

Security for loans granted to bodies corporate of sectional title schemes

Reghard Brits

BCom LLB LLD

Senior Lecturer, Department of Mercantile Law, University of Pretoria

CG van der Merwe

BA LLB BA (Hons) BCL LLD

Senior Research Fellow, Department of Private Law, University of Stellenbosch

OPSOMMING

Sekerheidstelling vir lenings aan beheerliggame van deeltitelskemas

Dit is soms nodig dat die beheerliggaam van 'n deeltitelskema 'n lening moet aangaan om sekere instandhoudings- of verbeteringsprojekte te finansier. Gewoonlik kan grootskaalse en langtermynfinansiering egter nie bekom word sonder die daarstel van saaklike sekerheid nie, wat beteken dat die beheerliggaam gedeeltes van sy eiendom met saaklike sekerheidsregte sal moet belas. Indien die Wet op Deeltitels asook die Wet op die Bestuur van Deeltitelskemas van nader beskou word, is dit duidelik dat die wetgewer voorsiening gemaak het vir die daarstel van saaklike sekerheid vir finansieringsdoeleindes, maar dat daar ook verskeie onsekerhede bestaan rondom die presiese vorme van saaklike sekerheid wat benut kan word. Die doel van hierdie bydrae is om die verskeie moontlikhede te ondersoek met verwysing na sowel die statutêre raamwerk as die gemeenregtelike beginsels wat tans in die Suid-Afrikaanse reg beskikbaar is. 'n Problematiese fokuspunt is die benutting van onstoflike sake (meer spesifiek die uitstaande bydraes wat deur eienaars van die skema aan die beheerliggaam verskuldig is) as sekerheidsobjekte. Die tradisionele opsie is om dié persoonlike regte van die beheerliggaam te sedeer in *securitatem debiti*, en dit word algemeen aanvaar dat die Wet op Deeltitels dan ook hiervoor voorsiening maak. Die probleem is egter dat die Wet op die Bestuur van Deeltitelskemas 'n baie enger vorm van sekerheidstelling voorskryf, naamlik die kwansuise registrasie van 'n notariële verband oor sodanige onstoflike eiendom. In weerwil van wat laasgenoemde wetgewing vooropstel, word tot die slotsom gekom dat voldoende saaklike sekerheid oor uitstaande bydraes (as onstoflike eiendom) om verskeie redes nie tans deur middel van 'n notariële verband kan geskied nie, maar dat sessie in *securitatem debiti* steeds die primêre opsie is. Voorstelle word gemaak oor hoe die huidige statutêre raamwerk uitgelê kan word of verkieslik gewysig behoort te word om prakties en regtens meer werkbaar te wees.

1 INTRODUCTION

Unit owners in a sectional title scheme automatically become (and remain for the duration of their ownership) members of a body corporate entrusted with the management of the scheme.¹ The fulfilment of such management functions is primarily financed through compulsory financial contributions collected from

¹ S 36(1) of the Sectional Titles Act 95 of 1986 (STA); s 2(1) of the Sectional Titles Schemes Management Act 8 of 2011 (STSMA).

each owner.² However, the body corporate may, on occasion, need to make use of credit facilities to finance certain projects or aspects of its functions. For example, it may need to obtain a loan to finance large-scale improvements or maintenance work. It may also need access to an overdraft facility with a bank in order to facilitate the operating cash flow of the scheme.

Access to affordable credit is however dependent on the debtor's ability to furnish the creditor with security for the repayment of the loan. Therefore, especially for larger and long-term loans, a financier will in all likelihood require the body corporate to provide it with a form of real security like a mortgage or pledge. The STA presently empowers bodies corporate to enter into credit agreements and to provide real security to its creditors.³ However, it appears that the STSMA, which will replace certain sections of the STA when it comes into operation, could have an important impact on the kind of security available to creditors due to certain changes in terminology.⁴

The purpose of this contribution is to discuss the options that are available under the STA and STSMA when a body corporate wants to utilise its property as objects of real security. If it owns immovable property, a mortgage bond can be registered; if it owns movable property, it can be delivered in pledge or a notarial bond can be registered over it. Notwithstanding these traditional options, it has become apparent that a body corporate's most valuable asset for real security purposes is the aggregate of its monetary claims against each owner for the payment of their monthly contributions. This incorporeal asset, which includes present and future unpaid contributions, represents a relatively secure source of continuous income – rendering it quite attractive to creditors.

Although this article also considers the normal forms of real security over immovable property and corporeal movable property, the main focus is on how unpaid contributions – conceptualised as incorporeal movable property – can be utilised as security. The traditional solution, namely, to make use of a cession *in securitatem debiti*, is embraced by the STA which mentions “the hypothecation of unpaid contributions (whether levied or not)”⁵ as one of the methods by which loans can be secured. However, the STSMA changes the wording used and only empowers the body corporate to register a “notarial bond over unpaid contributions”. In this contribution, we shall critically evaluate whether a notarial bond over outstanding contributions is a suitable form to secure a loan entered into by the body corporate, or whether a cession *in securitatem debiti* is a better option. And if so, how should the structure and wording of the STSMA be interpreted or amended to make practical and legal sense?

2 STATUTORY FRAMEWORK⁶

Section 38 of the STA authorises bodies corporate to exercise the powers conferred upon them by the Act or by the rules of the scheme, and then sets out a

² See para 4.3 below.

³ S 38(f) of the STA.

⁴ S 4(f) of the STSMA.

⁵ S 38(f) of the STA.

⁶ See further Van der Merwe and Sonnekus *Sectional titles, share blocks and time-sharing* Vol 1: *Sectional titles* (Service Issue 20, October 2015) 14-62–14-64; Pienaar *Sectional titles and other fragmented property schemes* (2010) 96 164–165; Van der Merwe “Third generation sectional titles” 2012 *TSAR* 611 627–628.

list of such powers. Two of these powers are relevant for purposes of this contribution. First, the body corporate is empowered to borrow money if required for performance of its functions or exercise of its powers.⁷ Second, the body corporate is empowered to secure repayment of such moneys and interest thereon, “by negotiable instrument or the hypothecation of unpaid contributions, whether levied or not, or by mortgaging any property vested in it”.⁸

In other words, the body corporate may make use of at least three forms of security: (1) providing a negotiable instrument; (2) hypothecating unpaid contributions; and/or (3) mortgaging any property vested in it. Since option (1) entails a form of personal security that is not frequently used in practice, it will not receive attention in this contribution – also because this option is not taken over in the STSMA. The focus will rather be on forms of real security, as these are usually preferred by credit providers – hence options (2) and (3).

Section 38 of the STA has been repealed in the schedule to the STSMA⁹ and, therefore, will fall away as soon as the STSMA comes into operation and be replaced by a new provision. Section 4 of the STSMA confers a similar list of powers as section 38 of the STA on the bodies corporate but with two important differences. First, while the body corporate is still empowered to borrow money in order to fulfil its functions or exercise its powers, such power is now subject to an important qualification, namely that a special resolution is required for its exercise.¹⁰ Second, the body corporate is still empowered to provide security for the repayment of such borrowed moneys, but the forms of security available are slightly different. The option of a negotiable instrument is omitted and the security options are restricted to two, namely (1) passing a notarial bond over unpaid contributions; and (2) mortgaging any of the property vested in the body corporate. Option (2) corresponds to the option provided for under the STA, but option (1) contains the most notable difference insofar as the broad term “hypothecation” is replaced by the much narrower security mechanism of passing a “notarial bond” over unpaid contributions. In what follows, the scope of both of these options will be analysed.

With regard to option (2), one must consider the scope of the phrase “mortgaging any property vested in it”. Does it encompass only a “sectional mortgage bond” as contemplated by the STA and STSMA,¹¹ or does it refer to the concept of mortgage in the wider sense, encompassing all forms of real security? The academic literature on real security rights generally accepts that the term “mortgage” can have both a narrow and wide meaning. In its narrow sense, the term “mortgage” is restricted to the granting of a specific real security right over immovable property (whether corporeal or incorporeal) as evidenced

7 S 38(e) of the STA.

8 S 38(f) of the STA.

9 See item 19 of the schedule to the STSMA.

10 S 4(e) of the STSMA. For the meaning of a special resolution for purposes of the STSMA, see s 1(1) sv “special resolution” of the STSMA. The reason for introducing a special resolution requirement seems to be to prevent the trustees from accumulating huge debts on behalf of the body corporate. This sledge-hammer approach may, however, prevent trustees from acquiring small loans to bridge temporary cash flow problems. A better solution may have been to require a special resolution only for larger loans amounting to say more than 10% of the annual budget: see Van der Merwe *Sectional titles* 14-62 fn 322.

11 See para 3 below.

by the registration of a mortgage bond. In its wide sense, the term is taken to refer to real security rights in respect of all kinds of property (including pledges, tacit hypothecs and liens).¹² The fact that the provision empowers the body corporate to mortgage “any property vested in it” seems to indicate a broader reading of the term “mortgaging” – empowering the body corporate to secure a loan by mortgaging any kind of property whether movable or immovable property, corporeal or incorporeal. Therefore, the apparent legislative intention is that the body corporate should be able utilise any kind of property vesting in it as objects of real security. Finally, as the term “mortgage bond” is not employed, there is no apparent reason why a narrow interpretation of the term “mortgaging” should be adopted.

In the light of the above conclusion, the term “mortgaging” in this context should arguably include:

- (a) a registered mortgage bond over immovable property (land and other assets deemed to be land, including limited real rights in land);
- (b) a pledge of corporeal movable property (through delivery to the creditor);
- (c) a registered special or general notarial bond over movables; and
- (d) a pledge of incorporeal movables (personal rights) by means of a cession *in securitatem debiti*.

Therefore, option (1) in the STSMA contains the narrow and very specific possibility of passing a notarial bond over one specific asset, namely unpaid contributions, while option (2) arguably includes all other forms of real security over “any property” belonging to the body corporate. In the following parts of the contribution, the major forms of real security that can be utilised by bodies corporate will be discussed with reference to the provisions of the STA and STSMA as well as to the common-law and statutory requirements laid down for these forms of real security.

3 MORTGAGE OF IMMOVABLE PROPERTY

The body corporate can mortgage immovable property as security for the payment of a loan by the registration of a “sectional mortgage bond”, which is a specialised version of mortgaging. In terms of the definition of “sectional mortgage bond” in the STA, taken over in the STSMA, the body corporate may mortgage the following kinds of immovable property vested in it:

- (1) a unit or an exclusive use area, land or an undivided share in such unit, area or land held under a separate sectional title deed; or
- (2) a registered long term lease or sub-lease of any such unit, exclusive use area or land or an undivided share in such unit, area or land; or
- (3) any other registered real right in or over any such unit or undivided share in a unit or common property or the rights to extend the scheme by the addition of sections referred to in section 25 or the right to exclusive use areas referred to in section 27.¹³

12 See, eg, Badenhorst, Pienaar and Mostert *Silberberg and Schoeman's The law of property* (2006) 357; Scott and Scott *Wille's Law of mortgage and pledge in South Africa* (1987) 1; Maasdorp “The law of mortgage” 1901 *SALJ* 233.

13 S 1(1) sv “sectional mortgage bond” of the STA and the STSMA.

From this definition, read with the authorisation given in the STA and STSMA to mortgage any property vesting in it, one can confirm that the following kinds of immovable property are available to secure loans entered into by the body corporate.

First, the body corporate is empowered, upon special resolution, to acquire and mortgage sectional title units¹⁴ when essential for the proper compliance of its duties.¹⁵ This allows the body corporate to acquire one or more units in order to let them out and earn additional income to finance the fulfilment of its functions or to decrease the levies owners are obliged to contribute. This means that even the purchase of a unit, when essential for the proper compliance with its duties, can be financed by a mortgage over that unit. And once acquired, such a unit (or an undivided share in it) can be mortgaged.¹⁶

It should be noted that the STA and STSMA empower the body corporate, when essential for compliance with its duties, in addition to hire or let units¹⁷ but not to register a long term lease over such units.¹⁸ The personal rights under letting and hiring of units are therefore incapable of being used as security for a loan.

Another relevant form of immovable property is the common property comprised in a sectional title scheme. Common property comprises (1) land included in the sectional title scheme; (2) such parts of the building or buildings that are not included in a section; and (3) additional land acquired by the body corporate.¹⁹ The common property under (1) and (2) is owned by the owners of sections jointly in undivided shares proportionate to the quotas of their respective sections as specified on the scheme's sectional plan.²⁰ Under (3), the body corporate with the consent of all its members (owners), is empowered to acquire additional land,²¹ which is then registered in the name of the body corporate, and which will become part of the common property owned in undivided shares by all the owners.²²

In principle, the common property does not belong to the body corporate, but is owned in undivided shares by all the owners. However, the owners may by unanimous resolution²³ instruct the body corporate to "alienate" or let the common property or any part thereof on their behalf.²⁴ Most commentators assume that the term "alienate" in this context probably includes the encumbering of the common property with a mortgage.²⁵ This interpretation is fortified by the fact that the reference to land (or an undivided share therein) in the definition of

14 A unit is deemed to be land: see s 3(4) of the STA.

15 S 38(b) of the STA; s 4(b) of the STSMA, requiring a special resolution.

16 Para (a) of the definition of sectional mortgage bond in s 1(1) of the STA and STSMA.

17 S 38(b) and 4(b) respectively.

18 See the definition of "lease" in s 1(1) of the STA and the STSMA. It is submitted that the terms "hire" and "let" in ss 38(b) and 4(b) respectively, refer to a short term lease which cannot be registered.

19 S 1(1) sv "common property" of the STA; s 1(1) sv "common property" of the STSMA.

20 S 16(1) of the STA.

21 S 26(1) of the STA; s 5(1)(d) of the STSMA.

22 S 26(2) of the STA; s 5(2) of the STSMA.

23 S 1(1) sv "unanimous resolution" of the STA; s 1(1) sv "unanimous resolution" of the STSMA.

24 S 17 of the STA; s 5(1)(a) of the STSMA.

25 Van der Merwe *Sectional titles* 11-4 fn 10; Pienaar *Sectional titles* 142 fn 305.

a “sectional mortgage bond”²⁶ in both Acts can arguably be interpreted to include common property, since the definition of “common property” expressly includes all land of the scheme. The ambiguity as to whether the common property can be mortgaged to secure a loan negotiated by the body corporate, means that the body corporate is deprived of a valuable security mechanism in the event that the scheme consists of valuable portions of unimproved land. In our opinion, there is no objection in principle to mortgaging a specific part of the common property, particularly because a unanimous resolution is required for such a legal transaction. However, the question can be raised whether in the case of financial distress, it would not be more prudent for the body corporate to sell off or to lease delineated parts of the common property rather than to resort to money lending to finance maintenance or other desperately needed projects.

Another specimen of immovable property that may be mortgaged to secure a loan is the real right to an exclusive use area. An exclusive use area is defined as “a part or parts of the common property for the exclusive use by the owner or owners of one or more sections”.²⁷ A right of exclusive use of part of the common property registered in favour of an owner, is deemed for all purposes to be a right to immovable property over which, amongst others, a mortgage bond can be registered.²⁸ In general, exclusive use areas are registered in favour of the owners of sections and not in favour of the body corporate. However, the STA provides for instances where the right to exclusive use may indeed vest in the body corporate itself. Thus, where the developer had a right to an exclusive area but ceases to be a member of the body corporate, this right will vest in the body corporate free from any mortgage bond.²⁹ Similarly, if an owner who held a right to an exclusive use area ceases to be a member of the body corporate, any such right still registered in his or her name will vest in the body corporate free from any mortgage bond or registered real right.³⁰ Therefore, the definition of a “sectional mortgage bond”,³¹ read with the power to “mortgage property vested in it”, enables a body corporate who holds a right to an exclusive use area to encumber such right with a mortgage bond for real security purposes. For the same reason, an undivided share in such an exclusive use area as well as a registered lease or sub-lease of such an area (or undivided share in it) may also form the object of a sectional mortgage bond.³² Even so, a body corporate vested with a right of exclusive use would rather sell the right to the highest bidder than to mortgage it as security for a loan; and financial institutions would be wary to accept such rights as security.

Another registered real right that can potentially vest in the body corporate is a right of extension, which is described in the STA as a right that the developer of

26 Para (a) of the definition.

27 S 1(1) sv “exclusive use area” of both the STA and the STSMA. Exclusive use areas are regulated by s 27 of the STA.

28 S 27(6) of the STA.

29 S 27(1)(c)–(d) of the STA.

30 S 27(4)(b)–(c) of the STA.

31 Paras (a) and (c) of the definition. It seems that para (a) refers to a mortgage bond over the exclusive use area itself, while para (c) refers to a mortgage bond over the registered real right to such an exclusive use area. It is not clear how these two options differ.

32 Paras (a)–(c) of the definition.

a scheme can reserve for himself or herself to extend the scheme by the addition of a building or buildings and by the horizontal or vertical extension of an existing building on a specified portion of the common property and to subdivide the added building into sections and sell them for his or her own account.³³

Such a right of extension is also deemed to be immovable property capable of being mortgaged.³⁴ In certain instances, the right to extend the scheme may vest in the body corporate, for instance when the developer does not reserve such a right or in the event that the developer's right of extension lapses. The body corporate is also authorised to "alienate" such a right – which probably includes the mortgaging thereof – but only if it has the written consent of all its members and of all the mortgagees of each unit in the scheme.³⁵ Therefore, read with the definition of a "sectional mortgage bond"³⁶ as well as the power to mortgage any property vesting in it,³⁷ it is clear that a body corporate vested with a right of extension can mortgage this "registered real right" to a financial institution in order to secure the repayment of a loan. However, the value of the security is limited by the fact that the exercise of the right requires the written consent of all the owners and mortgagees of all the units. Furthermore, as the body corporate will in practice only mortgage such a right in the event that it exercises the right according to specifications in the sectional plan of extension, financial institutions would be cautious to accept such a security for the money advanced since they are not interested in taking over the completion of the building works which the body corporate has started.

From the above, it is clear that several kinds of corporeal or incorporeal *immovable* assets which vests in the body corporate may qualify as immovable property capable of being mortgaged and thus, available as objects of real security. This does not mean that bodies corporate should not in each particular instance carefully consider the risks involved in mortgaging a particular asset, most notably the possibility of their sale in execution should the body corporate default and the financial institution decides to foreclose on the security. At the same time, the credit institutions should consider the practicalities involved in foreclosing a particular asset. As pointed out above, in the case where the body corporate has secured finance for an extension of the scheme and defaults on payment due to a lack of funds to complete the scheme, the institution would experience difficulties in selling the right to extend the scheme and might have to take over the task of completing the proposed extensions of the scheme itself.

4 PLEDGE OF MOVABLE PROPERTY

4 1 Introduction

In addition to the mortgaging of corporeal and incorporeal immovable property, the body corporate may also, in terms of the wide meaning of the term, mortgage the movable property vested in it as security for a loan provided by a credit institution. In this context, the body corporate may pledge corporeal or incorporeal movables as security or register a notarial bond over specifically defined movable property.

³³ S 25(1) of the STA.

³⁴ S 25(4)(a) of the STA.

³⁵ S 25(6) of the STA.

³⁶ See para (c) of the definition in s 1(1) of the STA; s 1(1) of the STSMA.

³⁷ S 38(f) of the STA; s 4(f) of the STSMA.

4 2 Pledge of corporeal movable property

The body corporate is empowered to acquire movable property “for the use of owners for their enjoyment or protection, or in connection with the enjoyment or protection of the common property”.³⁸ Examples that come to mind are golf carts, lawn mowers, other gardening equipment, and security equipment such as cameras and electronic gates. Depending on the distinction between immovable and movable property (a controversy not considered here), it may also be that valuable things such as lifts or sprinkler systems could qualify as movables belonging to the body corporate.

Therefore, movable property owned by bodies corporate may also serve as objects of real security – either by delivering them in pledge or by registering a notarial bond over them. The traditional pledge option will rarely make practical sense, since the body corporate would have to give up physical control of the movables by means of one of the accepted forms of actual or constructive delivery. These movables may also be essential for the proper maintenance of the scheme and the enjoyment of the facilities of the scheme. On the other hand, financial institutions would not be interested in taking delivery of these objects due to a lack of storing space. Often, such movables will also not be sufficiently valuable to secure the kind of loans required. Notwithstanding, the possessory pledge remains a theoretical possibility within the broad meaning of the power conferred on bodies corporate to mortgage (in the wide sense) any property vested in it.³⁹ However, it will be explained below why a notarial bond is considered a more suitable security mechanism in this context.⁴⁰

4 3 Incorporeal movable property

As mentioned already, probably the most valuable asset of a body corporate – or at least the most important asset for real security purposes – is the aggregate of claims which the body corporate has against the owners for the payment of their levies. The asset represented by these personal monetary claims is conceptually regarded as an incorporeal movable thing and, as such, they can be given in security by means of a cession *in securitatem debiti*.⁴¹

The right that the body corporate has to claim “unpaid contributions whether levied or not”⁴² has its origin in the statutory obligation of all sectional owners to pay “all charges, expenses and assessments that may be payable in respect of his or her section”.⁴³ A body corporate is tasked with establishing an administrative fund for various purposes related to the managing of the scheme.⁴⁴ In order to stock this fund, as well as the reserve fund (see below), the body corporate must determine the amounts that ought to be raised, and then raise these by levying contributions on the owners in proportion to the participation quotas of their respective sections.⁴⁵ In the event that the owner of a section is entitled to a

38 S 38(c) of the STA; s 4(c) of the STSMA.

39 S 38(f) of the STA; s 4(f) of the STSMA.

40 See para 4 4 below.

41 See para 4 5 below.

42 S 38(f) of the STA; s 4(f) of the STSMA.

43 S 44(1)(b) of the STA; s 13(1)(b) of the STSMA.

44 S 37(1)(a) of the STA; s 3(1)(a) of the STSMA.

45 S 37(1)(c) of the STA; s 3(1)(e) of the STSMA. Regarding the determination of participation quotas, see s 32(1)–(2) of the STA.

registered or a rules-based exclusive use area on the common property, the body corporate must require such owner to make such additional contribution to the funds as estimated necessary to defray certain extra costs and expenses in respect of such area.⁴⁶

The owners become liable for any contributions levied under any of the above provisions on the passing of a resolution to that effect by the trustees of the scheme.⁴⁷ The body corporate may then recover the contributions by proceedings in any court (including any magistrate's court) of competent jurisdiction from the persons who were owners of units and holders of exclusive use areas at the time that the resolution was passed. Upon the change of ownership of a unit or holderhip of an exclusive use area, the successor in title becomes liable for the *pro rata* payment of such contributions from the date of change of such ownership or holderhip.⁴⁸

Apart from the ordinary contributions discussed above, the body corporate may also raise special contributions in respect of any of the above charges if it appears that the expenses budgeted for the current financial year were not sufficient to cover the costs of an unforeseen expense.⁴⁹ A special contribution becomes due when the trustees pass a resolution levying such a contribution. Such a contribution may also be recovered from the persons who were owners of units and holders of exclusive use areas at the time that the resolution was passed. Recovery takes place by proceedings in any court (including any magistrate's court) of competent jurisdiction or by application to the relevant ombud.⁵⁰

Important for present purposes is that all of these claims that the body corporate might have against the owners will endow it with an incorporeal asset that is capable of being given as an object of security for the repayment of a loan.

Another incorporeal asset of a body corporate that might be relevant for security purposes is the reserve fund that it is mandated to establish and maintain. This fund must contain "such amounts as are reasonably sufficient to cover the cost of future maintenance and repair of the common property" and may not be less than the amount that may be described by the Minister of Human Settlements.⁵¹ The body corporate must also require owners to make contributions towards maintaining such a reserve fund.⁵² It seems that the main idea behind this reserve fund is to use it to finance maintenance or repairs to the common property, but the body corporate may decide that it will be better to borrow the money needed and then offer the fund as security for the repayment of the loan.

In this regard, it is necessary to consider that regulation 2 of the proposed Sectional Titles Schemes Management Regulations published for public

46 S 37(1)(bA) of the STA; s 3(1)(c) of the STSMA.

47 For more detail regarding the determination of the amounts levied and the notifications given to each owner, see the Prescribed Management Rules in Annexure 8 of the Sectional Titles Regulations, especially rule 31.

48 S 37(2) of the STA; s 3(2) of the STSMA, the latter now entitling the body corporate to recover the contributions by an application to the relevant ombud.

49 S 37(2B) of the STA; s 3(4) of the STSMA.

50 S 37(2A) of the STA; s 3(3) of the STSMA.

51 S 3(1)(b) of the STSMA. Cf also s 37(1)(a) of the STA.

52 S 3(1)(c) of the STSMA.

comment⁵³ provides that, for these purposes, the minimum amount of the annual contribution to the reserve fund for a financial year being budgeted for, must be determined in accordance with the amount of money in the reserve fund at the end of the previous financial year. In the event that this amount is equal to or greater than 100 per cent of the total contributions to the administrative fund for that previous financial year, there is no minimum contribution to the reserve fund.⁵⁴ However, in the event that this amount is less than 25 per cent of the total contributions to the administrative fund, or more than 25 per cent but less than 100 per cent of the total contributions to the administrative fund for that previous financial year, the budgeted contribution to the reserve fund must be at least 15 per cent of the total budgeted contribution to the administrative fund or the budgeted contribution to the reserve fund must be at least the amount budgeted to be spent from the administrative fund on repairs and maintenance to the common property in the financial year being budgeted for, respectively.⁵⁵

Furthermore, in the proposed management rules in Annexure 1 of the Sectional Titles Schemes Management Regulations it is proposed that the body corporate must prepare a written maintenance, repair and replacement plan for the common property, setting out the following: the major capital items expected to require maintenance, repair and replacement within the next 10 years; the present condition or state of repair of those items; the time when those items or components of those items will need to be maintained, repaired or replaced; the estimated cost of the maintenance, repair and replacement of those items or components; and the expected life of those items or components once maintained, repaired or replaced. The annual contribution to the reserve fund for the maintenance, repair or replacement of each of the major capital items must be determined according to the following formula: [(estimated cost minus past contribution) divided by expected life]. At each annual general meeting, the trustees are obliged to report the extent to which the approved maintenance, repair and replacement plan has been implemented.⁵⁶ It is hoped that these two provisions would make it much less likely for the body corporate to borrow money for maintenance and repair of the common property in the scheme. However, it does not seem as if the fund can be used to finance things other than maintenance or repairs, which exclude utilisation of these funds to effect improvements or expansions, rendering it necessary to borrow money or collect a special levy from the owners.

In what follows, the two major options for hypothecating movable assets – namely notarial bonds and cession *in securitatem debiti* – are discussed. Although corporeal movables are covered with reference to notarial bonds, the main focus will be on comparing these two forms of security when it comes to unpaid contributions (an incorporeal movable).

4.4 Notarial bonds

4.4.1 Introduction

The main purpose of a registered notarial bond is to serve as an alternative to the traditional pledge, especially in light of the fact that the latter is dependent of the

53 GN 909 RG 10505 Vol 604 GG 39247 of 2 October 2015 (p 37).

54 Reg 2(b).

55 Reg 2(a) and (b) respectively.

56 Annexure 1 rule 32 (p 74–75).

strict requirement that physical control of the object of security must pass to the creditor through one of the recognised forms of delivery. Above, it was mentioned that bodies corporate may own movable objects that are capable of being offered as security, but that the traditional pledge is wholly unsatisfactory, since the residents will by and large not want to give up the use and enjoyment of these assets for a long (or any) duration of time. Consequently, a notarial bond may be a more feasible solution. Depending on the kind of notarial bond and on whether all the requirements are met, the bondholder might acquire a real security right without the body corporate having to physically deliver the property to credit providers.

The Deeds Registries Act provides for the registration of general and special notarial bonds as means of hypothecating (mortgaging) movable property.⁵⁷ This device is therefore also available to bodies corporate who have such assets available under the broad category of “mortgaging any property vesting in it”. Corporeal movable property are not problematic, since they can be used in the course of registering special or general notarial bonds. However, incorporeal movable property such as the body corporate’s claim for unpaid contributions may cause problems. As explained above, when the STSMA becomes operational, it will provide for the use of notarial bonds registered over unpaid contributions as security for a loan.⁵⁸ However, it is doubtful whether this is currently a suitable instrument of real security over incorporeal assets.

In what follows, the general principles applicable to general and special notarial bonds are reviewed with regard to instances where a body corporate wants to hypothecate its corporeal movables by the registration of a notarial bond. However, the main focus will be on evaluating whether a notarial bond is a suitable security option in the case of unpaid contributions, the option which is expressly mentioned by the STSMA.

4.4.2 General notarial bonds

A registered general notarial bond hypothecates all the debtor’s movable property, corporeal and incorporeal, without exclusion.⁵⁹ However, it is trite that the mere registration of the bond does not create a limited real security right with regard to the particular property in favour of the creditor (bondholder). A further step must first be taken: the bond must be “perfected” by the bondholder obtaining physical control of the property.⁶⁰ General bonds usually include a so-called perfection clause which allows the bondholder, in certain circumstances (usually when the debtor defaults), to claim physical control of the bonded property. The creditor may not, however, use self-help to obtain the property. If the debtor does not voluntarily hand it over, the creditor must approach the court for an attachment order, after which the relevant property can be attached by the sheriff or deputy sheriff and kept safe for or placed in the

⁵⁷ Act 47 of 1973, s 102 sv “notarial bond”.

⁵⁸ S 4(f) of the STSMA.

⁵⁹ S 102 sv “notarial bond” of the Deed Registries Act.

⁶⁰ On general notarial bonds, see, eg, *Firstrand Bank Ltd v Land and Agricultural Development Bank of South Africa* 2015 1 SA 38 (SCA) para 4; *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd* 2003 2 SA 253 (SCA) paras 3–6; *Development Bank of Southern Africa Ltd v Van Rensburg* 2002 5 SA 425 (SCA) para 20.

bondholder's possession.⁶¹ On completion of the attachment, the bond is said to have been "perfected" and henceforth, the creditor is in exactly the same position as an ordinary pledgee. Consequently, the creditor will have a secured claim to the proceeds of the property on a sale in execution.

Unless the bond agreement contains a summary execution (*parate executie*) clause, the bondholder will have to obtain an execution order to have the property sold in execution and satisfy the debt from the proceeds of the sale. However, it is important to emphasise that the summary execution clause only allows the bondholder to side-step the judicial execution process and proceed with a private sale of the property in question; it does not authorise the seizure or attachment of the property without court authorisation.

The registration and perfection processes apply to both corporeal and incorporeal movables. Although general notarial bonds may be a workable option for creditors of bodies corporate to secure their credit, it must be cautioned that, as explained above, the creditor's security is dependent on obtaining control of the property, which is normally not ideal. It also requires the creditor to keep a close eye on the body corporate's affairs, so that it can step in and have the movables attached in the event of default or if broader financial concerns are on the cards. Most creditors would generally prefer not to be saddled with such a high degree of vigilance. In actual fact, one of the practical benefits of sound real security is that the creditor's risks are significantly reduced by the fact that it has a protected right to the proceeds of the burdened asset without being exposed to the general risks associated with the debtor's business affairs.

It is only on sequestration or liquidation of the debtor's estate that an unperfected general notarial bond provides a certain degree of security to its creditors. While unperfected, the bondholder technically only has a personal right to the debt and must therefore share proportionately with all other concurrent creditors in the proceeds of the estate. However, in the event of insolvency the bondholder's claim will enjoy some kind of preference over other personal claims; its claim will be settled from the free residue of the estate before other concurrent creditors are satisfied.⁶² In most instances, this limited (second-to-last) preference will not be much consolation, especially if the free residue has been depleted or significantly reduced. Nevertheless, there may be instances where the free residue will be sufficient to make this a worthwhile option for a creditor who is mindful of the risks involved.

Although this *quasi-security* benefit in case of sequestration can provide some kind of satisfaction in ordinary insolvency proceedings, it is doubtful whether it can play any significant role in the sectional title context. The reason for this is that the instances for which a body corporate can be dissolved – so as to make the Insolvency Act applicable – appear to be much more limited than is the case with other natural and juristic persons.⁶³ From a literal reading of the STA and

⁶¹ The bondholder cannot obtain a perfection order without such a clause: see, eg, *Eerste Nasionale Bank van SA Bpk v Schulenburg* 1992 2 SA 827 (T); *Boland Bank Bpk v Spies* 1993 1 SA 402 (T); *Boland Bank Ltd v Vermeulen* 1993 2 SA 241 (E).

⁶² S 102 of the Insolvency Act 24 of 1936.

⁶³ The Companies Act 71 of 2008 – and therefore its provisions regarding the liquidation of companies – does not apply to bodies corporate: see s 36(5) of the STA; s 2(6) of the STSMA. Accordingly, a body corporate can only be wound-up if the Insolvency Act applies directly.

the STSMA, it is apparent that bodies corporate can only be dissolved in the event that the buildings of the scheme are actually or notionally destroyed.⁶⁴ It is currently not clear whether a body corporate can be sequestrated due to its insolvency in whatsoever case.⁶⁵ Without going into any further detail on this complicated issue, one can assume that bodies corporate will never be wound-up due to insolvency, except in the case of actual or notional destruction of the buildings in the scheme. Therefore, the preference afforded to general notarial bonds in the Insolvency Act will not be an attractive form of security in this context. Of course, when a body corporate is indeed wound-up because the buildings are actually or notionally destroyed, then this preference might kick in.

Consequently, the only practically relevant scope for general notarial bonds is the mechanism it creates to perfect the bond and acquire physical control of the bonded assets. Under appropriate circumstances, a general notarial bond may function as a useful additional form of security, but certainly not as the primary security for any creditor who provides large-scale financing.

4.4.3 Special notarial bonds

By contrast to a general notarial bond, a special notarial bond purports to burden only specifically described movable property.⁶⁶ Before 1993, such a bond only endowed its holder with a real security right (deemed to be a pledge) if the bond complied with the Notarial Bonds (Natal) Act and which only applied in the former Natal Province.⁶⁷ In the rest of the country, special notarial bonds provided no real security. Nevertheless, the courts for many years assumed that such bonds at least had an effect similar to general notarial bonds, namely that they provided a special preference with regard to the free residue of the debtor's insolvent estate.⁶⁸ However, the Appellate Division (as it was then) found that this was an incorrect interpretation and that, in actual fact, such bonds provided no security whatsoever, unless they were perfected and the holder obtained physical control of the movables.⁶⁹ In response to this unsatisfactory and fragmented position, the Security by Means of Movable Property Act⁷⁰ expanded the regime that applied in Natal to the rest of South Africa.

According to section 1 of the Act, the position currently is that, if a special notarial bond complies with the requirements of the SMPA, the bondholder is deemed to have acquired a pledge as if the bonded movables were delivered to him. The prime requirements for bestowing real security on the creditor are (1) the registration of a notarial bond in terms of the Deeds Registries Act; and

⁶⁴ S 48(6)(a) of the STA; s 17(6)(a) of the STSMA. See, generally, Van der Merwe *Sectional titles* 16–15–16–16(4); Pienaar *Sectional titles* 94–95 278–283.

⁶⁵ See *Ex parte Body Corporate of the Caroline Court* 2001 4 SA 1230 (SCA); *Reddy v Body Corporate of Croftdene Mall* 2002 5 SA 640 (D); and see further Boraine and O'Brien "The winding-up of a body corporate established in terms of the Sectional Titles Act" 2002 *THRHR* 307.

⁶⁶ S 102 sv "notarial bond" of the Deed Registries Act. For a recent overview, see Brits "Two decades of special notarial bonds in terms of the Security by Means of Movable Property Act" 2015 *SA Merc LJ* 246.

⁶⁷ Act 18 of 1932. See, eg, *Milne and Du Preez v Diana Shoe and Glove Factory (Pty) Ltd* 1957 3 SA 16 (W) 20.

⁶⁸ See, especially, *Vrede Koöp Landboumaatskappy Bpk v Uys* 1964 2 SA 283 (O) 285–286.

⁶⁹ *Cooper v Die Meester* 1992 3 SA 60 (A) 80–85.

⁷⁰ 57 of 1993 (SMPA).

(2) an adequate description of the specific movables that are meant to be bonded.⁷¹ No physical delivery (actual or constructive) is required.

These two requirements are intended to satisfy two interconnected principles of real security law, namely publicity and specificity. The registration of the bond publicises to the world at large that the debtor's property is burdened with a real security right, and outsiders who peruse the bond would know exactly which movable assets are burdened. Hence, the publicity principle is meant to be satisfied not by delivery of the asset, but by giving notice of the transaction through registration of the notarial bond in the deeds registry. Furthermore, for the notarial bond to create a valid real security right, it is imperative that the bonded movable property must be "specified and described in the bond in a manner which renders it readily recognizable".⁷² This requirement satisfies the specificity principle.

The current approach to the interpretation of the latter provision is that the requirement will not be satisfied if extrinsic evidence would be needed to identify the bonded property. In other words, by looking at the bond (and the bond only) one should be able to know exactly which specific movables are bonded. The description must not be general or generic, but must refer to unique features of the movable, such as a serial number, a bar code or other distinct markings.⁷³

If the requirements of the SMPA are met, the bondholder will be in the same position as an ordinary pledgee – he is deemed to have control of the movable, even though he does not. In the case of the debtor's insolvency, the special notarial bondholder's right will be the same as a "special mortgage",⁷⁴ and hence it will qualify as a "security".⁷⁵ Therefore, the bondholder will have a fully effective real security right for non-insolvency and insolvency purposes – a true "non-possessory" of "possessionless" pledge.⁷⁶ Significantly, the bondholder's real security right allows the bondholder to follow the property even into the hands of good faith acquirers.⁷⁷ Although it is not legally necessary for the bondholder to obtain physical control of the property, bondholders may still stipulate for such a right in the notarial bond agreement for instance, if they fear that the value of the movable might be under threat if it continues to remain with the debtor.⁷⁸

A body corporate can therefore make use of special notarial bonds to hypothecate certain specific movable property as security for the repayment of a loan. This will be a worthwhile option in the event that the body corporate owns certain valuable movables such as a sprinkler system of which the body corporate wants the continued use. However, it is unlikely that special notarial bonds over corporeal movables will play a major credit security role in sectional title schemes.

⁷¹ S 1(1) of the SMPA.

⁷² S 1(1) of the SMPA.

⁷³ *Ikea Trading und Design AG v BOE Bank Ltd* 2005 2 SA 7 (SCA).

⁷⁴ S 2 sv "special mortgage" of the Insolvency Act, as amended by s 4 of the SMPA.

⁷⁵ S 2 sv "security" of the Insolvency Act.

⁷⁶ *Bokomo v Standard Bank van SA Bpk* 1996 4 SA 450 (C) 457; *Senwes Ltd v Muller* 2002 4 SA 134 (T) 139; *Ikea Trading* (fn 73) para 22.

⁷⁷ *Bokomo* (fn 76) 454.

⁷⁸ *Senwes* (fn 76) 140 143–144; *Farmsecure Grains (Edms) Bpk v Du Toit* 2013 1 SA 462 (FB) paras 35–36.

4.4.4 Notarial bonds over incorporeal assets?

The next question is whether, as the STSMA seems to contemplate,⁷⁹ a notarial bond mortgaging an incorporeal asset, such as the aggregate of unpaid contributions, is a legal and practical possibility for securing loans in the sectional title context. As stated above, a general notarial bond per definition already includes all incorporeal assets of the body corporate, but the bondholder will only enjoy a real security right once the bond has been perfected. In other words, control of the asset must first pass to the bondholder, which requires a voluntary transfer or a compulsory attachment order in pursuance of a perfection clause. The voluntary transfer can only take place through a cession of the claim for unpaid contributions by the body corporate to the creditor. All things considered, and as discussed in more detail below,⁸⁰ it would consequently make more sense (and it would be less complicated and more affordable) to start by simply ceding the claims *in securitatem debiti*.

It is important to note that as special notarial bonds may be registered only over identifiable corporeal movables,⁸¹ a special notarial bond over an incorporeal movable will not endow the creditor with the desired real security right in the form of a deemed non-possessory pledge. Although the registration of such a bond is not prohibited, the bond must be perfected (control must be obtained) before the creditor is endowed with a real security right – hence, it has the same effect as general notarial bonds, but without the limited preference in insolvency. In other words, the incorporeal must be attached by judicial proceedings, or the debtor must voluntarily give up control of the asset by ceding the personal right to the creditor. As mentioned above, this situation clearly defeats its purpose, as the creditor could simply have insisted on a cession *in securitatem debiti* to begin with, without following (and paying for) the cumbersome registration procedure associated with notarial bonds.

The fact that the SMPA only allows specifically identified objects to be notarially bonded and thus excludes incorporeal movables (such as claims to future contributions) from its operation, has been rightly criticised.⁸² It could have been a valuable option in the sectional title context. Even so, since cession *in securitatem debiti* is a common and practical form of security in the case of incorporeal assets, it seems unnecessarily complicated to use notarial bonds for security purposes – except that registered notarial bonds could provide the publicity that is currently absent in cessions *in securitatem debiti*. On close inspection, therefore, the SMPA in its current version is simply not suitable or intended as a security mechanism in the context of incorporeal assets.

Strangely, however, the legislature appears to regard a notarial bond as the preferred mechanism to encumber outstanding contributions with a form of real security. The reason that the term “hypothecation”⁸³ (a broader concept that includes all forms of real security) is replaced with the term “notarial bond”⁸⁴

⁷⁹ S 4(f).

⁸⁰ See paras 4 5 and 4 6 below.

⁸¹ S 1(1) of the SMPA.

⁸² See, eg, Van der Walt, Pienaar and Louw “Sekerheidstelling deur middel van roerende goed – nog steeds onsekerheid!” 1994 *THRHR* 614 615–617; Scott “Notarial bonds and insolvency” 1995 *THRHR* 672 681–683.

⁸³ S 38(f) of the STA.

⁸⁴ S 4(f) of the STSMA.

(a much narrower concept with a specific technical meaning) is therefore not easy to explain. A *prima facie* reason might be that the legislature wanted to be more specific and, accordingly, replaced the somewhat archaic term “hypothecation” with the modern and easily recognisable concept of “notarial bond” coupled with the fact that registration of the notarial bond would publish to the world which particular movable property of the body corporate is encumbered. Unfortunately, this was done without comprehending the practical outcome of settling for notarial bonds as a real security mechanism in the context of the sectional title industry as described above.

In what follows, the only feasible option for utilising the unpaid contributions of members of the body corporate as objects of real security, namely cession *in securitatem debiti*, is discussed.

4.5 Cession *in securitatem debiti*

The STA’s reference to “hypotheicate”⁸⁵ is generally understood to refer to any form of security that can encumber unpaid contributions, but especially the pledge of such assets through a cession *in securitatem debiti*.⁸⁶ In South African law, cession *in securitatem debiti* (or “security cession” or, more generally, “security by means of claims”) is still the primary and most common way of utilising incorporeal movables (personal rights or claims sounding in money) as objects of credit security.⁸⁷ It is used in many different contexts (for example shares, insurance policies, book debts, *et cetera*) and works reasonably well in practice. Therefore, there is no reason why unpaid contributions (a collection of personal rights sounding in money – very similar to book debts) may not be hypothecated in a similar way, particularly as future debts are commonly ceded *in securitatem debiti*.

Although the notion of ceding a future debt – which is technically non-existent at the time of cession – has been criticised for dogmatic reasons,⁸⁸ the practical necessity of such a device has been confirmed by our courts on numerous occasions.⁸⁹ It transpired that the best way to make sense of a cession of future debts is to conceptualise it as a cession in anticipation (*in anticipando*), which means that as soon as the hope (*spes*) of a future right comes to fruition – when the debt comes into being – the cession, which had been agreed on previously, will automatically take effect without any further action on the part of the cedent.⁹⁰

A cession *in securitatem debiti* can be construed in two ways, namely either as – (1) an absolute (or “out-and-out”) fiduciary security cession; and/or (2) a pledge (or *quasi*-pledge) of the claims to the creditor. The first theory entails that the personal right is in totality transferred by its holder (the cedent) to the secured creditor (the cessionary) by means of a cession. However, the cession agreement includes – either expressly or tacitly – a fiduciary agreement (*pactum fiduciae*) in terms of which the cessionary must return the ceded right to the cedent after the

⁸⁵ S 38(f).

⁸⁶ See, eg ,Van der Merwe *Sectional titles* 14-64.

⁸⁷ In general, see especially Scott *The law of cession* (1991) ch 12.

⁸⁸ See, especially, De Wet and Van Wyk *Die Suid-Afrikaanse kontraktereg en handelsreg* (1992) 354–256.

⁸⁹ See, eg, *Standard General Insurance Co Ltd v SA Brake CC* 1995 3 SA 806 (A) 815; *First National Bank of SA Ltd v Lynn NO* 1996 2 SA 339 (A) 346 358–360.

⁹⁰ See further Lubbe “Cession” in 3 *LAWSA* (2013) para 148; Scott *Cession* 49–52.

secured debt has been discharged. Essentially, “ownership” (*dominium*) of the right passes from the cedent to the cessionary for the duration of the security transaction. This deceptively simple structure based on the principles of contract law, is often regarded as the most doctrinally acceptable way of constructing security transactions involving incorporeal assets.⁹¹

However, in the course of time, despite some dissenting opinions,⁹² the greater part of the South African judiciary⁹³ has decided to follow a more pragmatic approach by structuring a cession *in securitatem debiti* as a pledge or *quasi*-pledge of movable property. After cession, ownership of the claims remains with the debtor (cedent/pledgor), whereas the secured creditor (cessionary/pledgee) acquires a real security right similar to a limited real right of pledge in the incorporeal object. The most important difference between the pledge and the out-and-out cession construction is that, in the case of the pledge construction, “ownership” of the asset remains in the estate of the pledgor (cedent), whereas in the case of an out-and-out cession, ownership in the incorporeal is transferred to the cessionary. Although some dogmatic objections could be raised against the pledge of incorporeal property, it is clear that this construction is more in line with the true purpose of the transaction and that it produces more equitable results in the case of insolvency of the debtor. Most recently in *Grobler v Oosthuizen*,⁹⁴ the Supreme Court of Appeal emphatically re-affirmed that the doctrinal debate has been settled in favour of the pledge theory. The court held that the pledge construction will henceforth be the default position and that an alternative construction (such as an out-and-out security cession) will only be acknowledged if the parties had unequivocally agreed to such a construction. The Supreme Court of Appeal cautioned that any uncertainty with regard to the intention of the parties will cause the court to fall back on the pledge construction.

In view of the above, it is more realistic to accept the view of Susan Scott who has always contended that the pledge of claims and the out-and-out security cession of personal rights are two distinct legal institutions with distinct rules and requirements, and that both are available depending on the parties’ intention.⁹⁵ This approach was approved in several high court judgments⁹⁶ and perhaps indirectly by the Supreme Court of Appeal in *Grobler*⁹⁷ where the court left the door open for parties unequivocally to choose an out-and-out security cession as basis for their credit agreement and so to prevent the court falling back on the pledge construction as the default position.

This brief overview of the doctrinal debate does not do justice to the complicated intricacies of the various theories and arguments, but for present purposes it is sufficient to consider the general position that bodies corporate can,

91 See, especially, De Wet and Van Wyk *Kontraktereg* 415–424.

92 See, eg, *Lief v Dettmann* 1964 2 SA 252 A 271; *Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd* 1968 3 SA 166 (A) 173–174 189.

93 See, especially, *National Bank of South Africa Ltd v Cohen’s Trustee* 1911 AD 235, confirmed in, eg, *Leyds v Noord-Westelike Koöperatiewe Landboumaatskappy Bpk* 1985 2 SA 769 (A); *Bank of Lisbon and South Africa Ltd v The Master* 1987 1 SA 276 (A); *Lynn* (fn 89); *Picardi Hotels Ltd v Thekwini Properties (Pty) Ltd* 2009 1 SA 493 (SCA).

94 2009 5 SA 500 (SCA), especially paras 17 23–24.

95 See, especially, Scott *Cession* ch 12.

96 See, eg, *Alexander v Standard Merchant Bank Ltd* 1978 4 SA 730 (W) 739 740–742.

97 2009 5 SA 500 (SCA).

in theory, use their claims for unpaid present and future contributions as objects of credit security in two ways – either by way of an out-and-out fiduciary cession or by constructing the cession as a pledge. However, if one considers the wording of the STA and STSMA on this point, it does not seem as if the transfer of “ownership” of the claim is envisaged as none of the terms used (namely “hypothecation”, “notarial bond” and “mortgaging”) can be interpreted so as to include a full transfer of the asset for security purposes; the terms only imply the creation of limited real rights. Accordingly, it seems more likely that only the pledge construction is envisaged by the empowering provisions in the Acts.

One of the central features of the pledge of claims is that the power to enforce the ceded right – or to collect upon the ceded unpaid contributions – passes to the pledgee. Consequently, on default, only the secured creditor, and not the body corporate, has *locus standi* to claim and receive the amounts payable by the sectional owners.⁹⁸ However, it is unlikely that the parties would have contemplated a situation where sectional owners should, for the duration of the loan transaction, pay their monthly contributions to the secured creditor instead of to the body corporate. From the manner in which South African courts have applied the pledge construction over the years, it appears that the pledge construction is sufficiently flexible to take account of the practical needs of the parties involved and that parties enjoy a large degree of freedom to structure their credit agreement in a way that best suits their commercial needs. As the management and maintenance of the scheme would clearly deteriorate if all collected contributions would go towards repayment of the loan, the ideal solution would be if the credit agreement contains a clause which allows the body corporate (cedent) to continue collecting the contributions each month on the creditor’s (cessionary’s) behalf and obliges the body corporate to pay an agreed-upon instalment in satisfaction of the loan until the debt is discharged. This is in line with the present legal situation where, despite some objections,⁹⁹ the law of cession *in securitatem debiti* allows a cedent/pledgor to be appointed as the cessionary’s/pledgee’s agent for the purpose of collecting the payments made under the ceded personal right.¹⁰⁰

Furthermore, the body corporate and its finance provider could agree on specific arrangements to reschedule repayment of the debt on foreclosure so that a portion of the collected unpaid contributions should be handed over to the creditor each month in satisfaction of the loan, while a portion of the contributions should be left for the body corporate to fund the performance of its functions.¹⁰¹ However, in the case of foreclosure when the body corporate

⁹⁸ See, especially, *Cohen’s Trustee* (fn 93) 251, confirmed most recently in, eg, *Millman v Twiggs* 1995 3 SA 674 (A) 678; *Lynn* (fn 89) 357.

⁹⁹ See, eg, *Standard General Insurance Co Ltd v Eli Lilly (SA) (Pty) Ltd (FBC Holdings (Pty) Ltd, Third Party)* 1996 1 SA 382 (W).

¹⁰⁰ See, eg, *Illings (Acceptance) Co (Pty) Ltd v Ensor* 1982 1 SA 570 (A) 577–578; *Aussenkehr Farms (Pty) Ltd v Trio Transport CC* 2002 4 SA 483 (SCA) 491.

¹⁰¹ The body corporate is advised to refuse to agree to an acceleration clause, which will allow the creditor to demand full the payment of the outstanding capital debt as soon as the loan agreement is breached. It would also not be prudent for the body corporate to allow the inclusion of a summary execution (*parate executie*) clause in the security agreement, which would allow the creditor to realise the object of security without going through the normal court processes. However, depending on its bargaining position, the body corporate might have to accept the inclusion of either or both of these clauses. Both clauses will strengthen the creditor’s security.

defaults on its repayment obligations, it is doubtful whether the credit provider would be willing to accept such a form of piecemeal satisfaction. Instead, it may want to realise the entire security by, for instance, having the incorporeal asset (the aggregate of outstanding contributions) sold in execution. Also, once the reserve fund provisions of the STSMA are in operation, the credit provider would presumably make more direct demands on the money in the reserve fund in the event that the later was pledged to it.

4.6 Cession *in securitatem debiti* versus notarial bonds

One advantage of a cession *in securitatem debiti* is that it has no formal requirements. In terms of both the STA and the STSMA, its formation requires neither writing nor a particular wording; all that is needed is an intention to cede.¹⁰² However, nothing prevents the owners of a particular scheme, to change their rules so as to contain additional requirements, for example that the owners (the debtors of the unpaid contributions) should be notified of the cession or give their permission to it. Of course, a special resolution is required to enter into the loan agreement that underlies the security transaction.¹⁰³ Such a resolution has the indirect effect that most owners would have agreed to the broader transaction or at least would be aware of the cession.

Unlike notarial bonds, security cessions are not accompanied by any form of publicity – except for the extent to which the owners will be made aware that moneys were borrowed and that their unpaid contributions have been ceded. On the whole, this apparent deficiency in security cession transactions has proven not to be problematic in practice.¹⁰⁴ Indeed, the lack of formality in creating this form of security is hailed as one of the major benefits of security cessions, rendering them very popular and easy to conclude. Yet, if one wants the security transaction to be made known to outsiders as well (for instance, other creditors of the body corporate), which could have a beneficial effect, some form of registration or notification would be the ideal option, but as has already been indicated, a cession takes place without registration.

In summary, it is abundantly clear that a cession *in securitatem debiti* of the body corporate's unpaid contributions is currently a far better security mechanism than the notarial bond contemplated by the STSMA. First, notarial bonds over incorporeals only give rise to real security if the bond is perfected, whereas a security cession provides a fully protected security right without requiring anything more than an agreement to cede. Furthermore, in view of the specificity requirement for special notarial bonds in terms of the SMPA, cession *in securitatem debiti* is the only mechanism by which future debts can be mortgaged – except in the case of general notarial bonds, which must be perfected to provide real security. Finally, the fact that notarial bonds must be registered, involves both time and cost constraints, which are absent in the case of a security cessions.

102 See, eg, *Cohen's Trustee* (fn 93) 250 253; *Oertel v Brink* 1972 3 SA 669 (W) 674; *Botha v Fick* 1995 2 SA 750 (A) 762.

103 S 4(f) of the STSMA.

104 An exception is *Britz v Sniegocki* 1989 4 SA 372 (D).

5 CONCLUDING REMARKS

The above analysis has shown that the body corporate of a sectional title scheme can, in general, utilise any property that it owns as an object of real security for the repayment of a loan. However, the structure and wording of the STA and STSMA do not necessarily make it easy to reach such a wide-ranging conclusion. The mortgaging of immovable property is relatively uncontroversial, since both statutes provide the same reasonably wide definition of a “sectional mortgage bond”, which can basically include a mortgage over any kind of immovable asset, and both statutes generally authorise the “mortgaging” of “any property vesting in” the body corporate.

The problem is that land in a sectional title scheme is designated as common property in both the STA and the STSMA. This means that land is owned in undivided shares by sectional owners in proportion to their respective participation quotas and that therefore, it could only be utilised as security for a loan by a very complicated process as set out above. In circumstances where the body corporate acquires ownership or a lease of a unit, such unit is deemed to be land, or a real right in land capable of being mortgaged for a loan provided by a financial institution. This may turn out to be a very sound real security mechanism as ordinary foreclosure proceedings apply in these circumstances. It has also been mentioned that the mortgaging of other real rights in the sectional title context, such as the real right to exclusive use areas and the right to extend the scheme are not worthwhile security mechanisms.

The utilisation of movable assets as security for a loan is more complicated. Although the notion of “mortgaging any property” can be interpreted broadly so as to include traditional pledge transactions (including notarial bonds) of movable things, the mortgaging of incorporeals (particularly, the claim for unpaid contributions) is treated in an unsatisfactory manner in the STSMA. The STA authorised the “hypothecation of unpaid contributions”, which is sufficiently wide to readily include an ordinary cession *in securitatem debiti* of a personal claim. However, the STSMA replaces the phrase “hypothecation of unpaid contributions” with the phrase “notarial bond of the unpaid contributions”. We have shown that the latter is wholly unsuitable for incorporeals like unpaid contributions, whereas the former is the only realistic legal option. It is regrettable that the drafters of the STSMA did not consider the implications of this replacement of terminology, and therefore the authority for ceding such contributions *in securitatem debiti* must be found elsewhere.

One option is that the phrase “mortgaging any property vested in it” can be interpreted broadly to include any form of real security – hence, including a cession *in securitatem debiti*. We contend that if this interpretation is accepted, then there should be no problem for bodies corporate to continue ceding claims for unpaid contributions for security purposes. However, to avoid unnecessary debate about such an important issue, it is proposed that the STSMA should be amended to set out in specific – and more accurate – detail the kind of security transactions that the body corporate is permitted to enter into. If it was the legislature’s intention to insist upon a form of publicity – a registered notarial bond – when unpaid contributions are given in security, the current statutory framework is not sufficient. Other amendments would have to be made, such as the inclusion of incorporeals in the SMPA. However, because this is presently not the situation, one must accept the fact that a cession *in securitatem debiti* is currently the only feasible way of using unpaid contributions as objects of real

security. However, it is doubtful whether credit providers would accept the suggested stipulations in the credit agreement which would force them to accept payment in piecemeal fashion. Instead, creditors would probably insist on the power to accelerate repayment of the full debt as well as the power to realise the security without having to obtain court authorisation (*parate executie*) in the event that the body corporate defaults.

In the sphere of liability for debts, it is important to emphasise that the body corporate of a sectional title scheme differs from a limited company in that its corporate status does not insulate its members (the sectional owners) from personal liability for the debts of the body corporate. If a body corporate defaults on an obligation to repay a loan (for instance, if it fails to timeously pay an instalment), the creditor may institute debt enforcement proceedings in order to obtain a judgment for the outstanding amount. If such a judgment is obtained against the body corporate but the latter is unable to satisfy it (and there is no property against which the judgment can be executed), the judgment creditor can apply for a joinder of the members of the body corporate in their personal capacities as joint judgment debtors in respect of the judgment debt.¹⁰⁵ In other words, the liability of the sectional owners is subsidiary – the sectional owners can only be sued if the creditor has an unsatisfied debt against the body corporate.¹⁰⁶

Upon such a joinder, the judgment creditor may recover the amount of the judgment debt still outstanding from the members on a *pro rata* basis in proportion to their respective quota or a different proportion if a rule to that effect was adopted by a special resolution.¹⁰⁷ This is, however, subject to the proviso that any member who has paid his contributions before the creditor obtained its judgment against the body corporate,¹⁰⁸ may not be joined as a joint judgment debtor in respect of the judgment debt.

This risk of owners being held personally liable for the body corporate's debts means that it is to the advantage also of sectional owners if the body corporate's debts are secured with a strong real security right. It would mean that the creditor will be able to satisfy its claim by executing its judgment debt against the mortgaged property, without having to rely on the subsidiary personal liability of the owners.

However, as a word of caution it is necessary to emphasise that the aforementioned possible benefit of securing the repayment of a body corporate's debts (so that the owners are protected against personal liability) should be balanced with the potential risks that secured credit transactions could hold for the financial and social well-being of the scheme as a whole. It should always be kept in mind that if things go wrong and the loan becomes enforceable due to the body corporate's default, the calling up of the real security right will very likely culminate in the loss of the encumbered assets due to their sale in execution. Depending on the value and nature of the lost assets, the enforcement of the security could seriously jeopardise the efficient management and maintenance of the scheme as a whole. This is particularly the case if some of the facilities in the scheme can no longer be utilised.

105 S 47(1) of the STA; s 15(1) of the STSMA.

106 *Caroline Court* (fn 65) para 8; *Reddy* (fn 65) 644–645.

107 In terms of s 32(4) of the STA; s 11(2) of the STSMA.

108 Proviso to s 47(1) of the STA and proviso to s 15(1) of the STSMA.

Consequently, in the sectional title context security transactions should preferably be structured in such a way that the impact of default will cause as little disruption as possible of the normal use and enjoyment of the scheme's facilities and functions. Bodies corporate should very carefully consider all their options and the potential consequences of their decisions when choosing to borrow money and grant real security, since the negative impact of the enforcement of the real security could have a ripple effect on the continued financial and social good fortune of the scheme. Getting into debt and encumbering one's property is not a decision that any person should take lightly, but this is even more relevant in the case of bodies corporate who represent many people's financial and social interests.