

The challenges confronting strata titled properties: lessons learned

Strata Title Workshop
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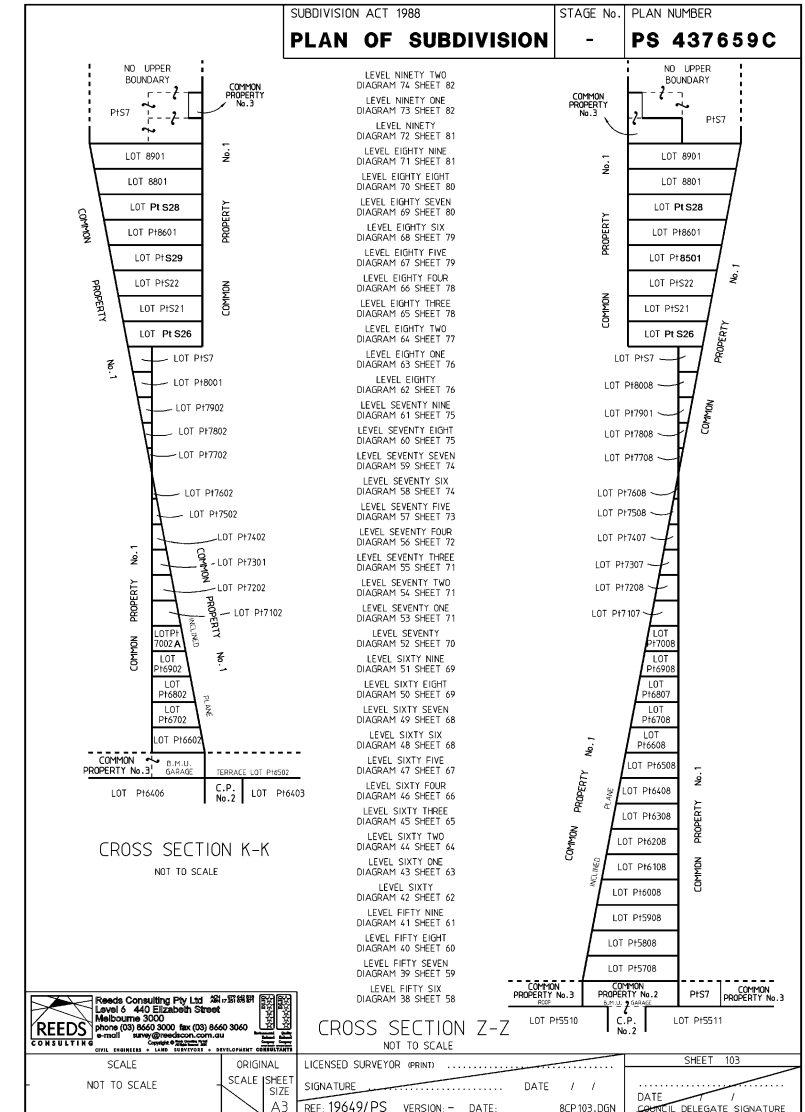
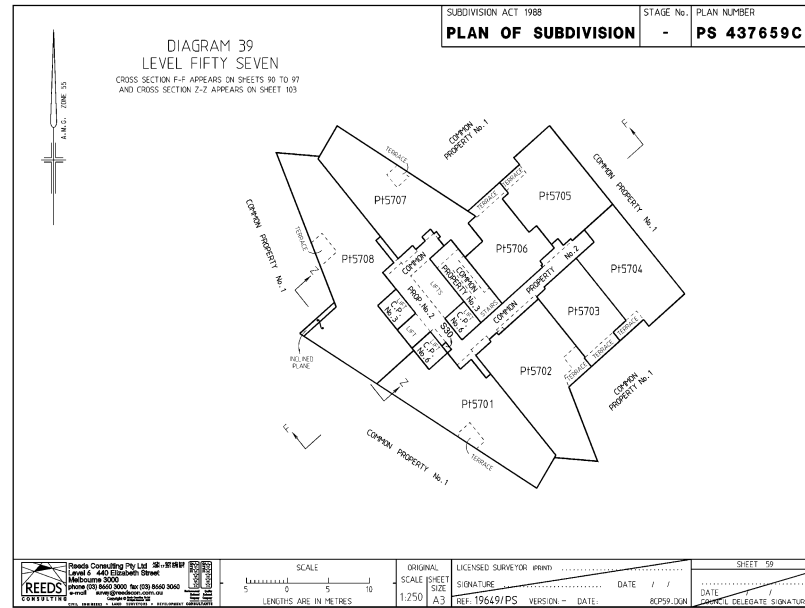
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- Examples of strata schemes in Australia
- Implementation of Strata Systems – The Value of Research
- Legislative Framework
 - Federal system
 - Language complications
- The Challenges and Lesson Learned (recent reforms)
 - Planning and Design
 - Scheme Establishment
 - *Registration (workshop focus)*
 - Governance and Management
 - *Lot Entitlements / liabilities (workshop focus)*
 - *Sinking Funds (workshop focus)*
 - Termination and Redevelopment

Eureka Tower – Vertical Scheme



Currumbin eco-village - Horizontal Scheme



Sphere – Staged Scheme (medium density & townhouses)



Implementation of Strata Titling – the Value of Research Challenge



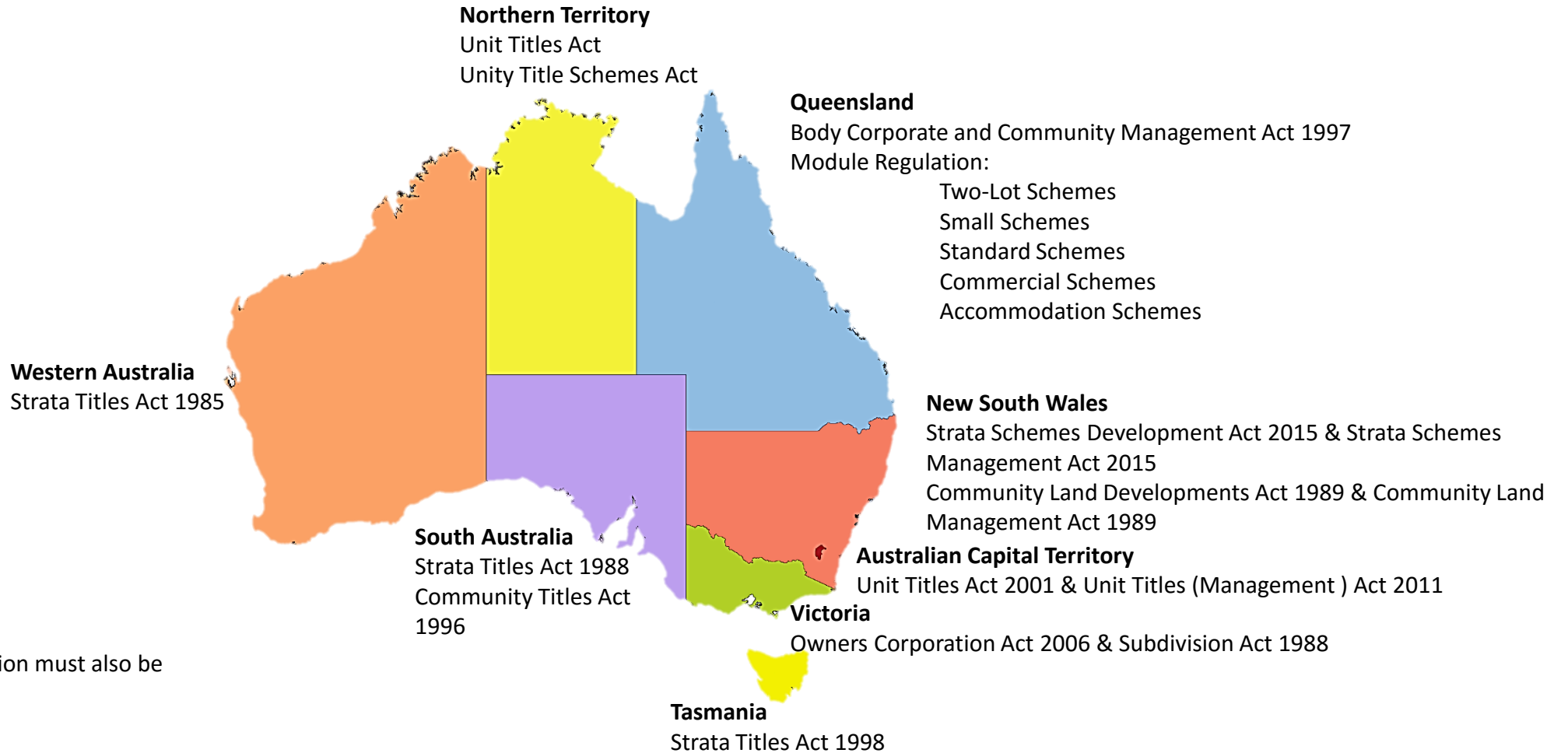
The key challenge in most jurisdictions is the lack of research. In the absence of research, constant reform will be required.

Changes to the legislation are often prompted by complaints made by lot owners to the government and the reform process is often based on submissions made by various stakeholders in consultation rounds.

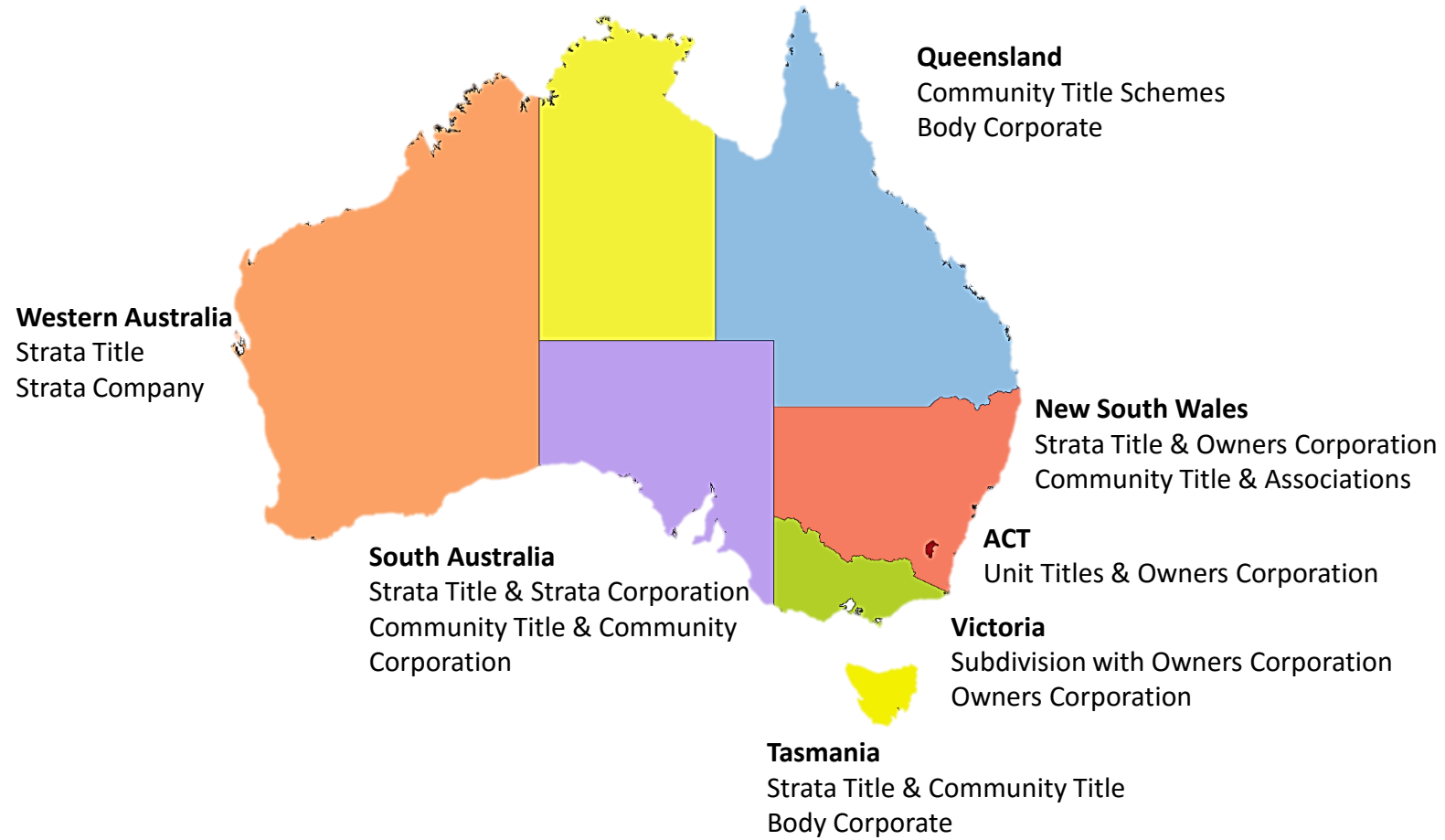
Rarely is reform based on empirical based evidence.

Need to understand how people live, their perceptions of community living, level of apathy (involvement), what they read, other systems and how those systems impact upon strata, expectations in relation to communal living

Example: Disclosure regime (How much needs to / should be disclosed? How do humans process complex information?)



Numerous ancillary legislation must also be considered



Challenges arise both in relation to LGA planning schemes and how individual strata schemes are designed.

- One area of common dispute in Australia relates to short-term letting (rise of Airbnb etc). It is dependent upon the zoning of land and what the planning scheme has allowed. Disputes in areas close to tourism or city centres are prolific. Problem – owners v short-term tenants. Use can be different (residence / accommodation) and leads to conflict (noise, parties, traffic flow through building (bags), damage).
 - Consideration: LGAs need to understand the level of conflict arising from mixed tenancies and ensure approvals include conditions to alleviate common concerns.
- Effective designs are critical to scheme success and alleviating disputes. Issues arise relating to lot layout, storage, privacy and ventilation. In relation to the building, issues relate to the design of common areas - minimising the transmission of noise and smells, car spaces, moving in and out, laundry, pets etc. Care also needs to be taken in relation to equipment choice, maintenance and energy costs.
 - Consideration: guidelines, educational seminars, developer / builder incentives to ensure quality of product
- Determining lot boundaries is critical (next slide) to scheme success

Lot Boundaries – what is common property and lot property?

1. Determined in conjunction with developer & surveyor – scheme dependent and need to view plan of survey to determine boundaries
2. Median line (centre) – centre of doors, walls, slab. Governed by legislation
3. Inner face (airspace) – boundary is inner face of walls, doors, floor, roof. Governed by legislation
4. Car spaces and storage – separate lot, part lot or common property with rights to use (licence or lease)

Challenges

Disputes relating to responsibility -
Common property v lot – need to clear about definition of common property

More problematic in states where boundaries can only be determined by reviewing the plan of survey (inconsistent) – reliance of experts

Lot owners are generally more reluctant to maintain and repair (absence of mandated requirements)

Car spaces / storage – rights change depending on ownership

Considerations

1. Should lot boundaries be determined on an individual scheme basis?
2. If not, where should the boundary lines be?
3. Who is best positioned to maintain the property? Lot owner or body corporate?
4. Impacts on body corporate funding
5. Should car space, storage spaces etc be a separate lot, part lot or common property?
6. Requirement for operational plan (clarity of responsibility)

Registration: each jurisdiction in Australia has different requirements relating to registration documentation.

- Community Management Statements (in some jurisdictions) – includes entitlements / liabilities, calculation methodology used, by-laws, architectural and landscape codes (if applicable), leases and licences, shared agreements.
- Plan of subdivision
- Lot entitlements / liabilities and basis for the allocation
- Rules / by-laws

Governance planning: each jurisdiction in Australia has different requirement relating to pre-sale information disclosure

- Aspects of governance and management are determined (necessitate effective running from outset) – bylaws, management, levies, leases and licences etc

Scheme Establishment

Developers necessarily need to make arrangements for the transition in governance once the scheme is registered. That is, before the scheme is registered and the B/C is created, the developer needs to make decisions regarding lot entitlements, budgets, management, by-laws. The developer also has control for a period of time post-registration and holds all the voting power.

Challenges

Developer control: often developers want to control the B/C until all lots are sold and the developer exits the development. Decisions are made that may be in the best interests of the developer and not the B/C.

E.g.: setting levies (underestimated), negotiate contracts that advantage developer or associated entity, bylaws that benefit retained lots, lack of documentary handover, leases favouring developer or associate

Considerations

1. Disclosure requirements?
2. What information should be provided upon registration?
3. How much information to disclose?
4. Use of proxies and powers of attorney (limitations)
5. Limitations on developers powers (pre and post registration)
6. Regulations / prohibitions regarding developer-initiated arrangements

- Legislation creates a governance framework
- Body corporate (entity) is responsible for governance and management (although management is often delegated)
- Challenges are vast – owners lack of knowledge, apathy, complexity of schemes / legislative environment, various attitudes to compliance (different from living in free standing dwelling)
- Next slides highlight lessons learned / reform ideas from Australia
- South Africa has implemented new Ombuds system – bodies corporate are required to lodge an annual return. Once the information provided in the return meets the requirements of the Act, the Chief Ombud issues a compliance certificate. Purpose of the system is to regulate the conduct of parties; to regulate, control and quality assure all scheme governance documentation; provide dispute resolution services, provide stakeholder training, consumer education etc. Each body corporate must pay a levy to the Ombuds service

Committees

Requirement to form a committee derived from B/C members

Challenges: apathy, limited turnover, liability (decisions), knowledge

Reforms/ considerations: Granting power to management companies to act as committee (problematic ?), delegating responsibility (corporate model), compulsory education, codes of conduct (embedded in the legislation)

Financial Management

Requirement to prepare budgets, fund expenditure, levy owners, make payments

Challenges: underestimated budgets, recalcitrant lot owners, inadequate sinking funds, statements not audited

Reforms/ considerations: mechanisms to recover debt from owners, stricter regulations around initial budget forecasting, implementation of accounting standards

Management

Engagement of body corporate manager (60% of schemes) and/or resident manager – different roles

Challenges: commissions, terms of contracts, associated entities, professionalism, role of manager is unclear

Reforms/ considerations: legislative restrictions on contract terms and fairness provisions, restrictions on commissions (or at least disclosure), education / licensing for managers

Maintenance and Repairs

Requirement to maintain and repair the common property and body corporate assets

Challenges: delays in maintenance and repairs, defect rectification (developers), underinsured properties

Reforms/ considerations: requirement to value property for insurance purposes, well funded sinking funds, obligation on developer to arrange final inspection and report on defects

Meetings

Committee, EGMs, AGMs – procedural requirements

Challenges: quorum, electronic voting, proxies (farming), tenant participation, procedural irregularities, urgent decisions

Reforms/ considerations: some states have interim resolutions – forcing apathetic owners to take steps to oppose resolution, limit proxy use, allow tenants to observe meetings

Record Keeping and Access

B/C required to keep records and provide access to “interested persons”

Challenges: standards and access, incomplete records, inaccurate information

Reforms/ considerations: Who should be able to inspect and/or request copies or access to the BC records?

By-laws

Model by-laws and parameters around types of by-laws

Challenges: Inappropriate and unenforceable by-laws

Lessons learned / reforms:
NSW reforms – review all to ensure compliance

Dispute Resolution

Internal dispute resolution mechanisms, CATs, Courts (adjudication in Qld)

Challenges:
Resolution to commence proceedings, lots of disputes

Lessons learned / reforms:
important to establish informal mediation processes

Legal Duties

Statutory duties imposed on committee members, managers, developers (acting in best interests of B/C)

Challenges: limited penalties for wrong doing, reluctance by B/C to commence action

Lessons learned/ reforms:
need for clear duties (or prohibitions), civil penalties applied

Lot entitlements / liabilities allocate:

- Expenses - The allocation of expenses should reflect both the cost burden that each lot creates on the expenses of the body corporate and the benefit that each lot receives from the expenditure of the body corporate.
- Voting Power
- Share in common property and body corporate assets
- value of the lot for calculating local government rates and charges

Responsibility:

Developers are currently responsible for setting lot entitlements

Usually engage – manager or quantity surveyor to assist

Changes / amendments – BC resolution or seek tribunal order (owner)

Queensland

Contribution schedule lot entitlement = each owner's share of the B/C costs and value of each owner's vote (if a poll is called)

Interest schedule lot entitlement = each owner's share of the common property and B/C assets and value of the lot for calculating local government rates and charges

New South Wales

Unit entitlement = lot owner's voting power, beneficial interest in the common property and lot owner's share of the annual fees

Victoria

Lot entitlements = lot owner's voting power

Lot Liabilities = lot owner's share of the annual fees

Distribution of entitlements / liabilities set at the discretion of the developer which led to:

1. Advantages to certain lots (usually retained by the developer) - inappropriate and unequal distribution
2. Disadvantages to certain lots (when distribution was identical) – equal distribution

Examples:

Scenario 1

Scheme A has 40 lots. The top lot (penthouse) is retained by the developer and 2 other commercial lots are also retained by the developer. In the absence of clear methodology calculations and legal requirements, the developer allocates entitlements and/ or liabilities to ensure high voting power and low contributions.

Scenario 2

Scheme B has 200 lots. 40 lots are 1 bedroom apartments, 100 lots are 2 bedroom apartments and the 60 lots are 3 bedroom apartments. The Developer allocates an equal distribution and therefore all lots contribute equally to the financial costs (levies) and all have same share in common property. All pay same local government rates and charges (problem when water and other utilities are included in local rates and charges). Apartment with 4 people are paying the same costs as an apartment with 1 person.

Queensland (Part 5 BCCMA)

Contribution schedule principles –

The Equality Principle

Lot entitlements must be equal except to the extent to which it is just and equitable in the circumstances for them not to be equal

The Relativity Principle

Lot entitlements must clearly demonstrate the relationship between the lots by reference to 1 or more particular relevant factors – how the schemes was structured, the nature, features and characteristics of the lots, the purposes for which the lots are used, the impact the lots may have on the costs of maintaining the CP, the market value of the lots

Interest schedule principle –

The Market Value Principle

Must reflect the respective market values of the lots except to the extent to which it is just and equitable in the circumstances for the individual lot entitlements not to reflect the market value.

New South Wales (Schedule 2 SSDA and s 7 SSDL)

Apportioned on a market value basis at the valuation day

Definition of market value basis - the basis for determining the value of a lot is to estimate the amount for which the lot would be sold by a willing but not anxious seller to a willing but not anxious buyer.

Section 236 SSMA 2015 allows for the Tribunal to make an order allocating unit entitlements if the Tribunal considers that the original allocation was unreasonable when the plan was registered. The tribunal must consider the respective value on the lots.

Victoria

No calculation methodology specified in the legislation for the initial calculations

However, section 33 of the Subdivision Act specifies how lot entitlements and liabilities can be altered.

Requires a unanimous resolution of the members

1. Lot entitlement changes – OC must have regard to the value of the lot and the proportion that the value bears to the total value of the lots affected by the OC
2. Lot liability changes – OC must consider the amount that it would be just and equitable for the owner of the lot to contribute towards the administrative and general expenses of the OC

Consultant Recommendations:

In relation to allocating expenses:

1. Shared equally – most expenses benefit all lots equally (cleaning, service contractors, management)
2. Shared on interest schedule – some expenses benefit all lot differently, depending upon the location, size or nature of the lot. Therefore, expenses should be shared among all lots on the basis of their interest entitlement (repair and replacement of any building or structure (including roof), painting of the building, repair or replacement of lift, public liability insurance, etc)
3. Benefitting some but not all – some expenses benefit some, but not all, lots (usually capital in nature). Therefore costs should be shared either equally or on the basis of the interest schedule but only among the lots that receive some benefit from the relevant expenses

In relation to determining interest schedule:

1. Change from market value principle to relative market value – determined by a valuation valuer as at the date the scheme is established.

Impose obligation on developer to exercise reasonable skill, care and diligence and to act in the best interests of the body corporate when allocating expenses into the expense categories. Civil penalties should apply for non-compliance.

Points to consider – Entitlements and Liabilities



1. Who should be responsible for calculating the initial and subsequent (amended) allocations?
2. Should a duty be imposed on the party responsible for making this determination?
3. Should the allocations be expressed as one (NSW) or two allocations (contribution/ interest or entitlement / liability)?
4. What is the best / better calculation methodology?
5. If using valuation method, which method is preferable (market, relative)?
6. What resolution should be required to amend the allocations?

Three alternative approaches to funding capital expenditure in strata schemes:

1. Funds raised from owners at the time common property capital expenditure is required (special levy raised);
2. Debt funding – borrowing money from third party (financial institution) on agreed terms;
3. Owner contribution to an accumulating fund prior to common property capital expenditure (sinking or maintenance fund).

Purpose of sinking / maintenance fund: is to set aside money to fund the cost of capital works during the year and future years. That is, works of a non-recurrent nature (e.g. painting the building, carpet replacement, lift replacement). This is the temporal equity approach = the equitable allocation of costs to different lot owners over the life of a scheme. That is, everyone involved in the scheme over its life cycle contributes to the capital expenditure.

It is common practice that a forecast report is provided in order to plan for the future capital expenditure.

Summary of Expected Expenditure – example (forecast)



	Expected Sinking Fund Requirements				
Categories	To March 18	To March 19	To March 20	To March 21	To March 22
Doors, Windows & Screens		\$2,145		\$8,656	\$3,561
Tiles, Carpets, Vinyl	\$16,093				\$20,540
Loose Furniture & Fittings					\$6,571
Painting, Plastering & Wallpaper		\$236,093			
Air conditioning, Ventilation & Fans				\$2,054	
Fire Equipment			\$2,074		
Lift Interiors					
Irrigation & Drainage Systems					\$13,501

Variability in the approach to fund capital expenditure in each Australian state

- Mandatory provisions – requiring sinking fund forecasts to be prepared and funded (Queensland, NSW)
- Discretionary provisions – obligation to prepare a plan for certain types of schemes (e.g. 100 lots) but no requirement to fund the plan (Victoria)

Problem when sinking fund is insufficient = Building neglect (maintenance and repair delayed) leading to serious financial and personal consequences (health risks) for future owners and residents

Challenges:

- Quality of forecast and costs associated with regular updates
- If no requirement to fund or fund at certain level, schemes may have limited funds
- Most jurisdictions don't require an expert to prepare the plan – B/C can determine funding required which can lead to inadequate funding
- Inability to transfer between funds if short fall

Pros of sinking funds

- Assists in the adequate planning for longer term maintenance costs
- All lot owners contribute over the life of the scheme (fairness)
- Selling point if well funded (should add to the value of the property)
- Protects quality of build / scheme

Cons of sinking funds

- Limits flexibility and self-management (schemes may prefer to fund works in alternative way)
- For short term investors or owners, see putting money aside for future owners (benefitting others)
- Money tied up in collective account – drawing on individual funds
- Risk of embezzlement and waste (money is available to spend unnecessarily)



1. Should sinking funds be mandatory? That is, should B/C be required to future plan for capital expenditure?
2. Should funds be based on forecasted plan? What level of discretion should B/Cs have? Should plans be mandatory? Does the professional infrastructure exist to mandate this? Accountability of quantity surveyors? Ensuring professionalism of industry. (Option for schemes to engage surveyor or building inspector at intervals to inspect and report on current state of play)
3. Does there need to be a differentiation for different sized schemes? If so, what are the characteristics?
4. What should be the procedure? Committee, general meeting, type of resolution
5. What level of flexibility should be afforded to B/C to re-evaluate the funding at a particular point in time?
6. Should there be capacity for money to be paid out of sinking fund for unplanned works? Under what circumstances?
7. Should the developer be required to prepare first sinking fund?



Generally, to terminate a scheme (due to building ageing or redevelopment), bodies corporate need either an unanimous resolution or a court order. Due to the difficulty in obtaining such consent, recent reforms and submissions have tended toward the implementation of a lower resolution (e.g. 75%) and a collective sale process (forming a strata committee and developing a strata renewal plan).

Option – order of court to terminate

Issue – property rights of individuals

Thank-you

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