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## Body Corporates Loans

Written by Chantelle Gladwin-Wood (Partner), Lisa Schmidt (Associate)  
and Ayanda David Katjitaë (Candidate attorney)

### Introduction

Many owners living in sectional title schemes fail to pay their levies on time or at all and management contracts. Management contracts (which are contracts that deal with the obligations and duties of the managing agent as prescribed by the **Sectional Titles Act 95 of 1986** ("the STA") and the **Sectional Titles Schemes Management Act 8 of 2011** ("the STSMA")) often contain provision that mandate the managing agents to be actively involved in the collecting of arrears.

The process of collecting levies from defaulting owners is lengthy and often results in a cash flow shortage to the Body Corporate ("the BC") and renders the BC unable to settle its monthly obligations (i.e. its municipal accounts) and pay its creditors.

In an effort to assist struggling BCs' managing agents often loan money to BCs' to meet their monthly obligations and pay their creditors.

This article will consider the following questions:

- what provisions of the **National Credit Act 34 of 2005** ("the Credit Act"/"the NCA") and the **Sectional Titles Schemes Management Act 8 of 2011** ("the STSMA") regulate such loans /a BC borrowing money;
- who may loan a struggling BC money; and
- if there are any formalities that need to be met in order for a loan advanced to a BC to be valid and collectable.

### **National Credit Act 34 of 2005**

The credit industry is governed by the Credit Act. A requirement of the Credit Act is that a person must register as a credit provider with the **National Credit Regulator** ("NCR") if the total principal debt arising from the credit agreement exceeds the threshold prescribed by the Minister of Trade and Industry from time to time, which limit is currently **R0 (nil)**.

As a result, if the amount owed under a credit agreement by the consumer to a credit



provider exceeds the threshold, that credit provider must register as a credit provider with the NCR, irrespective of whether the credit provider provides credit in the ordinary course (in a series of transactions) or if it is a once-off transaction.

#### **What instruments are governed by the NCA?**

- Personal loans
- Home loans
- Business loans depending on threshold values applicable to the consumer, i.e. juristic persons
- Overdrafts
- Credit cards
- Asset-based finance
- Instalment sale agreements
- Lease agreements

There are exemptions afforded in the Credit Act, as not every credit provider is obliged to register with the NCR. These for example relate to exemptions from registering as a credit provider, being considered a credit provider as well as the types of credit agreements or transactions that fall within the ambit of the Credit Act.

#### **Body Corporates - Borrowing Money**

The powers of a body corporate are dealt with in Section 4 of the STSMA. Section 4(e) and (f) of the STSMA states that:

*"4. The body corporate may exercise the powers conferred upon it by or under this Act or the rules, and such powers include the power –*

*(e) upon special resolution, to borrow moneys required by it in the performance of its functions or the exercise of its powers;*

*(f) to secure the repayment of moneys borrowed by it and the payment of interest thereon, by notarial bond over unpaid contributions whether levied or not, or by mortgaging any property vested in it"*

In light of the above it is clear that BC can raise money it requires to carry out its functions and powers through various means. This means that the BC can, apart from raising levies, also borrow money. A BC is only permitted to "borrow money" when finances are genuinely required for the BC to perform its functions or to exercise its powers (as set out above same requires a special resolution of the members).

Furthermore, section 4 of STSMA (as quoted above) would allow for a BC that is in dire financial straits to raise money through the cession of unpaid levies. In these cases, the trustees usually instruct the scheme's managing agent to approach a company that is a registered credit provider which specialises in these types of loans to loan the body corporate money against the cession of unpaid levies. This cession may only take place after the appropriate resolution (a special resolution) by the members has been obtained (as explained above).

At this juncture it is worth noting that in *"Body Corporate of Frenoleen v Dlamini (case no. AR 611/09,11/ 03/2010), it was considered that*



*sectional title owners are statutorily liable for levies and their liability for levies is not entrenched on a "incidental credit agreement". A levy contribution is not a "credit agreement" and a Body Corporate is not a "credit provider" and owners of units are not "consumers", all phrases as defined in the NCA. Furthermore, there is no agreement as such that is concluded between the body corporate and the owner."*

Where Managing Agents make payments on behalf of the BC to provide cover for other expenses incurred by the BC, such payments would be considered a loan. In the event that the aforesaid loan agreement is hit by the provisions of the Credit Act, the loan would be governed by the provisions of the Credit Act. Accordingly, failure to register as a credit provider may result in unlawful credit agreements that are void.

Accordingly, should managing agents wish to charge interest for payments and/or loans advanced to BCs, they would be required to be register as credit providers in terms of NCA, regardless of whether they do this in one transaction, a series of transactions (ie in making payments to creditors on behalf of the BC), or whether they do this only for one client or for many clients. The NCA imposes and binds Registered Credit providers to general duties when entering into such transactions. For the sake of brevity, we will discuss section 80(1) of the NCA which deals with assessment of creditworthiness and reckless credit.

What is reckless credit?

Reckless credit means credit granted to a consumer under a credit agreement where the credit provider:

- Failed to carry out a proper credit risk assessment to ensure that the consumer can afford the loan;
- Proceeds to grant a loan to the consumer despite the consumer not being able to afford the loan based on the assessment conducted; and
- The consumer does not understand his/her rights and obligations in a credit agreement as well as the costs involved in taking the loan.

In terms of the Credit Act a court can declare an agreement 'reckless' on the request of either the debt counsellor or the consumer. Furthermore, only a court can suspend a credit agreement that has been declared reckless or change the terms and conditions of the agreement. If a credit agreement is found to be reckless, the credit provider cannot enforce the agreement and the obligations of the consumer are set aside.

In light of the above, it is important for managing agents to blindly advance loans and make payments to or for struggling BCs without seeking specialized entities who would be able to assist the BC with a sound financial plan to address financial distress. Furthermore, "reckless" loans made by the managing agent to the BC could lead the BC into greater financial distress. In this regard, managing agents that are not registered as financial providers and/or managing agents that



advance “reckless” loans to BC are at risk of statutory penalties being imposed on them and such loans could be declared invalid if challenged in a court of law.

### **The loan agreement**

PMR 21(3)(e) allows trustees by way of a written resolution to enter in to contract on behalf of the body corporate. However as indicated above the trustees may only enter in to a loan agreement on behalf the body corporate after a special resolution of the members authorising the body corporate to “borrow money” has been obtained.

- **We are often asked what happens if a loan agreement is entered in to by the trustees on behalf of the body corporate without having obtained the appropriate resolution?** In such cases the loan agreement may be void. However, the third party granting the loan may have a claim based on unjustified enrichment against the body corporate for the amount loaned. The amount payable in terms of an unjustified enrichment claim may be different to the amount payable in terms of a contractual claim based on the loan. If the creditor were claiming in the ordinary course based on a valid loan agreement, they would claim repayment of the capital amount loaned plus all interest and ancillary charges. However, if the loan is invalid for want of compliance with the Credit Act, the creditor may still have a claim

for unjustified enrichment, in which case the creditor would only normally be entitled to claim repayment of the capital amount loaned, excluding interest and other ancillary charges. This makes it risky for managing agents (or any other person in the business of or thinking about) lending BC's money, if they are not properly advised of the relevant laws and do not take the relevant steps to ensure that they comply with same.

Furthermore, Trustees have a fiduciary duty to act in the best interest of the body corporate and should thus not enter in to a management contract that allows a managing agent to automatically (without approval by the trustees/members of the BC) advance loans to a body corporate. This might leave the BC in the precarious position of being unable to repay the loans. It may be possible for a BC in such a position to apply to court to have the loan agreement set aside and the BC's repayments in terms thereof nullified based on the fact that the granting of the credit by the creditor to the BC was reckless. However, each case must be decided on its own facts.

- **Can the loan agreement and the management agreement be contained in a one single contract or should the management contract and the loan agreement be contained in separate contracts?** It is advisable that the



management agreement and the loan agreement be independent of each other and contained in different contracts as the management contract deals with the obligation and duties of the managing agent as prescribed by the STA and STSMA and the loan agreement deals with the lending of money to the body corporate and has to comply with the provisions of the NCA. However, there is nothing in law precluding them from being contained in one document.

Furthermore, PMR 28 deals with "executive managing agents and managing agents" and PMR 28(7) and (8) prescribes that

*"(7)a management agreement may not endure for a period longer than three years and may be cancelled, without liability or penalty, despite any provision of the management agreement or other agreement to the contrary —*

*(a)by the body corporate on two months notice, if the cancellation is first approved by a special resolution passed at a general meeting, or*

*(b)by the managing agent on two months notice.*

*(8 )The body corporate or trustees may by ordinary resolution cancel the management agreement in*

*accordance with its terms or refuse to renew the management agreement when it expires."*

It is thus clear that it would not be advisable to have the loan agreement and management agreement both contained in the same contract as allowing for same may lead to automatic cancellation of the loan after a period of three years even if the body corporate has not paid up the loan, if the agreement itself does not provide for different cancellation/termination periods for the loan, as opposed to the managing agent contract, both dealt with in the same document. Furthermore, incorporating the loan agreement and management agreement in to one contract would put the loan provider at risk of not being able to claim penalties/interest etc, as PMR 28 (7) specifically states that a management contract *"may be cancelled, without liability or penalty, despite any provision of the management agreement or other agreement to the contrary"*.

### **Conclusion**

In summary a managing agent should exercise a level of caution prior to advancing loans to BCs' and should ensure that a special resolution of the members has been obtained prior to lending a BC money. Furthermore, managing agents wishing to lend money to BC and charge interest should register as credit providers, the management agreement and the loan agreement should be independent of each other and contained in different contracts and the loan agreement would need to comply with the relevant provisions of STSMA



and NCA in order for a loan granted to a BC to be valid and collectible.

Phone +27 (0) 11 448 9684  
[katjitae@schindlers.co.za](mailto:katjitae@schindlers.co.za)



**Chantelle Gladwin-Wood**  
Partner at Schindlers Attorneys  
Phone: +27 (0) 11 448 96  
[gladwin@schindlers.co.za](mailto:gladwin@schindlers.co.za)



**Lisa Schmidt**  
Associate at Schindlers Attorneys  
Phone: +27 (0) 11 448 9729  
[schmidt@schindlers.co.za](mailto:schmidt@schindlers.co.za)



**Ayanda David Katjitae**  
Candidate Attorney at Schindlers Attorneys

