

## Comments on the Proposed Body Corporate and Community Management and Other Legislation Amendments Bill 2012

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### 1.0 Brief background for Leary & Partners Pty Ltd

Leary & Partners Pty Ltd has over 30 years of experience providing services to the strata industry. A number of these services, such as sinking fund forecasts and replacement insurance valuations, directly involve us in the process of assessing body corporate expenses and their payment by lot owners using the contribution entitlements.

We have provided expert contribution entitlement adjustment advice for both applicants and bodies corporate since 2002 and are one of the leading providers of cost impact analysis reports for bodies corporate. We are also one of the leading providers of shared facility cost advice to Building Management Committees in Queensland and New South Wales.

Leary & Partners has now provided formal contribution adjustment advice for over 100 schemes and had general 'briefing level' discussions in relation to many others. Our experience covers a broad spectrum of schemes from the most complex (such as layered schemes, mixed use developments and developments with a mixture of GTP and BFP lots in the same scheme level) through to simple standard format plan townhouse developments.

We made detailed submissions in relation to both the 2009 discussion paper *Sharing Expenses in Community Titles Schemes* and the *Body Corporate and Community Management and Other Legislation Amendment Bill 2010*.

We have directly observed the contribution adjustment and reversion process in all its forms, as well as being briefed on their experiences and opinions by many of our clients. We hope that the insight we have gained from this experience will be of assistance to the Committee.

### 2.0 Adjustment, reversion and proposed reverting of contribution entitlement schedules

Unfortunately, there is no policy position regarding the setting, adjustment, reversion or the changing back of reverted entitlements (for the purposes of this submission described as 'adjustment reinstatement') of contribution entitlements that does not adversely affect certain lot owners while benefiting others. It is both understandable and reasonable that lot owners disadvantaged by either an

initial adjustment order, a subsequent reversion, or an adjustment reinstatement will argue that legislators are acting unfairly and unjustly when they enabling such changes to occur.

There is no doubt that both adjustments and reversions have created genuine pain and hardship for particular individuals. The same will be true if the adjustment reinstatement process in the *Body Corporate and Community Management and Other Legislation Amendments Bill 2012* (2012 Bill) is enacted. However, we cannot avoid the observation that with each proposed amendment to the Act we have heard the same hardship based arguments, just from a different group of people.

We been a party to the adjustment system from the start (we believe our first consultation was for the third court case run) and subsequently we having been involved, at least to some extent, in what is probably over seventy percent of officially ordered contribution schedule adjustments, acting both for lot owner applicants and body corporate respondents. Unfortunately, the full range of adjustment circumstances we have observed is not being mirrored in the public debate.

We note that much of the public debate, articles and submissions appear to be very Gold Coast tower centric. This demographic comprises a significant proportion of the adjustment orders but it is by no means representative of the total pool of adjustment effected schemes or the full range of adjustment experiences. For example, there appears to be little reference to the canal style land developments where entitlements were adjusted so that lots on the water facing side of the road did not pay twice the cost of body corporate management or access road maintenance merely because they had a water view. I have seen no reference to schemes where lots had been changed from commercial to residential use without the resulting cost impact on the body corporate having been recognized. I have seen no reference to the townhouse schemes that were registered with a mix of GTP and BFP lots and in which all the lots paid identical levies but only BFP lots were maintained by the body corporate. In many of these schemes the majority of the lot owners were actively seeking to obtain an adjustment order because the inequity was obvious and the community disruption it was causing otherwise insolvable. The need for a adjustment order was normally because people were disputing exactly what the entitlements should change to, not if a change was required.

Not surprisingly, the public discussion has also focused on the extreme end of the levy adjustment range (with the amount quoted not always consistent with our knowledge of the facts).

Finally we note that much of the public discussion appears to have been based on misinformation or misconceived perceptions about:

- the lot type, financial circumstances or lifestyle choices of the people initiating adjustments – we saw applications lodged by pensioner two or three bedroom unit owners over the objections of the penthouse owner;
- the extent to which adjusted contributions varied between lots (with many people

appearing to incorrectly believe that entitlements all became equal); and

- the extent to which the factors that they assumed would affect the body corporate expenses actually did so.

In our 2009 discussion paper submission we provided a detail analysis of the impact and equity of the contribution entitlement adjustment process as it then applied. We set out the reasons why we believe that a mechanism to put in place equity based contribution schedules is important for the long-term viability of many schemes. We also addressed many of the adjustment stereotypes in greater detail. We would be happy to provide the Committee with a copy of this paper if they wish to review these points in greater detail. We have assumed that our current comments are more appropriately focused on the areas of legislation being directly changed by the 2012 Bill.

This has been a drawn-out and fluctuating policy debate. In our opinion, attempting to judge the merits of the proposed Bill based on its short-term impact on a specific group of people is unlikely to ensure the best long-term policy outcome.

In our 2010 submission I stated,

As a matter of principle we are strongly opposed to the concept that previous adjustment orders can be automatically overturned without any regard to how inequitable or legally non-compliant the original schedule may have been.

Whatever the merits of the original policy decision to allow contribution entitlements to be adjusted, the lot owners who exercised their legal right to apply for an adjustment of the contribution entitlements did so in good faith and with a reasonable expectation that, having expended the effort and expense and having convinced an independent hearing party of the merits of their case, they would obtain the specified outcome. Indeed the 2003 amendments to the Act clarifying and simplifying the adjustment process along with the accompanying government press statements encouraged many lot owners to proceed with an application. The lot owners who took up this option are no more “evil” or deserving to suffer financial loss than any other lot owner. Nor are they any different in principle to those lot owners who have sought an adjustment of their interest entitlement schedule in order to obtain a more equitable liability for council rates and insurance premiums and whose adjustment rights are not proposed to be either terminated or reversed.

The proposed reversal of the contribution entitlement adjustment will simply exacerbate the perceived problem by increasing the contribution entitlements for many new lot owners who were neither involved in the original application nor aware that it had occurred. Contrary to popular perception it isn't just penthouse owners whose levies were reduced and a substantial number of adjustment schemes did not include a penthouse. We have done a brief review of

the sales records for a number of the schemes adjusted between 2000 and 2005 and this indicated that, averaged across the schemes we reviewed, there would be at least as many new lot owner's whose levies go up as there would be original lot owners whose levies go down as the result of the entitlements reverting.

We find it particularly difficult to accept the reversion of orders made for post 2003 amendment schedules. As discussed at point 3.6, these adjustment orders were the result of the developer failing to comply with the clearly stated requirements of the legislation and lot owners in identical circumstances will be able to continue to apply for an adjustment order provided that the subject scheme was registered after the proposed amendments. There is no constancy or logic in the apparently arbitrary decision that people in schemes registered before date "X" should lose their existing rights but people in the same circumstances after that date can retain them.

In order for any system of legal administration or governance to work effectively the people operating within the system must do so with a basic level of confidence about how that system will function. The proposed reversion of existing adjustments fundamentally undermines that confidence. In our opinion, if the government has decided to change its policy on the issue of contribution entitlement adjustments it should do so by simply drawing a line in the sand and halting any further adjustment applications.

Our observation of the operation and impact of the reversion process have confirmed these initial opinions.

### ***2.1 The reversion process impacted lot owners not party to the original adjustment process***

Lot owners disadvantaged by an initial adjustment of their contribution entitlements often argued that they, along with all the other lot owners, purchased with a certain understanding of what their levy liabilities would be and that they should be entitled to rely on that understanding to prevent the proposed amendment. We are not convinced that this should be a decisive argument. But to the extent that it is a relevant consideration, it no longer always supports the case made by the 2012 Bill's opponents.

When contribution entitlement schedules have been reverted, many of those disadvantaged were new owners who had no knowledge of the scheme's contribution schedule history and were not personally disadvantaged by the original adjustment. This was equally true of many of those advantaged.

There was a gap of approximately nine years between the first contribution adjustment orders being made and the reversion legislation coming into effect in 2011. As a result, by 2011 a significant proportion of the lots in early-adjustment schemes had been purchased post adjustment. Our 2010 sample review suggested that in early-adjustment Gold Coast tower schemes there could have been an

ownership change of sixty percent or greater. This was consistent with Gold Coast rental accommodation lots having an average ownership length of around three years during much of that period. In more recently adjusted schemes, the turn-over percentage of pre-adjustment owners would be much lower. However, for the reasons discussed later, in these schemes public policy considerations may provide greater justification for not reverting entitlements back to their pre-adjustment form.

The time gap between the 2011 reversion legislation coming into force and the date on which the currently proposed amendments were announced is much shorter. Consequently, the pool of new owners who might be effected by the proposed adjustment reinstatement is comparatively small. We recommend that consideration (and potentially enactment) of this Bill be expedited in order to minimize the number of new lot owners potentially disadvantaged.

## **2.2 Proposed amendments' impact on community and consumer protection system**

A number of the adjustment schemes that are currently featuring prominently in the reversion debate had original contribution entitlement schedules that were registered after the Act was amended in 2003 to clarify the application of the adjustment provisions and to require all new contribution entitlements to be set using the equity principle. For example, the first Community Management Statement for Q1 was registered in 2005.

In these schemes in particular, suggesting that lot owners who used the Act to obtain an adjustment order were taking advantage of a 'black hole' in the legislation is taking 'political spin' to the extreme.

In our 2010 submission regarding the then proposed *Body Corporate and Community Management and Other Legislation Amendment Act 2011* I stated,

I disagree with the abolition of amendment applications in principle and strongly disagree with the reversion of entitlements where an application has previously been made. However, I would accept the amendments as simply the triumph of a different viewpoint if they were applied consistently. But, this is not the case. I can see no justice or equity in this proposal as it applies to schemes registered after the introduction of the BCCMA and in particular, schemes registered after the 2003 amendment of the Act. (For pre BCCMA schemes this criticism of inconsistency is not applicable.)

The owner of lot in a scheme registered after the section commences will be able to apply to a specialist adjudicator or QCAT for an amendment of the contribution entitlements, if the schedule was calculated using the *equity principle* and they believe that principle was incorrectly applied. The definition of the *equity principle* and all the provided instruction about how it is to be calculated, documented and applied are essentially identical to the current calculation methodology in the BCCMA; as is the method of application for the adjustment and the process and criteria that the hearing party must apply. By contrast, in a scheme registered

after the equivalent provisions of the BCCMA came into force but prior to the commencement of the amendments, a lot owner will no longer be able to apply for an adjustment on the basis that the mandatory equity principle was not correctly applied, and if they have already done so, that decision can be automatically overturned regardless of how non-compliant the original schedule was.

Contrary to popular myth, at the time many adjustment seeking lot owners entered a purchase contract for their lots they did not know, and could not reasonably be expected to have known, that they would be required to pay an inequitable proportion of the levies. The contract disclosure provisions only told them what their lot's contribution entitlements were to be and the proposed levy amount for their lot. It was not until later (often after the building was constructed) that they could compare what they were paying with what other lot owners were paying for different lots in the building and gross inconsistencies with the equity principle became obvious.

We saw blatant examples of developer non-compliance, such as identical contribution entitlement and market value based interest entitlement schedules that were accompanied by CMS explanatory statements that confirmed market value as the basis on which the contribution entitlements had been set. In other examples, the developer intentionally manipulated the contribution schedule to advantage lots in which they expected to have an ongoing interest. In all of these cases, a resolution without dissent to correct the non-compliance was never going to be a realistic option.

Regardless of anyone's personal opinion about the basis on which contribution entitlements should be set – the simple fact is, these entitlement schedules did not comply with the requirements of the law. All purchasers, when buying in, had the right to trust that what they were buying into would be a fully compliant funding system. Those who familiarized themselves with the strata system would have known that in the event of a major breach of this trust they could rely on the adjustment provisions in the Act to obtain equitable redress. We accept that many disadvantaged lot owners were not aware of the legal potential for an adjustment. But we question if this does not justify reviewing the public education / information systems rather than the adjustment system.

When adjustment orders were made for schemes registered after the 2003 amendment they were almost always made on the basis that the Court determined that a developer had failed to meet the basic requirements of the legislation. To the extent that certain owners were advantage by those adjustment orders, the advantage was designed to move the owners into the financial position in which they should always have been, had the original entitlement schedule been correctly registered.

Reverting the adjusted contribution entitlement schedules for post 2003 amendment schemes effectively voided the consumer protection mechanisms provided for lot owners disadvantaged by developers breaching the Act. It was our experience that in the period between 2007 and 2010 a substantial and increasing proportion of new adjustment orders (by the end over of 50% of the major

adjustment orders in which we were involved) related to schemes registered after the 2003 amendment. Many adjustment applicants were, appropriately, recommended to investigate the contribution entitlement adjustment system by the Office of the Commissioner for Body Corporate and Community Management. Having dedicated the necessary time and funds to obtain an adjustment order, they are now both out of pocket for the adjustment expenses and back to paying what the hearing bodies have independently determined is a legally non-compliant and inequitable proportion of the levies.

It is unfortunate other owners were disadvantaged by the adjustment order and would potentially be put back into that position of disadvantage by an adjustment reinstatement. In an ideal world it would be possible to scrutinize every contribution schedule before registration or force the developer to pay compensation to disadvantaged owners. But in reality we don't believe either of these are practical options.

As a matter of good policy development we ask,

- What is the point in regulating the manner in which contribution entitlements are set, if there is not to be a mechanism for ensuring compliance with that regulation?
- If it is appropriate to provide lot owners in schemes currently being registered with a consumer protection (adjustment) mechanism for when there is gross non-compliance with the Act, how do we logically justify reverting orders previously made to provide the same consumer protection?
- If members of the public cannot rely on the consumer protection advice and mechanisms provided in the legislation at the time they take an action, what can they rely on?

In our opinion, as a proportion of lot owners in post 2003 registered schemes are to be disadvantaged by whatever decision Parliament now makes, priority should be given to those lot owners seeking to obtain entitlements that are consistent with the requirement of the Act.

### ***2.3 Recommendations in relation to proposed amendments***

Section 47AA While we agree that it is desirable to clarify who has the right to hear disputes related to, or arising from, a section 47A resolution without dissent, we think that Section 47AA in its current form may create as many interpretative problems as it solves.

It seems reasonable people who owns a lot at the time when a amendment resolution is voted on, should be expected to vote "No" to the resolution if they believe that the proposed entitlements do not meet the requirements of 47A(3)(a) or (b), depending on which is relevant. This opposing vote would then block the change in entitlements from proceeding. Either the original sponsor of the motion or the opposing lot owner would than have the option of changing the proposed entitlements to address these

concerns and call for a new vote. (If the scheme for which the vote is being taken was registered after the 2011 amendments a losing lot owner can also seek an adjustment order.)

We can think of very few instances where (other than perhaps where a mortgagee has exercised their right to vote on behalf of the lot instead of the owner) a lot owner should not have had either a reasonable opportunity to vote on the resolution without dissent or an opportunity to seek an procedural order to ensure their vote is counted.

There does not appear to be any time limit on how long after the resolution without dissent the eligible lot owner may seek a section 47AA(2) order. Is it intended that as long as a lot owner at the time of the vote remains the owner of that lot, they will permanently have a right to seek an order under section 47AA? For reasons already discussed above, the impact of such an ongoing right on subsequent lot owners would be highly undesirable.

We assume that there are experienced based reasons to believe that lot owners may not be able to exercise a vote. If this is not the case, we suggest that it may be more appropriate to simply state the contents of sections 47AA (4) and (5).

On initial reading, we could understand if people believed that section 47AA gives an owner who would not otherwise have the ability to seek an adjustment order under section 47B, the ability to seek a full adjustment order. When read in conjunction with section 47AC it is clear that this is not the case. However, given the extent to which people have recently used QCAT's resources for applications based on interpretations that were not supported by the legislative context, we highly recommend the inclusion of a note at the end of 47AA(3) to clarify that the order is only to retain the pre-resolution entitlement schedule.

Section 47B(2)(b)As a matter of principle, we strongly disagree with this amendment which effectively limits 47B(2) adjustment applications to the originally registered entitlement schedule, by preventing an application in post 2011 amendment schemes once the body corporate has passed a motion changing the original entitlement schedule in any way. This is a very major policy shift that is not referred to in the press releases, or explained in the accompanying Explanatory Notes. We seriously doubt most people associated with body corporate developments are aware this amendment exists!

If it is the intent that section 47B(2)(a)(i), provide a consumer protection mechanism if developers inappropriately set the initial contribution schedule, then the following sections (ii) and (iii) do not appear appropriate. An order made under section 47AC could result in an already registered resolution-without-dissent schedule being



reverted back to the developer's original contribution schedule. It seems unreasonable that a lot owner could be prevented from seeking redress for blatant developer non-compliance, simply because they supported a consensus seeking resolution-without-dissent (that may not have fully rebalanced their own disadvantage) and this was successfully challenged post registration. Legal advisors would discourage lot owners from seeking to obtain a resolution without dissent before requesting an adjustment order, as they could never be certain that the proposed entitlement schedule would be fully endorsed by a hearing party. It could effectively create a 'race to lodge' with some lot owners racing to obtain an adjustment order before a new resolution without dissent based entitlement schedule could be registered. If the section 47(2) adjustment application is made before the newly voted entitlement schedule is registered what happens?

This policy would also put QCAT and specialist adjudicators in an invidious position. Normally in an adjustment hearing they have the ability to review all the facts and vary the requested contribution schedule, if appropriate, before making an adjustment order. The orders referred to in section 47AB(2)(ii) and (iii) do not mean that the existing contribution entitlement schedule has been judged legally compliant – merely that their proposed replacement is judged not to be. Under section 47AA(3) the hearing party can only determine whether or not the changed entitlements are consistent with the relevant deciding principle. Finding that the new entitlement schedule is not fully consistent with the relevant deciding principle could result in far grater inequity by preventing any future adjustment order to rectify an even less consistent developer's schedule.

If this policy change is to be implemented, we believe that 47B(2)(a) should refer to a resolution passed under section 47A that has not been subject to an order made under section 47AC.

Sections 403 & 404 We concur with many others that it is desirable to include maximum time frames for sections 403(2), 403(4), 404(2) and 404(4). We know from first hand observation of both the initial adjustment process and the current reversion process that a small percentage of bodies corporate will seek every opportunity to block and delay the process.

However, if it is appropriate that the body corporate seek external assistance to determine if, and how, the last adjustment order entitlements for the scheme should be modified, it is important that the time frame allows this to happen. As we can state from our own experience, it can be very difficult to identify a specialist consultant,

obtain committee consent for their quote, commission their advice and obtain their report within 30 days. Most specialist consultants and lawyers are not available to start work on your advice the day you inform them of your intention to proceed with their engagement. We think that the 60 day period for 403(3) is appropriate in order to allow a committee to integrate obviously required modifications in the section 403(3)(iii) advice – although the process could be completed well inside this time for uncomplicated adjustment reinstatements.

We believe that a limit on the section 304(4) submission period of 60 days would be appropriate, taking into account the complexity of some large, mixed use developments. In most instances a body corporate could reasonably choose to set a shorter period.

We believe that it is appropriate for there to be a maximum time for the committee's considerations under section 404(2). For the same reasons as discussed above, we think that 60 to 90 days is appropriate. If there are complex issues that require investigation and advice it is preferable that there be a reasonable opportunity for them to be undertaken now, rather than a rushed process resulting in a section 406 order.

In our opinion, the section 404(4) 90 day period for registration of the new community management statement is too long. The committee has plenty of time to determine who will physically prepare and lodge the amended CMS and to approve any associated costs before the section 404(3) decision is made. The exact numbers that will be used in the entitlement schedule are not required in order to make these arrangements. Even if these steps have not already been taken, it still should not require 90 days to have the CMS amended and lodged. When determining the maximum time limit, it is appropriate to take into account the 60 day period that lot owners have under section 406(2) to lodge an appeal application. However, there is nothing in the proposed amendments to prevent a body corporate from registering the new CMS earlier than 60 days and the prior registration of the new CMS does not prevent a section 406(2) order. It merely requires the newly registered CMS be replaced again, slightly increasing the potential cost to the body corporate. For these reasons we believe a 30 day maximum lodgment period is more appropriate. We also believe this maximum time period is more appropriate for section 407(5).

The above comments are also substantially applicable in relation to section 405.

An alternate, if the preferred choice is to maximize the efficiency of the adjustment reinstatement process in the majority of schemes, is to set shorter maximum times but

include a provision allowing the body corporate to seek a procedural order from a standard adjudicator, granting prior approval for a time extension because of exceptional circumstances.

Sections 408 To avoid the confusion currently existing, we suggest a note be included either here, or in another relevant location, to clarify to general readers that no vote of the committee or body corporate is required to authorize the lodgment of the CMS if it contains only order based changes.

Sections 410 This section could be subject to the same practical limitations that can currently apply to section 51B, if the original pre-subdivision lot's contribution entitlements are not capable of being divided in the required manner to produce a whole number. In the most extreme example, many entitlement schedules were set with one entitlement per lot and no direct division of the lot's entitlements is possible. In the context of sections 404(2) and 406(1) a practical solutions such as multiplying all the original lot's entitlements by 100 first appears possible. However, in section 51B this solution, which effects the physical number of entitlements that lots other than those created by the subdivision hold (although not the relative proportion of entitlements they hold), does not appear possible without a resolution with out dissent. This could effectively allow the body corporate to prevent the subdivision in a way not intended by the legislation. We recommend that a method for dealing with this issue be added to the Act in both section 51B and all other sections, including section 410, where the division of entitlements is required.

In addition to the above sections, we are also concerned about the blanket remove of the right to terminate a contract if important factors such as a lot's proportion of the contribution entitlements has changed after the purchase contract was entered. We recognize that owners seeking to avoid settlement for unrelated reasons have often sought to use minor changes to activate the termination provisions. But from a practical viewpoint, there is also a lot to be said for allowing people to terminate a contract if the developer has substantially changed the basis of their financial liabilities rather than relying on adjustment provisions that will also disadvantage many other lot owners to redress the situation.

### **3.0 Closing Comments**

We acknowledge that changes in contribution entitlements cause serious financial pain for a percentage of disadvantaged lot owners, although the percentage of all adjustment affected lot owners who had very large cost increases was not nearly as big as media reports might lead people to believe. In the majority of schemes in which we were involved, the adjustment created levy increase that were not significantly larger than those that could happen irregularly for other reasons such as: increases in the

caretaker contract fee, inadequacy of long-term sinking fund levies, rectification of structural defects or changes in rating methodologies. Indeed, the mandatory introduction of 10-year-plan based sinking fund levies in 1997 had a comparable impact on a much larger pool of lot owners. This observation is not intended to disrespect the difficulty caused to individual lot owners where large increases have occurred, but merely to point out that such increases were not the norm and that an expectation that levies will never be impacted by unforeseen events is not realistic.

Our long-term observation of the contribution entitlement system leads us to believe that it is more important to ensure that the underlying contribution entitlement schedules are equitable and sustainable for the future life of the scheme, than to focusing on the understanding, expectations or financial standing of individual lot owners who may have acquired lots at a particular point in time.

We make a similar observation about the importance of protecting people's confidence in and reliance on the court and adjudication systems.

The equity principle continues to be one of the deciding principles on which contribution entitlement schedules can be based. The original contribution entitlement adjustment orders reflected the Court's / Tribunal's / specialist adjudicator's considered judgment regarding the extent to which the original contribution schedule needed to be adjusted in order to be consistent with this deciding principle. To arbitrarily revert these adjustment orders without any form of judicial review permanently entrenches contribution schedules that advantage certain lot owners at the expense of others in a way that formal testing of the evidence has determined to be inappropriate. For these reasons we support the proposed amendments that prevent further reversion of adjusted contribution entitlements schedules and the reinstatement of schedules that have been reverted.

We strongly oppose the reduction of / removal of lot owner's rights to seek contribution schedule adjustment orders for post 2011 registered schemes. If this policy decision is implemented in the currently drafted form we believe that it will result in unintended and undesired outcomes.