

Why should your strata corporation borrow funds?

Lannock's view, supported by well-established principles of corporate, is that there are two main reasons why strata corporations should borrow funds:

Firstly, it's here and now. You might not be able to wait 5 or 10 years to save the money in a sinking fund. If your building is subject to a fire order, if there is a safety issue or if there are building works that cannot wait, then neither should or can you wait.

Borrowing is an enabler. Most people wouldn't contemplate buying a home without borrowing a substantial portion of the purchase price – adding borrowed funds to your own enables you to complete the purchase.

The second important reason is that it's usually cheaper.

Many owners are not aware that borrowing is one of the cheapest ways of providing funds for a strata corporation.

Sinking Funds cost money and make many owners worse off. Funds that are lying dormant in a sinking fund would be better used to repay credit cards, reduce mortgages and make investments. Money in a sinking fund earns a low rate of interest and is taxed. While it's sitting there, the cost of inflation in the building industry is usually greater than the returns and while you wait, the project becomes bigger and more expensive.

It's not that sinking funds are actually evil, but the fact that most people don't understand their disadvantages means that they represent a significant lost opportunity. At worst, a sinking fund reduces an owners' wealth. At best, it's benefit if maximised if it's just one of the ingredients in the mix of funding of your building.

Special levies are also not of themselves bad, but their timing is often problematical. People who live in houses can decide when it suits them best to undertake a building project. But when the equivalent situation arises in a strata property, you've no choice about when you have to pay that levy.

That leaves us to consider the cost of borrowing – if you get the maths right, then the cost of borrowing is the interest rate. The good news is that it's there for all to see. The bad news is that, because the costs of sinking funds and special levies tend to be hidden, people don't properly take them into account and so run the risk of making a poor decision.