

## RETIREMENT VILLAGES TRIBUNAL

**DATE:** 3 DECEMBER 2001

**APPLICATION NO:** V006-01

**APPLICANT:** RIDING THOMAS JOHN

**RESPONDENT:** AUSTRALIAN RETIREMENT HOMES LTD

**DATE OF HEARING:** 19 NOVEMBER 2001

**REFERENCE:** RVT V006-01 3 DECEMBER 2001

### REASON FOR DECISION:

1. This is an application by Thomas John Riding (Mr Riding) against Australian Retirement Homes Ltd (ARH) in which Mr Riding seeks an order that because the Sinking Fund, maintained by ARH as the scheme operator of the Manly Retirement Village, an existing retirement village, was a single fund for maintenance and repairs for the retirement village, ARH should transfer the balance in the fund to the maintenance reserve fund under section 233 of the *Retirement Villages Act 1999* (the Act) and not under section 234 of the Act which it has done.

2. ARH contend that the Sinking Fund was a single fund for capital replacement and maintenance and repairs for the retirement village and as such they were obliged by section 234 of the Act transfer the balance in the fund to the capital replacement fund and the maintenance reserve fund in the proportion that the amount decided by the quantity surveyor under section 92 as expected capital replacement costs is to the amount decided by the quantity surveyor under section 98 as expected maintenance costs. This they contend they have done and, Mr Riding does not contest the manner of the apportionment.

### The Evidence

3. The Tribunal was provided with statements from Mr Riding and from Mr Thomas Francis Hogan, the General Manager Operations for ARH and Mr Raymond Ralph Martin, the Manager of Manly Gardens Retirement Village on behalf of ARH.

4. While there was some evidence presented to the Tribunal as to the expenditure from the Sinking Fund, this was far from persuasive, and it was accepted by the parties that the determination of the issue depended upon the documents which constituted the agreement between the parties.

5. The relationship between Mr Riding and ARH is governed by the Residents Agreement entered into by the parties and dated 17 December 1996. The relevant sections of that agreement are sections 4(a) (b) and (d) of Part 3 of which the relevant parts state the following:

#### 4. Maintenance Fee

- a. From the date of occupancy of the Unit by the Resident hereunder until repayment of the Loan pursuant to Clause 13 the Resident shall also pay to the Owner a maintenance fee in calendar monthly instalments in advance on the first day of each month the first of such instalments being payable on the day the Resident enters into legal occupation of the Unit in the amounts specified in Item 8 of Schedule 1 or such other amount as shall be determined by the Owner pursuant to the provisions of sub-clause (b) hereof PROVIDED HOWEVER that all maintenance charges and any increase thereof *shall be* levied pro rata to the Residents and that in calculating such pro rata levy the costs relating to common areas facilities and buildings of the Village shall be included.

#### Notice of Increases

- b. The Owner shall notify the Resident in writing prior to the execution of this License Agreement and prior to the 30th day of June 1991 and thereafter if there is any increase, prior to each subsequent first day of May, August, November and February the Resident's pro rata *proportion of the Owner's* estimate of the total operating costs of the Village. The Owner shall make available to the Resident full details of how the Resident's pro rata proportion of the Owner's estimate of total operating costs of the Village was calculated. The maintenance fee payable hereunder shall not be increased by the Owner beyond the maximum amount provided for by the Retirement Villages Act 1988.

#### Total Operating Costs

(d) For the purposes of this Clause "total operating costs" of the Village shall mean all outgoings, costs and expenses which in the opinion of the Owner are properly or reasonably incurred in respect of the conduct and management solely of the said property as a Retirement Village and without limiting the generality of the foregoing shall include:-

...

- i. all costs for or in connection with the maintenance, repair, operation, renovation, replacements and upkeep of the Village including the cost of any structural work;

...

- i. depreciation of plant and equipment and fittings and furnishings;

(ix) such sum in each year as the Owner may reasonably decide to set aside in the Sinking Fund to cover repairs, renovations, replacements and maintenance of a substantial but infrequent or irregular nature, but in any event not less than an amount equal to 2.5 per cent of total operating expenses;

6. The *Retirement Villages Act 1988* did not define "maintenance", "capital replacement" or "capital improvement" and they are not defined in the Residents Agreement.

7. The Act defines "maintenance" as follows:

"**maintenance**", of a capital item, see the rulings of the Commissioner for Taxation under the *Income Tax Assessment Act 1936* (Cwlth) dealing with maintenance of capital items.

8. "Maintenance" is not specifically defined in those rulings.

9. The Act does not define "capital replacement" but provides for a capital replacement fund which it defines as follows:

#### What is a "capital replacement fund"

17. A "**capital replacement fund**" is a fund established under section 91 for replacing the retirement village's capital items.

10. Of relevance, section 92 of the Act then goes on to provide as follows:

**Capital replacement fund**

**91.(1)** A scheme operator must—

(a) establish and keep a fund (the "**capital replacement fund**") for replacing the retirement village's capital items; and

(b) hold amounts standing to the credit of the fund in a separate account—

(i) that is established and kept for the purpose; and

(ii) the name or style of which includes—

(A) the operator's name; and

(B) the retirement village scheme the account is for followed by the words 'secured capital replacement fund account'; and

(iii) that requires withdrawals from it, whether by cheque or otherwise, to be signed by the scheme operator.

Maximum penalty—540 penalty units.

**(2)** The scheme operator is solely responsible for contributing to the fund.

**(3)** No amount standing to the credit of the fund may be applied or used for a purpose other than—

(a) replacing the village's capital items; or

(b) paying the quantity surveyor's reasonable fees for giving a report for section 92; or

(c) paying tax on amounts paid into the fund under section 94(1)(b).

**(4)** ..."

11. This section seems to suggest that scheme operators are solely responsible for contributing to the Capital replacement fund but sub-section (2) of section 92 is not the final word on who is required to contribute to the fund. In this regard section 94 provides as follows:

## Payments into capital replacement fund

94.(1) The following amounts must be paid into the capital replacement fund—

(a) ...

(d) if an existing residence contract requires an amount from a resident's services charge to be paid towards capital replacement—

(i) if the amount is stated in the contract—the amount; or

(ii) if the amount is not stated in the contract—the amount decided by the operator worked out in the way stated in the public information document;

12. Now all of the above definitions are relevant to the situation after 1 July 2000 but do not assist in defining what was meant by the Residents Agreement when referring "Total Operating Costs" and to what of those costs were able to be charged to the Sinking Fund established by virtue of the Residents Agreements.

13. However, they do illustrate the point that the Act contemplated that some Sinking Funds, in existence when the Act came into effect, required residents to contribute to capital replacement and the Act provided for the continuation of this position.

14. Mr Riding submitted that the agreement does not refer to "capital replacement" and that the reference to "replacement" was in the context of being part of maintenance.

15. ARH pointed to the word "replacement" in sub-clauses 4(d)(v) and (ix) as proof of its point that "capital replacement" was contemplated by these sub-clauses. The Tribunal considered that this was not necessarily conclusive as in Taxation Ruling 97/23 at paragraph 36 it is stated:

"Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal or reconstruction, as distinguished from repair, is restoration of the entirety."

16. On this basis "replacement", particularly of subsidiary parts of a whole, can still come within the definition of "repair" and would not involve "capital replacement" See Windeyer J in *W Thomas & Co Pty Ltd v FC of T* (1965) 115 CLR 58 at 72: (1965) 14 ATD 78 at 87.

17. Buckley LJ in *Lurcott v Wakely & Wheeler* [1911] 1 KB 905 at 924 discussed the concepts of repair and replacement and said:

"Repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion... the question of repair is in every case one of degree, and the test is whether the act to be done is one which in substance is the renewal or replacement of defective parts, or the renewal or replacement of substantially the whole."

18. However, ARH were able to point to the Residents Agreement in sub-clause (v) as referring to "replacements ...including any structural work". Interestingly this reference in sub-clause (v) does not refer to the Sinking Fund which is only referred to in sub-clause (ix). The Tribunal considered that "structural work" was more likely to involve replacement of substantially the whole. The Tribunal considered, as an example, the work required following termite infestation of a timber framed building as an example of work which could involve replacement of substantially the whole and could include structural work. The Tribunal would be inclined to define this work as capital replacement.

19. ARH's last submission related to the Residents Agreement involved sub-clause (viii) which referred to depreciation of plant and equipment and fittings and furnishings. The Tribunal considered that an allowance for depreciation was an accumulated expense that wrote off the cost of a fixed asset over its expected useful life. A fixed asset is a long-term, tangible asset held for business use and not expected to be converted to cash in the current or upcoming fiscal year, such as "plant and equipment and fittings and furnishings". A fixed asset is a capital item and the Tribunal considered that an allowance for depreciation indicated that the Sinking Fund was to be used for replacement of these capital items.

20. The Tribunal, therefore, finds that the Sinking Fund was a single fund maintained for capital replacement and maintenance and repairs and that the scheme operator acted appropriately in transferring the balance of the Sinking Fund in accordance with section 234 of the Act.

21. However, the Tribunal was of the opinion that the Sinking Fund was primarily for maintenance. On the basis of this finding, the Tribunal was surprised at the amount apportioned by the independent quantity surveyor for capital replacement in the report, until it examined the items included in that report for capital replacement. This is the Report of Leary and Partners, quantity surveyors, as to the requirements of the capital replacement fund calculated at 11 July 2000.

22. While the Tribunal was not required to examine the classification of the various work required as adopted by the independent quantity surveyor, the Tribunal formed the view, for the above reasons, that it would have classified some of the work, classified by the quantity surveyor as capital replacement, as maintenance work. However, the Tribunal is of the opinion that, as the apportionment of the Sinking Fund has been made on the classification adopted in that report, the expenditure on capital replacement should also be made on the same classification.

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*MR B A COTTERELL - CHAIRPERSON*

**for the Retirement Villages Tribunal**

B.A. Cotterell

D. Newman

J. Guy

Chairperson

Member

Member

Dated:; 3 December 2001

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