

ARQRV Position Paper

Village budgeting - Operation of s106 and s102A

1. Introduction

This paper concerns the correct construction and application of provisions in Part 5 Division 7 of the *Retirement Villages Act 1999* (Qld) (**the Act**) which regulate charges for general services, and the extent to which residents and other parties are required to contribute to those charges.

Residents cannot leave a village without incurring a significant loss of capital through exit fees (and the operator's share of capital gains) so it is critical to ensure residents are not forced to leave their village prematurely as a result of the general services levy becoming unaffordable. On the other hand, it is also important to ensure that sufficient funds are raised in each financial year to ensure that service levels are maintained.

Before examining the provision of Division 7, it is useful to first consider the meaning of a key phrase used throughout the Division (and which is also the title of the Division): "*charges for general services*".

A proper understanding of that phrase is essential in order to properly apply the scheme imposed by Division 7.

2. '*Charges for general services*'

This phrase is not defined in the Act, and nor is the term '*charge*'. However the Schedule Dictionary does define '*general services*', as follows:

general services are services supplied, or made available, to all residents of a retirement village.

Examples of general services—

- management and administration
- gardening and general maintenance
- a shop or other facility for supplying goods to residents
- a service or facility for the recreation or entertainment of residents

The natural meaning of the word "charge" is *cost* or *amount payable*. So the natural meaning of '*charges for general services*' could be stated as '*the costs or amounts payable for services supplied or made available to all residents of a retirement village*'.

The next question is whether the phrase '*charges for general services*' refers only to amounts payable *by residents*, or whether it includes contributions from other parties. The Act contemplates '*charges for general services*' being paid by:

- (a) *scheme operators* in accordance with s104(2) and s105;
- (b) *former residents* in accordance with s104; and
- (c) *relatives* of former residents in accordance with s70B(4).

So the phrase '*charges for general services*' could not have been intended to refer only to amounts payable by residents.

Where Parliament intended the term '*charge*' to refer only to an amount payable by residents, it did so expressly. For instance ss. 102, 103 and 107 are specifically limited to charges payable by residents, whereas provisions such as ss. 102A, s106 and s107A are not. Also the definition of '*services charge*' in the Schedule Dictionary to the Act is specifically limited to charges payable "*by a resident*", which indicates that the term "charge" alone was not seen as sufficient to imply an amount payable by a resident.

That definition is used only in provisions concerning amounts payable by residents, such as ss. 45(g), s63(3)(c), s73, s76(a) and s108, but it is not used in provisions which refer to charges payable by a wider range of contributors, such as ss. 102A, 106 or 107.

The term "services charge" was clearly not intended to capture all charges for general services (ie it excludes those payable by parties other than residents) because s63(3)(b) and (c) treat "*general services charges*" separately from "*services charges*".

In summary then, the phrase '*charges for general services*' means the amounts payable by all relevant contributors (including residents, the scheme operator and former residents) towards the costs of the services supplied or made available to all residents of a retirement village.

3. The relevant provisions

The relevant provisions in Part 5 Division 7 are ss. 102A to 107A.

These provisions operate in two important ways:

- (1) firstly, they mandate and regulate a process of annual budgeting for the costs of providing general services in a village (ie ss. 102A, 106, 107 & 107A); and
- (2) secondly, they regulate the contributions towards the budgeted costs (ie ss. 103, 104, 105 & 107).

(1) The budgeting process

The process of budgeting for the costs of providing general services in a village can be summarised as follows:

- (a) In advance of each financial year, the operator must adopt a budget for "*charges for general services*" (s102A(1)).
- (b) The budget is to cover the cost of providing all of the general services for *the* coming financial year (s102A(2)(a)). This provision ensures that the budget:
 - (i) does not include anticipated costs for years beyond the coming financial year;
 - (ii) does not include costs from previous financial years (other than in accordance with s102A(6)); and
 - (iii) covers the cost of providing all general services regardless of the extent to which they are funded by residents or other contributors.
- (c) In preparing the budget the operator must ensure that the charge for any given general service is not increased without considering whether a more cost effective alternative exists (s107A).
- (d) In preparing the budget the operator must also ensure that the amount budgeted for each general service is "*reasonable*" (s102A(2)(a)). This prevents the operator from simply grossing up each line item by reference to the permitted CPI amount without

regard to the *actual* amount expended in the previous financial year, and any factors likely to increase or decrease the expense in the coming year.

- (e) In preparing the budget the operator must also ensure compliance with s106(1), which requires that the '*total of general services charges*' in the budget must not increase by more than the permitted CPI amount when compared with the corresponding total in the budget for the previous year. The '*total of general services charges*' is specifically defined in s106(2) as the sum of all "*charges for general services*" (ie the key phrase considered above) less any individual charges that have increased by more than the permitted CPI limit:
- (i) in accordance with s107(a) to (d); or
 - (ii) with special resolution approval of residents.

The "*charges for general services*" that are referred to in the definition of '*total of general services charges*' must be the same "*charges for general services*" that are referred to in s102A. So each such "*charge*" for a general service must be the amount budgeted in advance of the financial year as being necessary to provide that general service in the coming year. This is consistent with the earlier analysis of the phrase "*charges for general services*" because the *amount payable* for each general service is determined by the budget, as are the contributions payable by all relevant contributors.

So the '*total of general services charges*' is the total of the amounts *budgeted* for each general service in the coming year, less any budgeted amounts that have increased from the previous year by more than the permitted CPI limit:

- (i) in accordance with s107(a) to (d); or
- (ii) with special resolution approval of residents.

The '*total of general services charges*' is a statutory creature that will not necessarily equate to other totals that are commonly considered in village budgeting, such as:

- (1) the total amount *budgeted* to provide the general services in the coming year; or
- (2) the total amount *levied from residents* during the year; or
- (3) the total *actual* costs incurred during the year in providing the services.

It would be erroneous to apply the s106(1) CPI test using any of these totals.

- (f) When applying the CPI test to a budget in preparation, an operator may find that, despite removing all charges that have increased beyond CPI in accordance with ss. 107(a) to (d), the '*total of general services charges*' still increases beyond the CPI limit imposed by s106(1). Assuming the operator has complied with s107A, and with the requirement of reasonableness in s102A(2)(a), there should be no scope to adjust or re-allocate any expense items in order to achieve compliance with s106(1), and it will instead be necessary for the operator to seek special resolution approvals so that more items can be removed from the '*total of general services charges*'. This process requires that *all* items in the budget that have increased by more than the permitted CPI amount (other than via s107) are put before residents for approval, with each such item being the subject of a separate resolution.

(Residents base their voting decisions on the budget as presented before the vote, including the anticipated expenditure on items that are not the subject of a resolution, as well as the quantum of any budgeted contribution by the operator. Therefore, once a vote is held, the operator cannot subsequently alter any items in the budget (including its own contribution) without giving residents an opportunity to re-cast their votes in light of the changes.)

The individual increases that are approved by special resolution can be excluded when re-calculating the 'total of general services charges', whereas any rejected increases are to remain in that total for the purposes of assessing compliance with s106(1). (Even though a rejected increase can remain in the budget, it cannot be passed on to residents, regardless of whether compliance with s106(1) has been achieved. This is a result of the cap placed on the charges payable by residents in s107, which is considered further below).

- (i) Once compliance with s106(1) is achieved the operator can "carry forward and take into account" any deficit (or surplus) from the previous financial year (s102A(6)). This is the amount by which the actual cost of providing the general services in the previous year exceeded (or fell short of) the budgeted cost of providing the services in the previous year.
- (j) The final step in the budgeting process is for the operator to "fix" the contributions payable during the coming year in order to raise the budgeted cost of providing the general services during that year (s102A(2)(b)). This is not limited to contributions by residents, and includes contributions by former residents and the scheme operator.

(2) Fixing the relevant contributions – s102A(2)(b)

Once a budget is adopted in accordance with the provisions above, other provisions in Division 7 regulate the process of fixing the contributions by residents, former residents and the scheme operator. These provisions are ss. 103, 104, 105 and 107.

Contributions by the operator

The contributions by the scheme operator are, sensibly, not limited. Instead the Act simply imposes certain minimum contributions by the operator as follows:

- (i) operators must pay a share of the charges attributable to units that have been vacated but remain unsold after 90 days (s104(2));
- (ii) operators must pay all of the charges attributable to units that have been vacated and remain unsold for 9 months (s104(2));
- (iii) operators must pay all of the charges attributable to new units that have no residence contract in place (s105).

In addition to these mandatory contributions, operators will also make voluntary contributions for commercial reasons. The costs of providing the general services in a village will increase over time, yet the Act limits the extent to which those increases can be passed on to residents. So where the costs exceed the amount recoverable from residents, an operator must make a commercial decision as to whether they will make a voluntary contribution to the budget to cover the cost, or whether they will seek to be absolved from the cost of providing a particular service in accordance with s73 of the Act.

Section 73 protects operators from having to provide any unaffordable services, provided they have put the issue to a meeting of residents and have acted reasonably in the circumstances. The requirement of reasonableness would impose an obligation to wind back a service to the extent where it is again affordable, rather than to remove the service entirely. (And it would be unreasonable to determine the extent of the wind back without consulting residents).

Winding back a service in accordance with s73 reduces the attractiveness of the village to prospective residents, so operators must balance the cost of a voluntary contribution against the need to ensure that the service offering, and the levies payable, remain attractive. Remaining attractive to prospective residents is, obviously, more important in incomplete villages, or in villages where there is a large stock of unsold units (either new or used).

In newer villages that are built in stages, the communal facilities may be completed but not all of the planned units. In that situation, operators usually contribute voluntarily to the general services budget to ensure that the levies payable by the existing residents remain competitive with completed villages (where the costs are shared among a larger number of residents).

Some operators describe their voluntary contribution as a "*budgeted deficit*". However this is not a true 'deficit' for the purposes of s102A(6). A true deficit is the amount by which the cost of providing the general services in a given year exceeded the budgeted cost for providing those services, regardless of whether the budgeted cost was contributed by residents, former residents or the scheme operator. The term "*budgeted deficit*" is effectively synonymous with "*operator's voluntary contribution*".

Contributions by former residents

The amounts payable by former residents are limited by s104. The scheme operator must pay the charges attributable to former residents' units to the extent that they are not payable by the former residents.

Contributions by residents

Section 103 requires that the amounts payable by residents must be calculated in accordance with the formula in their PID. However their contribution is also limited by s107, which prevails over the formula in the PID (by operation of s37(4)).

Section 107 absolves residents from paying an increase in a "*charge for a general service*" (ie an increase in the amount budgeted in advance of each year for a general service) beyond the amount disclosed in their residence contract, unless the increase is:

- (a) "*under s106*"; or
- (b) in accordance with s107(a) to (d).

The PID provided to each resident before entering their village forms part of their residence contract (s37(1)) and includes the most recent budget for charges for general service. That budget determines the amount "*payable under the contract*" in relation to each general service for the purposes of s107. Increases in the amount disclosed in the PID for each service are only payable by residents if they are in accordance with s107(a) to (d) or are "*under s106*".

The language of s107 is plainly concerned with charges for *individual* services rather than with any total of those charges. So the reference to an increase "*under s106*" cannot be a reference to an increase in the '*total of general services charges*' under s106(1). It can only be a reference to an increase in an *individual* charges under s106, which is contemplated in the definition of '*total of general services charges*' in s106(2). That definition contemplates increases in *individual* charges either:

- (a) by approval of residents by special resolution; or
- (b) in accordance with s107(a) to (d).

The reference in s107 to an increase in an *individual* charge "*under s106*" must be a reference to an increase with the approval of residents by special resolution, as it would be redundant to refer to an increase under s107(a) to (d).

So s107 absolves residents from paying for an increase in a charge for a general service unless the increase is in accordance with ss. 107(a) to (d), or has otherwise been approved by residents by special resolution.

If during the budget-setting process the residents reject any proposed increases that are put to them for special resolution approval then, regardless of whether compliance with s106(1) is achieved, if the operator elects to retain the rejected increase in the budget, it must be funded by the operator's voluntary contribution and cannot be passed on to residents because of the limitation in s107. This allows residents to ensure that any increases in their levies are expended on the services preferred by the majority. (And in relation to the services where increases are rejected, the operator can either fund the increase voluntarily or seek the protection of s73 of the Act).

It is also important to note that the operator's ability under s102A(6) to carry forward a deficit from the previous financial year is similarly subject to the limitation in s107. The ability to carry forward a deficit prevails over s106(1) (in accordance with s102A(7)) and therefore a deficit can be taken into account after compliance with s106(1) is achieved. However s102A(6) does not prevail over s107, so although a deficit in any line item from the previous year can be carried forward and taken into account, the amount payable by residents for that item cannot be increased as a result of the deficit because s107 protects residents from increases other than those:

- (a) "*under s106*"; or
- (b) in accordance with s107(a) to (d).

An increase in a charge as a result of a deficit carried forward under s102A(6) must be absorbed by the scheme operator as part of its own contribution to the budget.

There are obvious policy reasons for this. If a deficit could be passed on to residents, there would be no incentive for an operator to constrain spending to budget, and no incentive to budget prudently. The very purpose of the budgeting process would be defeated, and residents would effectively be required to indemnify the operator against its own failure to properly manage spending. Also if deficits could be recovered from residents without limitation, the CPI cap in s106(1) would be rendered nugatory.