinking Fund

A distinction can be made between the overall assets of an OMC, its Cash Reserves and its Sinking Fund. Normally, an OMC begins with no assets and its 'total net assets' at the end of a particular year (as per its Balance Sheet) is the total of the surpluses it has generated over time, i.e. service charges it has billed out, plus any other income, minus the expenditure required to manage the development over time.

However, it is likely that at least a portion of these assets will be tied up in service charge arrears (included in the 'Debtors' figure on the Balance Sheet). These are assets of the company as they are monies owed to it but they do not form part of OMC Cash Reserves until they are collected. This is a source of frustration to many OMCs as legal processes in Ireland make it difficult to collect service charges from owners who refuse to pay them. It is a particular source of frustration to owners who pay their service charges.

Even the portion of assets held as Cash Reserves is not the same as the available Sinking Fund as an OMC will normally have two bank accounts, a current account and a Sinking Fund account. A certain amount of Cash Reserves needs to remain in the current account to cover day-to-day expenses and contingencies. The amount required will vary by the MUD and, normally, the OMC will be more cautious on keeping a little more in the current account than it strictly requires.

As such, what is normally in the Sinking Fund account is the total net assets of the OMC minus the amount tied up in service charge arrears and also minus the amount which needs to be kept in the OMC current account. It is normally just the amount that is actually in the Sinking Fund account that is available to an OMC for major, non-routine investment projects such as replacing lifts, roofs etc. An OMC needs to ensure it does not confuse these concepts and become complacent through believing that a high 'total net assets' figure on its Balance Sheet implies that it is well prepared for Sinking Fund expenditures required.

In this regard, drawing up a list of wasting / depreciating assets, when they need to be replaced and how much that will cost is a key task. This is generally done via a BIF Report (see next section) to ensure that:

- The OMC doesn't underestimate the works required over time;
- An independent expert can stand over figures and provide owners with a logic to underpin annual contributions;
- There is a benchmark against which periodic reviews of implementation of the BIF Report can be undertaken;
- There is a basis for the OMC to prioritise and undertake investment projects.

In practice, there may be pushback from some owners for what they perceive as high Sinking Fund contributions and a logical, rigorous approach can strengthen the case of an OMC Board looking to build an appropriate Sinking Fund¹.

1.4 Dealing with a Sinking Fund Shortfall

Based on the experience of SCSl members who work as Managing Agents, there are several common reasons why an OMC will not have an adequate Sinking Fund when long-term investment projects are required. These include:

1. OMC members adopting an approach of 'let's cross that bridge when we come to it' for long-term investments. This can be reinforced by property owners under short-term financial pressures and therefore adopting budgets that cover ongoing expenditure but do not generate enough income to build an appropriate Sinking Fund. (This can be made worse again if some owners do not pay the charges).
2. The OMC and its members are aware of their general obligations on the Sinking Fund but have not undertaken a BIF report and are not aware of the amounts required to build an appropriate fund and when the funding will be required.

¹ Separate to Sinking Fund contributions, which go towards longer-term expenditures, an OMC may wish to have a budget line for contingencies, to cover expenditure on smaller capital projects & unforeseen events. Such 'unplanned spends' do arise and an OMC should try to ensure it does not use owners' Sinking Fund contributions for such expenditures.

3. In some cases, while a BIF report has been completed, members have not then contributed annually in line with the report to build up an adequate fund.

In these scenarios, the likely outcome is that when an element fails in a MUD, e.g. a need to replace a lift, the OMC may not have adequate funds to do this. This creates a serious scenario as there could be health and safety implications and it might mean the building is not habitable.

In such a situation, the most common OMC response is to issue a “special levy” to members. This usually requires an EGM and can lead to division between owners and financial distress if requests for large payments are issued. Levies can also mean delays in undertaking works as funds take time to collect.

As such, it is clearly good practice to try to avoid such levies as much as possible and to build the

Sinking Fund over time. This is not to say that levies do not have a role to play, e.g. in part-paying for certain works in the year in which they are required.

In planning the budgeting of its Sinking Fund, an OMC should be conscious that, while building elements normally deteriorate in line with their prescribed lifespan, failures can occur before this. As such, an OMC should ‘hope for the best but prepare for the worst’. An OMC also needs to be conscious of the general economic cycle, i.e. it can be particularly difficult to raise levies or increase general sinking fund contributions during an economic recession.

Another scenario that arises when OMCs do not have adequate Sinking Funds is that investment projects seen as ‘non-essential’, such as replacing carpets or repainting corridors, are not undertaken. The consequence in this scenario is that the appearance of developments deteriorates, reducing rental and resale values for owners.





2.0 Building Investment Fund Reports

2.1 What is a Building Investment Fund Report?

A Building Investment Fund (BIF) report highlights the wasting or depreciating assets of a building to establish when each material or element will need critical maintenance or replacement. It is commonly set out for 20-25 years. The report informs the OMC of the funding required to maintain its building(s) and keep them in good and functional order. It is commonly used to establish an adequate estimated annual provision to the Sinking Fund.

As noted, the MUD Act allows an OMC to use Sinking Fund monies to seek advice from a 'Suitably Qualified Person'. In preparing a BIF report, such a person would be a construction professional with experience of the lifespan and maintenance requirements of construction materials and

electrical and mechanical fittings and fixtures in a MUD. A Chartered Building Surveyor possesses the expertise to undertake this type of work as he/she will be trained in maintenance and repair of existing buildings and have a grounding in the costs of works. More complex installations may require the Surveyor to bring in a Chartered Mechanical and Electrical Engineer. (A list of Chartered Building Surveyors can be found at www.scsi.ie)

The cost to an OMC of a BIF report is negligible compared to the cost of maintaining the building. The average cost of a BIF report in 2018 was €3k to €7k (including VAT), depending on the size and complexity of the MUD. For a large scheme with multiple blocks and cores, an absence of plans and complex mechanical and electrical systems, costs could be higher. However, the cost per individual property in most development is normally at most a

few hundred euros to gain essential information for the future management of the MUD.

A BIF report should not be viewed as a 'once-off' report that is completed and put away. It should be a 'living document' that guides an OMC Board and Managing Agent and is revisited and updated periodically (e.g. every five years) to establish if the deterioration of wasting assets is continuing at the same pace as per original inspections. A review also allows the OMC to update costs taking into account construction price inflation (or deflation), market conditions, changes in technology etc. The cost of BIF reviews is lower than the cost of the original report as the surveyor will not have to undertake the same measurement exercises. (This exercise may also support the calculation of the reinstatement value of the development, as required for block insurance purposes.)

The BIF report focuses on both the **type** of materials and **form** of construction. It is not a defect report but reviews the different elements of the building. The report will identify the current condition and expected remaining lifespan of the elements.

An important starting point is whether the Surveyor receives an accurate set of 'as-built' layout drawings so he/she can scale off to establish the meter-squared areas of relevant elements. If these are available, it allows a good amount of work to be done as a desktop study in comparison to having to measure all areas on site.

A Building Investment Report will be able to build on any building lifecycle report that was prepared as part of the original planning process for the development. These were traditionally not prepared but they may become the norm in the future. This is as per Section 6 (and particular Section 6.13) of the Sustainable Urban Housing: Design Standards for New Apartments – Guidelines for Planning Authorities (2018). It remains to be seen how these new standards will be interpreted and implemented in practice.

Example of One Possible Issue in a BIF Report

A report would likely have different findings for a development with a slate-covered pitched roof or a felt-covered flat roof. As the slate-covered pitched roof has a life expectancy of over 80 years, its replacement would be outside the scope of a 20-year BIF. However, the surveyor would still review the condition of the roof to check for evidence of slipped or broken tiles. The Report may contain a recommendation that the OMC allocates a sum of money in a certain year for maintenance to prolong its lifespan.

A flat roof may often have a warrantee from a manufacturer of 15 years, but it may last 20 to 25 years if well maintained and has limited exposure to UV light. The Surveyor will have cognizance of the age of the building to establish the remaining lifespan but will also review its current condition to see if it is ageing in line with its warranted lifespan. It is most likely that the flat roof will require full replacement within the 20-year span of a standard BIF.

Therefore, a building with a flat roof in comparison to a pitched slate roof will typically need a higher annual Sinking Fund contribution to prepare for its replacement. This also shows how the specification undertaken by the original designer of the development can have a major impact on its ongoing management.



2.2 Examples of Contribution Amounts Required in MUDs

There is no average adequate Sinking Fund level due to the bespoke nature of each MUD. The tables below show high-level information from three examples based on actual BIF reports prepared by an SCSl member and Chartered Building Surveyor in 2016 or 2017:

Table 2: Example of OMC with Large High-End Development (333 Properties)

Type and location of building	Apartment Building, South County Dublin
Standard of development	High End
Age of building when BIF undertaken	9 years old
Roof type	Mixture of pitched and flat
External wall type	Mixture of painted render and brickwork
Window type	Double glazed uPVC
Basement area?	Yes
Lifts?	Yes
Recommended annual Sinking Fund contribution per property	€250 initially, rising to €1,100 by year 20

The BIF report in Table 2 found that to have the appropriate Sinking Fund, the OMC should have an average annual contribution per unit of €250 in Year 1, rising to €1,100 in Year 20.

Table 3: Example of OMC with medium-sized mid-Quality Development (74 Properties)

Type and location of building	Apartment Building, Dublin 14
Standard of development	Moderate to high
Age of building when BIF undertaken	10 years old
Number of units	74
Roof type	Flat roof
External wall type	Mixture of painted render and brickwork
Window type	Double glazed UPVC
Basement area?	Yes
Lifts?	Yes
Recommended annual Sinking Fund contribution per property	€1,014 initially, rising to €1,422 (Year 13), then falling to €1,232 (Year 20)

The BIF report in Table 3 suggested that high annual contributions were needed, starting at just over €1,000 and rising to a peak of over €1,400 before falling again.

Table 4 shows different levels of annual contributions were recommended in this MUD, depending on the type of dwelling. For houses, the annual contribution would be €77 per year over the full period with higher contributions for duplexes and apartments.

Table 4: Example of an OMC with Large Mid-Quality Development (652 Properties)

Type and location of building	Mixed development in Dublin 15
Standard of development	Moderate
Age of building when BIF undertaken	12 years old
Breakdown of units	72 apts. contributing to amenity and apt Sinking Fund 304 duplexes contributing to amenity and duplex sinking fund 276 houses contributing to amenity budget only
Roof type	Flat roofs to apartments, pitch to duplexes
External wall type	Mixture of painted render and brickwork
Window type	Double glazed timber framed windows
Basement area?	No
Lifts?	Yes – only to apartments
Recommended annual Sinking Fund contribution per property	Houses - €77 Apts. - €457 (€380 for apts. & €77 for amenity), rising to €980 in year 9, 10 & 11 before falling to €457 Duplexes - €570 (€493 for duplexes & €77 for amenity)

The figures above partly reflect an under-provision into the Sinking Funds in earlier years. They show that leaving the building of an appropriate Sinking Fund to later in the life of a MUD can lead to relatively high contributions being needed as elements such as roofs and lifts begin to fail and there is less time to put money aside.

It is the experience of SCSl Managing Agents that, sometimes, owners of properties that were originally sold for relatively competitive prices (compared to other areas) may believe that this should mean that a lower Sinking Fund is required. However, this is

not always the case as less expensive materials in the original development may mean a shorter lifespan of materials. Each MUD has to be reviewed on its own merits.

While it may be that some of the funding required for certain longer-term projects can be gathered through levies at the time the work is required, the above examples (and wider experience of SCSl Building Surveyors and Managing Agents) suggest that, in most cases, the annual contribution per property to the Sinking Fund should be higher than the €200 guideline in the MUD Act.



3.0 Evidence on Current Sinking Fund Provision

3.1 Survey Data

Data was gathered in relation to the MUDs managed by nine large Managing Agents in Ireland who are represented on the SCSl Residential Management Sub-Committee. For each company, data was gathered centrally by a senior manager who liaised internally with individual managing agents as required. The data was gathered in late 2017 and early 2018 and across the nine Agents it relates to 632 OMCs which contain approximately 52,600 properties.

As such, based on the total number of occupied apartments in Ireland as per Census 2016 (204,145), the survey covers approximately one-quarter of these². Despite this relatively high proportion, the data is indicative of the national situation rather than fully representative. This is because:

- the data relates mainly to the greater Dublin area (although this is also true for MUDs in general). Six of the nine Agents were based in Dublin, one in Kildare, one in Limerick and one in Galway;
- the data mainly excludes MUDs under 20 properties as the companies that completed the survey do not manage many such developments;
- the data does not relate to local authority blocks;
- the data is likely to exclude OMCs that choose an Agent based solely on price as the Agents involved tend not to compete solely on this criterion.

As such, as compared to the total population of MUDs in Ireland, the properties covered by the data in this report were somewhat more likely to be in larger developments, perhaps more likely to be in urban areas (especially Dublin) and to choose a

² Some of the MUDs for which data was collected included houses so the figure of one-quarter is approximate.

Managing Agent based not only on price. Given this, the survey results are, if anything likely to understate the challenges facing OMCs as the nine Managing Agents who provided the data would already have a certain level of knowledge of the challenges facing OMCs around Sinking Funds³.

The age profile of the 632 MUDs surveyed is shown in Figure 1.

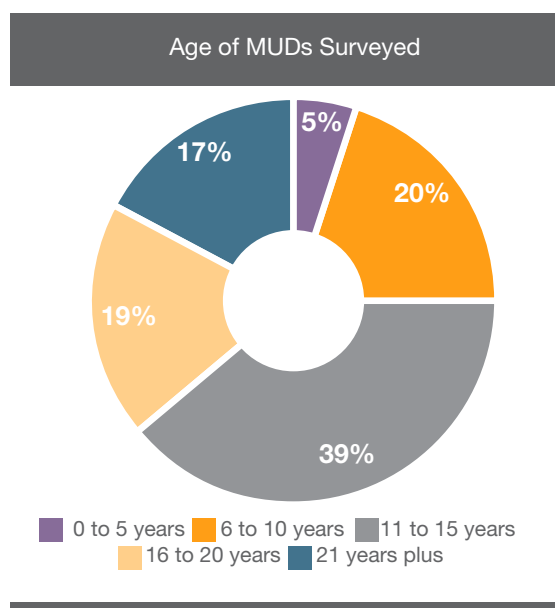


Figure 1 shows that the single biggest cohort of MUDs (39%) was 11-15 years old. The figure reflects the wider situation in Ireland with the vast majority of multi-unit developments built in the last 20 years and most completed between approximately 2000 and 2010. For Sinking Funds, an important implication is that many developments in Ireland will start to hit periods of significant capital expenditure between 2020 and 2030. For example, the average lifespan of a passenger lift is 20-25 years and certain kinds of roofs have similar lifespans. Replacement of carpets is also often required (assuming normal levels of wear and tear) around a 20-year time horizon.

3.2 Current Situation regarding Sinking Funds

The MUD Act states that all MUDs must have established a Sinking Fund within three years of the first unit in a development being sold. The survey found that 98.1% of MUDs surveyed had a Sinking Fund in place. This suggests that MUDs in Ireland (at least in the OMCs covered by the survey) are complying with the law as regards the establishment of Sinking Funds, at least as regards a 'nominal' Sinking Fund in their accounts. This is a positive finding and is a positive outcome arising from the MUD Act.

When asked how many of the MUDs had a specific dedicated bank account in place for the Sinking Fund, the survey indicated that 88% of MUDs had such an account. Again, this is a positive finding although it does suggest that there are about 10% of MUDs which have a Sinking Fund but do not (yet) have a dedicated bank account for it.

The issue of whether a dedicated bank account is required is not entirely clear from the MUD Act which states: "The contributions made to the Sinking Fund shall be held in a separate account and in a manner which identifies these funds as belonging to the Sinking Fund ...". The survey suggest that most OMCs interpret this as requiring a separate bank account. However, in some cases, OMCs (and their auditors) may deem it sufficient to have a 'notional' account with a portion of the funds in the OMC current account 'allocated' to the Sinking Fund and this being noted in annual financial statements. It may also be that the administration involved in opening bank accounts (which has increased considerably in recent years) has discouraged some OMCs from opening dedicated Sinking Fund bank accounts, especially if the amounts involved are low.

³ In preparing this report, a number of research studies carried out in recent years by students of DIT were reviewed, which covered similar topics. In particular, research studies by Adele McKeown and Finbarr Malone were pertinent. Their findings, while based on smaller sample sizes, are similar to the findings of this report.

The survey asked if annual Sinking Fund contributions made tend to vary based on the size or age of the MUD or for other reasons. The responses suggested that:

- Three of the nine Agents surveyed said that the OMCs with which they work vary their Sinking Fund contributions based on the age of the MUD. One noted that many MUDs stick to the guideline amount in the MUD Act of €200 per property per year. This relatively low linkage between age of development and contribution may reflect the fact that many OMCs have not yet properly focused on the issue of Sinking Funds. Two Agents commented that it is somewhat easier to persuade property owners in older developments of the need for increased annual contributions as owners can see the coming need for investment projects.
- Five Agents said that the OMCs with which they work vary their annual contributions based on the size of the MUD. Some noted that it was not size per se that drove contributions but the specification of the building, e.g. number of properties per lift. One Agent noted that larger MUDs were more likely to have commissioned BIF reports and these in turn tended to lead to increased contributions.
- Eight of the nine Agents said that their developments vary contributions for other reasons. Specific reasons noted included the qualifications of directors and the extent to which they had engaged with the issue; the number of up-and-coming projects; the level of day-to-day services needed (higher day-to-day costs can mean lower Sinking Fund contributions); the proportion of owner-occupiers (who may be more willing to contribute towards long-term investment needs); and the socio-economic profile of the MUD (with 'middle-class' developments more likely to have higher contributions).

The Managing Agents were asked their opinion on the extent to which the MUDs under their management had adequate Sinking Funds in place given their age and current state of repair. The responses showed that seven of the nine Agents said that under one-quarter of the MUDs under their

management have adequate Sinking Funds. Given the knowledge that Managing Agents have of the finances of OMCs they work with, this is a serious finding. Three of these said they felt the proportion was actually either 0% or close to 0%.

Given that most Agents feel the vast majority of MUDs with which they work have inadequate Sinking Funds, the Agents were asked why they feel this is the case. The responses showed that:

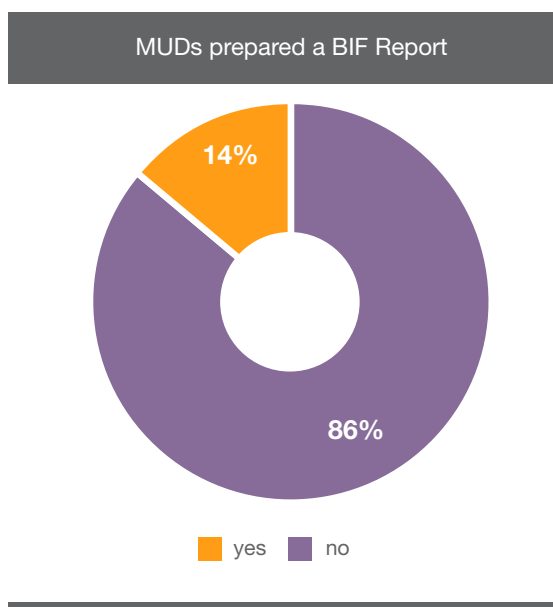
- Eight of the nine Agents believed property owners do not wish to have increased charges today in order to build up a Sinking Fund for the future. This reflects the experience of Agents in discussing the idea of higher Sinking Fund contributions with OMC Boards and at AGMs;
- Seven of the nine Agents cited a lack of appreciation by OMC Boards and members, and perhaps by themselves, of the levels of long-term expenditure that would be required in the MUDs. This shows the importance of BIF reports, even purely from the perspective of educating property owners (and Agents);
- Five of the nine Agents cited the challenge for owners of already paying the service charges to cover the day-to-day service charges, never mind higher contributions to build a Sinking Fund.

Given the sense that many developments have inadequate Sinking Funds, the Agents were asked if any OMCs with which they work had needed to introduce specific levies for investment projects. Eight of the nine Agents said that this had been the case.

3.3 Building Investment Fund Reports

The survey asked about the proportion of OMCs that had prepared a BIF report.

Figure 2 shows that six out of seven of the 682 MUDs surveyed had not prepared a BIF report. Two of the nine Agents said that none of the OMCs that they work with had prepared such reports.



Even if an OMC has prepared a BIF report, this does not mean it has implemented its findings. Indeed, when asked what proportion of that minority of developments which had undertaken a BIF report were building their Sinking Fund in accordance with the report, only one Agent reported that all relevant

OMCs were doing so. Three Agents said that some OMCs (but under 50%) were doing so.

Thus, the survey indicates only a small minority of MUDs have prepared BIF reports and just a minority of those are in turn building a Sinking Fund in line with the report recommendations.

Finally, given that best practice would support preparation of BIF reports, Managing Agents were asked why they felt the MUDs with which they work had not prepared these reports. All nine Agents said that the OMCs tend not to want to prepare BIF reports as they are likely to recommend higher service charges, which property owners will then not want to pay. While this may be true, it may also be storing up issues for the future. Four Agents cited the cost of preparing the BIF Report itself is an issue – however, as per section 2.1, this cost is reasonably modest so it may be that OMCs overestimate it. A number of Agents also cited a tendency by property owners to focus more on short-term rather than longer-term issues.





4.0 Recommendations

4.1 Need for Change re Sinking Funds

The concern of the SCSi is that many Irish multi-unit developments are ill-prepared for the future. This is based on the findings set out in Chapter 3 as well as the knowledge of SCSi chartered property managers. The practice of under-contributing to Sinking Funds is storing up problems and may lead to MUDs falling into disrepair, becoming degraded and even posing health and safety risks. The fundamental point for OMCs is as per the quote from Benjamin Franklin (later modified by Roy Keane): “By failing to prepare, you are preparing to fail.” The challenge is to support OMCs in preparing better.

There is no one solution and the following are suggestions on how the issue can be addressed:

4.2 Education

1. There is a need for education of property owners regarding the importance of good Sinking Funds. This will need to encompass work by the SCSi, the Apartment Owners' Network, the Department of Housing, Planning and Local Government, the Housing Agency, other state and professional bodies, the media and others. The SCSi is ready to be an active stakeholder in this work. Property owners need to understand that a good Sinking Fund is an investment in their properties and low contributions cause problems later.
2. There is a need for education of Estate Agents who sell second hand properties in MUDs. They need to draw attention on a standard basis to the levels of Sinking Funds in a development and

whether the OMC has undertaken a BIF report. If a good Sinking Fund is fully reflected in the sale price of a property, this will assist in persuading property owners to build Sinking Funds.

4.3 For New Multi-Unit Developments

1. For new MUDs, information should be provided as part of the Safety File on the lifespan of all aspects of, and materials used in, the development as well as on long-term maintenance processes. This is of considerable benefit in managing the development. This builds on the provisions of Section 6 of the Sustainable Urban Housing: Design Standards for New Apartments – Guidelines for Planning Authorities (2018).
2. A Building Investment Fund (BIF) report should be prepared at the outset and provided to the OMC by the developer as part of the handover of the common areas (in advance of the first unit being sold). The report should be prepared by an expert, e.g. Chartered Building Surveyor, who is independent of the developer. (A spin-off benefit may be learning for developers on long-term maintenance costs of certain features or materials.)
3. The budget to manage a development in its first year, normally provided to prospective owners as part of the sales process, should include a Sinking Fund contribution, based on a BIF Report. This will send a clear signal to purchasers of properties as regards the level of annual Sinking Fund contribution expected. (It also starts building the fund early, when there are normally fewer large investment projects required.)
4. A small proportion (e.g. 1% or 1.5%) of the purchase price of new properties should be allocated to the Sinking Fund. While this may simply be added by the developer to the purchase price, it would be very positive in the long-run to have such an amount set aside by owners on day one. For purchasers, this amount would likely be added into their overall mortgage amount. The *quid pro quo* for purchasers is that having such an amount paid into the

Sinking Fund on day one would reduce annual contributions required.

4.4 For Owners' Management Companies in Existing MUDs

1. It is a responsibility of each OMC to issue information each year to members (as per Section 17 of the MUD Act). This could be strengthened with a requirement for more information on the level of cash reserves of the OMC, the specific balance of the Sinking Fund account and whether a BIF Report has been prepared and is being implemented. Some of this information is already provided in OMC financial statements but it can be hard to find and interpret.
2. Approval of the annual Sinking Fund contribution is already a standard agenda item for the AGM of an OMC. Every so often, e.g. every three to five years, an OMC could ask an external expert to make a presentation on this topic and to answer questions from members.
3. OMCs should make themselves aware of 'the worst that could happen' in a given year (e.g. lift may have to be replaced) and ensure they have at least the amount in the Sinking Fund to cover for such an eventuality.

4.5 For Government

1. The Department of Housing, Planning and Local Government may wish to take account of the recommendations above for new MUDs, in particular via its guidelines in relation to new apartment developments.
2. An inability to put aside a good contribution to the Sinking Fund each year is in part due to wider challenges that OMCs face in collecting service charges from people who refuse to pay them. OMCs which generate surpluses may not be able to build a Sinking Fund if their assets are tied up in service charge arrears (as is the case for many OMCs). Changes to make it easier for OMCs to collect service charge arrears would assist all

OMCs (see joint submission by the SCSi and Apartment Owners' Network to the Review Group on the Administration of Civil Justice in February 2018).

3. Any future amendment to the 2011 MUD Act (introduced by the Department of Justice and Law Reform but which perhaps better fits in future with the Department of Housing, Planning and Local Government) should make it a requirement that a dedicated Sinking Fund be established in a MUD from year one. It should make it explicit that this should be held separate to any other OMC funds (in a dedicated bank account) and should be shown as a separate account in OMC financial statements.
4. Given that elements of MUDs such as different kinds of lifts, roofs etc. are reasonably standard, it may be that the Department or Housing Agency could prepare, or sponsor preparation of, a guide for OMCs on standard 'wasting assets' in a MUD and issues that arise with them. The SCSi would be willing to support any such process. This would not replace the need for BIF reports in individual MUDs but could provide a starting point for OMCs in understanding the issues and broad amounts of expenditure involved.
5. The MUD Act states that the Minister can make regulations prescribing (among other things): a class or classes of expenditure which may be incurred by a Sinking Fund; the matters to be taken into account in the settings of such contributions; and the arrangements for levying and payment of such contributions. This SCSi believes that the Minister should use this provision to support good practice in relation to Sinking Funds (e.g. by stating that a BIF report must be prepared / updated / reviewed by an OMC every five years and that AGMs should take account of such reports in deciding on Sinking Fund contributions).
6. The MUD Act mentions the amount of the annual contribution to the Sinking Fund (per property) as '€200 or some other amount as may be agreed by a meeting of the members'. It should be noted more strongly to apartment owners that this is purely a guideline, not a recommended amount, and that the appropriate amount in a specific MUD can only be known following preparation of a BIF Report.
7. Given the public interest in MUDs having healthy Sinking Funds, the Government should consider if it can incentivise OMCs to put money aside

for longer-term needs. A 'top-up' scheme for *bona fide* OMC Sinking Fund bank accounts would be one possibility, based on an expert BIF report and up to a set limit. Reimbursing VAT to OMCs (generally not VAT registered) for legitimate Sinking Fund expenditures would be another option (not unlike the Home Renovation Initiative). Further suggestions have previously been put forward by the Apartment Owners' Network.

8. It is likely that some MUDs will face funding shortfalls in the coming decade for essential repairs and investment projects. As a generalisation, this is more likely to happen in areas that are less well off, especially in developments sold at the top of the property market in 2004-08, as these owners have been least able to build healthy Sinking Funds. The Government, the Housing Agency, local authorities and others need to consider if they will be willing to support investment projects in such MUDs, especially where health and safety issues are involved, and under what conditions. Any such thinking should link to the recommendations of the 2018 'Safe as Houses' report, published by the Oireachtas Joint Committee on Housing, Planning & Local Government.

4.6 For Others

1. The Law Society should review the list of questions posed by the solicitor for the purchaser of a second-hand property in a MUD as regards pre-contract enquiries. It may be possible to add more questions on the building of a Sinking Fund and whether a BIF report has been commissioned.
2. Local authorities and social housing associations own properties in many MUDs, or rent units on long-term leases. They should use their influence (and votes at AGMs) to support preparation of BIF reports and development of strong Sinking Funds. The Irish Council for Social Housing could help to coordinate such an approach.
3. The Construction Industry Federation should work to educate its members on the full life-cycle maintenance and renewal costs of MUDs.
4. Insurance underwriting companies that provide block insurance policies could consider including issues to do with the Sinking Fund in the development (and a BIF report) as part of their wider risk assessment of a MUD.





Annex:

Section 19 of the MUD Act

19 –

(1) An owners' management company shall establish a building investment fund (in this Act referred to as a "sinking fund") for the purpose of discharging expenditure reasonably incurred on –

- (a) the refurbishment*
- (b) improvement*
- (c) maintenance of a non-recurring nature, or*
- (d) advice from a suitably qualified person relating to paragraphs (a) to (c)*

(2) Expenditure shall be regarded as being expenditure on maintenance of a non-recurring nature where –

- (a) the expenditure relates to a matter in respect of which expenditure is not generally incurred in each year.*
- (b) it is certified by the directors of the owners' management company as being expenditure on maintenance of a non-recurring nature, and*
- (c) the expenditure is approved by a meeting of the members of the owners' management company as being expenditure of a non-recurring nature.*

(3) The owner of each unit in a multi-unit development (including a person who is the developer or building contractor of the development) shall be obliged to make payment to the sinking fund of the amount of contribution fixed in respect of the unit considered with this section.

(4) For the purposes of this section a developer or building contractor, as the case may be, shall be regarded to be the owner of a unit in a multi-unit development the first sale of which unit has to have been completed, as and from the day on which the first sale of a residential unit in the relevant part of the development is closed.

(5) Subject to subsection (6) the amount of the contribution to be paid as respects a unit by each unit owner of such a unit to the sinking fund in respect of a particular year shall be the amount of €200 or such other amount as may be agreed by a meeting of the members as the contribution in respect of the year concerned.

(6) The obligation to establish a sinking fund and to make contributions to such fund shall apply on the happening of the later of –

(a) the passing of a period of 3 years since the first transfer of the ownership of a unit in the multi-unit development concerned, or

(b) the expiry of 18 months from the coming into operation of this section.

(7) The contributions made to the sinking fund shall be held in a separate account and in a manner which identifies these funds as belonging to the sinking fund and such funds shall not be used or expended on matters other than expenditure of a type referred to in subsection (1)

(8) Where a dispute arises in relation to whether assets of an owners' management company should properly be applied to the sinking fund account or the annual service charges account the dispute may be the subject of an application under section 24 (of the MUD Act)

(9) The Minister may, for the purpose of advancing the objective of the fair, prudent, effective and efficient operation of owners' management companies and the fair, prudent, efficient and effective management of the common areas of multi-unit developments, make regulations prescribing -

(a) a class or classes of expenditure which may be incurred by a sinking fund,

(b) the procedures to be followed in setting contributions to the sinking fund, (c) the matters to be taken into account in the setting of such contributions,

(d) the arrangements for the levying and payment of such contributions, and

(e) the thresholds of expenditure (by reference to amounts of expenditure or by reference to the proportion of the sinking fund) which necessitate approval of the members of the owners' management company.







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