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The Real Estate Institute of New South Wales Limited

Submission 13 August 2015

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Strata Schemes Management Bill 2015

Strata Schemes Development Bill 2015

To:

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INTRODUCTION

This Submission has been prepared by The Real Estate Institute of New South Wales (**REINSW** or the **Institute**) and is in response to the draft *Strata Schemes Management Bill* 2015 (the **Management Bill**) and the *Strata Schemes Development Bill* 2015 (the **Development Bill**).

The REINSW is the largest professional association of real estate agents and other property professionals in New South Wales. The REINSW seeks to promote the interest of members and the property sector on property related issues. In doing so the REINSW believes it has a substantial role in the formation of regulatory policy in New South Wales.

The REINSW appreciates the opportunity to provide this submission and welcomes discussion of the issues raised with the Minister and/or policy officers from NSW Fair Trading.

It is unfortunate that stakeholders have been allowed such a short period of time to review, consider and comment on some 300 pages of draft legislation. Given the magnitude of this legislative reform, REINSW would have liked to see a longer period so as to meaningfully consult with our members in preparation for this Submission.

The Institute has provided the following previous submissions in recent years in relation to the proposed strata legislation reform and issues arising from the strata legislation, copies of which are available from REINSW on request:

1. Submission on the Strata and Community Title Law Reform Discussion Paper dated 21 November 2012;

2. Submission to the Minister for Fair Trading regarding Strata Insurance and Commissions Paid to Strata Managers dated 23 July 2013;

3. Submission in response to the "Children and Window Safety" Consultation Paper dated 23 April 2013;

4. Submission on the *Strata Schemes Management Bill* 2014 dated 31 January 2014;

5. Submission on the *Strata Schemes Management Bill* 2014 dated 11 April 2014;

6. Submission on the *Strata Schemes Development Bill* 2014 dated 11 April 2014.

GENERAL

From the outset the Institute has welcomed reform of the NSW strata legislation. REINSW appreciates the enormous challenge for the law makers to create a modern system which operates in a simple and straightforward manner whilst balancing the interests of the various stakeholders. The review of this legislation needs to be carried out as part of an overarching strategy to address the ever more pressing issue of housing affordability and availability in NSW.

The Institute is pleased to see that some of the suggestions for amendment made in previous submissions by the Institute have been taken into consideration in this latest draft of the legislation. But there are numerous areas, which still fall short.

Regrettably it seems the draft legislation, if passed in its current form, will introduce additional layers of red tape and will have the effect of substantially increasing compliance requirements and the costs of operating strata schemes.

From the perspective of the strata management industry, we note the following:

- The work of strata managers has over the years significantly increased and become more complex, with more areas of compliance and responsibility being imposed on strata managers. The draft legislation introduces further areas of compliance whilst reducing the security of contractual arrangements between strata managers and owners' corporations, taking away some of the legitimate income sources for strata managers and creating an unwarranted restriction to contract freely.

- The repairs to a strata scheme are subject to the authority and instructions of the executive committee. The draft legislation imposes liability on strata mangers in respect of matters, which are not within the control of a strata manager as they are subject to the instructions of the owners corporation.

- Insurance commissions are, and historically have been, part of the overall remuneration of a strata manager and in many cases are the only source of profit for strata management companies. The proposed changes will result in the insurance brokers receiving the commission instead of the strata manager, strata levies increasing and many strata management companies closing their businesses.

From the owners' perspective, the following issues are apparent from the draft legislation:

- The additional reporting and compliance requirements in the draft legislation will result in higher strata management costs for owners.

- The (repeatedly opposed) proposals to permit tenants to be present at meetings of the owner's corporation will result in unwanted consequences for landlords, including additional costs and disputes, and will discourage investors from purchasing strata properties.

- The insurance provisions will also result in higher costs for owners as the additional reporting and duplicated disclosure obligations will require additional paperwork and expenditure for owners' corporations. In addition, strata managers will be forced to use insurance brokers, which will also result in increased costs for owners.

- The proposed changes in long-standing and well-understood terminology and processes (for example, the election of committee members) within the legislation will potentially result in more disputes.

- The failure to reflect calls by the industry for a dedicated specialised Strata Commissioner to deal with strata issues, together with the increased red tape, will result in an unworkable dispute resolution regime, costs and frustration for the parties involved.

Some further specific comments on the draft Bills follow below.

STRATA SCHEMES MANAGEMENT BILL 2015

Tenant representative

The Institute repeats its numerous previous objections to the inclusion of tenants as parties entitled to receive notices of, and to attend, meetings of the owners' corporation.

REINSW presses for section 14(3)(b), section 33, clauses 11 and 21 of Schedule 1, and other references to tenants receiving notices of meetings and attending meetings to be removed from the draft Management Bill.

This is an unnecessary intrusion into proprietors' private business by third parties having no financial interest in the investment. Landlords commonly engage an agent so the landlord

does not have to deal with the tenant directly. It will result in unnecessary additional costs being incurred by investor owners for no particular benefit and will be a cause of conflict between the tenants and those owners. There is potential for these unnecessary frictions to reach boiling point in any face to face meetings between owners and tenants. It will also act as a deterrent for investors as it will discourage the purchase of rental properties in strata buildings.

Items for first AGM

The Institute repeats its previous calls for the following important additional matters to be included in section 15 for consideration at the first Annual General Meeting:

- to change the registered address of the strata scheme on the common property title deed; and
- to consider whether the strata scheme is required or wishes to register for Goods & Services Tax.
- a motion to consider the as-built plans and specifications and other building documents from the developer.

These are non-contentious but important matters, which will result in significant costs and delays if not added, and therefore should be reflected in the draft Management Bill.

Persons not eligible for strata committees

There does not appear to be any reasonable explanation for the proposed prohibition in section 32(1)(c) for a property manager to be elected as a member of the executive committee.

It is not unusual for a landlord to be absent from the state or country but to want representation on the executive committee for their investment(s).

This proposal ignores the reality that there are strata owners who reside overseas and who in some cases own a majority or even every lot in a strata scheme. Such investors engage a strata manager to deal with the compliance issues with the strata scheme as well as a property manager to act on their behalf for rental collection and have their property manager acting as a committee member for compliance purposes in their absence.

Frequently there are circumstances where the lot owner is not resident in Australia and not a committee member and has no other representatives in the country. In these cases the property manager, who works in conjunction with the strata manager, is the most obvious party to be acting on the executive committee. This assists in expediting decisions in respect

of repairs and maintenance for the purpose of complying with the equivalent of the current Section 62.

As there is no benefit in the arbitrary banning of a property manager as a committee member, it is the opinion of the REINSW that this section should be removed from the proposed Management Bill.

Term of appointment of strata managing agents

In the current climate of encouragement of free trade the concept of trade restrictions being imposed on this or any other industry is an anachronism.

The Institute calls for the removal, or at very least, the re-drafting of section 50 in the Management Bill.

With the exception of a few very large companies held by overseas or interstate interests, the strata management industry in NSW is run predominantly as small business.

Restricting the period of contractual arrangements negates the benefits to both strata scheme owners and strata managers of being able to enter into longer term contracts and enjoy consequent economies and certainty of tenure.

The proposed short term nature of the strata management contracts invariably will promote churn in the industry. This will result in additional set up costs being incurred with different managers on a regular basis and therefore higher overall costs to owners.

It is interesting that section 68 of the Management Bill allows the possibility for a building manager to be appointed for a period of 10 years, followed by a further 10 year term.

Strata managing agent to record exercise of functions

It is not evident what section 55 of the Management Bill intends to achieve.

Strata managers make a range of decisions every day from having a light bulb replaced to lawn mowing and/or building repairs (including emergency repairs such as burst pipes) which are dealt with by work orders.

The records of the strata scheme held by a strata manager are available for all owners to access during office hours.

Prima facie there is no apparent benefit to imposing this additional and duplicative administrative burden. This will result in potential substantial cost both in time and paperwork reproduction in providing copies of already accessible records to each strata scheme.

Breaches by strata managing agent

Section 57(1) is extremely problematic as it makes a strata managing agent guilty of an offence in circumstances where the agent is acting on instructions and authority from the owners' corporation. If the owners' corporation fails to provide instructions, the necessary funds or authority or carry out any other act necessary as a pre-condition to the agent exercising their duties, then the agent is still guilty of an offence.

REINSW calls for the removal of section 57(1), or at the very least, for the insertion of a range of reasonable exceptions incorporated into this provision. The section should take into account matters (outside the control of the strata manager or strata scheme) that prevent the strata manager from discharging their delegated duty.

In relation to section 57(2), we note the exception in section 57(3)(c) however have not had the benefit of seeing the proposed regulations setting out the prescribed amount of a gift or benefit which a strata managing agent is permitted to receive.

Disclosure of commissions

REINSW queries the need for section 60 or any benefit it is intended to have in addition to already legislated requirements for disclosure of commissions.

The disclosure of expected commission entitlements is already addressed in the agency agreement at the time of execution, as required under the *Property, Stock and Business Agents Act* 2002.

Information relating to commissions, which is usually only insurance commission, is also disclosed as a standard practise in notices of the annual general meeting on the insurance papers.

The proposal of additional separate reporting proposed in this section will achieve nothing more than additional administration costs to the owners corporations with no perceivable benefit arising as a result of incurring additional administration costs.

Preparation of 10-year capital works plans

The Institute congratulated the former Government for introducing section 75A into the *Strata Schemes Management Act* 1996 which requires sinking fund plans to be prepared and which this section is proposed to replace. However, both section 80 in the draft Management Bill and section 75A of the current legislation fall short in that there is no requirements to have the plans prepared by properly qualified professionals.

As a result the situation with some schemes is that the owners resolve to adopt something like $1 per annum as their sinking fund budget and then raise special levies as work is required on the building.

Even the tax legislation recognises that buildings deteriorate over a period of time and stipulates an annual percentage as an allowable deduction for capital depreciation.

The introduction of either a percentage of the building construction cost (or estimated cost) or preparation by a properly qualified person such as a quantity surveyor would address what is a growing problem with inadequate sinking fund budgeting.

Individual contributions may be larger if greater insurance costs

The proposal in section 82 of the draft Management Bill sounds good in theory. However, implementation will depend on the conduct of insurers, who often will not advise what the difference in the insurance is as a result of the change of usage.

To remove this impediment to implementation, section 82 needs to be strengthened by requiring insurers to provide this information within a reasonable time to the owners corporation (eg within 14 days of request).

Interest, discounts on contributions and payment plans

As submitted by REINSW previously on several occasions, the provision of optional discounts by the use of the words "pays" and "paid" creates a range of difficulties with software which cannot deal with the situation after the event, particularly where there is an intervening weekend.

The words "pays" and "paid" in section 85 of the draft Management Bill should be removed and the wording changed so that the requirement is that the payment should be "received" by the strata scheme prior to the due date.

Contributions for legal costs awarded in proceedings between owners and owners corporation

In addition, to section 90 of the draft Management Bill there should be provision to enable the Tribunal to award costs against applicants where it is found that they are vexatious litigants using the Tribunal as a cheap means of the harassment of other proprietors. There should be a corresponding power for the court to award costs against a vexatious litigant.

Provision of letterbox

Tens of thousands of strata schemes already have a letterbox marked "Secretary".

The proposal in section 121 of the draft Management Bill of remarking tens of thousands of letter boxes for compliance purposes to "The Owners Strata Plan 1" etc is not only a financial burden to existing strata schemes but an unreasonable proposal given the registered address may not be the building, as is the case with most strata schemes engaging a strata manager.

With more than 80,000 strata schemes in NSW, by the time a sign maker and an installation contractor are engaged, assuming a conservative cost of $100 per letterbox, this would amount to in excess of $8 million for no perceivable benefit but a substantial cost to proprietors.

This section should be removed and left to each owners corporation to decide whether to install a letterbox or not and if not have an alternate registered address for the service of notices on the strata scheme such as the strata managers office.

Occupancy limits

The Institute notes that section 137 appears to be in direct conflict with section 139(2).

By-law resulting from order cannot be changed

Section 139(3) does not appear to enable a subsequent Tribunal to amend or repeal a by-law.

Valuations for the purpose of insurance

In relation to section 163 of the draft Management Bill, the Institute repeats its concerns expressed in previous submissions that 5 years is too long a time between valuations and that this will leave many strata schemes underinsured.

Where a building is under-insured and a substantial or total loss occurs, the insurer may choose to rely on the averaging provisions of the policy. In this event the owners corporation may become subject to the unintended consequence of being unable to pay for the repair or re-building of the common property.

In addition, most mortgagees require the building to be fully insured. Therefore lot owners with mortgages will be in breach of the terms of their mortgage.

As an illustration of a worst case scenario, in the situation where a totally destroyed building is insured for $1 million but the replacement cost is $2 million, as the building is insured for half the value it should be insured for, the insurer may only be required to pay half of the insured sum – in this case $500,000.

Public liability insurance

In relation to section 165(2), REINSW reiterates its concern that $10 million cover for public liability insurance is insufficient as this has been the minimum cover since 1996.

The prescribed amount should be no less than $20 million.

Strata managing agent to obtain insurance quotations

Section 167 is problematic for the reasons stated in detail in the Institute's submissions dated 31 January 2014 and 11 April 2004.

The additional work involved in complying with this section will result in a wider usage of insurance brokers and, consequently, higher insurance costs for strata schemes.

Production of records of the owners corporation

It is submitted that the time period of 7 days in section 182 is inadequate and should be revised at least 21 days.

It is standard industry practice for strata management offices to close for the Christmas/New Year period with the majority of the industry closing just prior to Christmas and returning in the second week of January.

Where a notice is served on or around 24th December and the office is closed the licensee is unlikely to be aware of the service of the notice until returning from annual leave which would be at least 2 and often 3 weeks after the service of the notice.

Accordingly 21 days' notice under this section would be an appropriate time which is more in keeping with the standard operational activities of the strata management industry.

Building defects

It is submitted that the Management Bill should be primarily concerned with the management and administration of strata schemes. The inclusion of matters dealing with building defects complicates the strata schemes management legislation. The Institute is of the view that building defects should be dealt with in separate dedicated building legislation with a specific chapter relating to strata buildings.

All new buildings (whether torrens, strata or community title) should be subject to statutory warranties as a means of providing protection to consumers (similar to those applicable in respect of consumer products). These statutory warranties should parallel the consumer guarantees under the *Australian Consumer Law* (being Schedule 2 of the *Competition and Consumer Act* 2012 (Cth)).

The confusion around home building compensation insurance should be clarified. Frequently consumers believe that it is a "first resort" scheme, rather than a "last resort" scheme.

It is concerning to note that in recent years there appears to be a disconnect between the builder and the end user, as was found in the case of *Brookfield Multiplex Ltd v the Owners Strata Plan No 61288* (2014) 88 ALJR 911. In that case the High Court held that the builder did not owe a duty of care to the owners corporation. Some of the reasoning of the Judges was based around the existence and terms of the contract between the builder (Brookfield) and the developer (Chelsea). This situation needs to be remedied by the prescription of a duty of care to the end user by all parties involved in the construction process.

It is noted from section 193(3) that Part 11 relating to building defects does not apply to buildings which are subject to home building compensation insurance.

The provisions in the draft Management Bill will have the effect of introducing another layer of red tape, confusion and potential for disputes as to whether or not particular buildings are subject to Part 11. Smaller developers may also be disadvantaged due to the additional funding required for the building bonds.

If the intention of the building defects provisions is to truly protect consumers, then:

- the provisions should apply to all new buildings without exception;
- there should be prescribed consumer warranties in relation to all new building work;
- the provisions should operate fairly and equally to all builders and developers regardless of their size;
- each person in the construction chain should be held accountable to the owners corporation and purchasers of lots; and
- the builder and developer should be required to hand over all building documents including "as built" plans to the owners corporation and the agenda for the first annual general meeting should include an item for consideration of the building plans.

From an industry perspective this is another area (like asbestos), which is a matter strata managers are potentially being made liable for, but no training is offered or required to address these additional responsibilities. At the same time, strata managers' legitimate sources of income are proposed to be substantially diminishing under the proposed new legislation.

Dispute resolution

The Institute reiterates its previous calls for a dedicated specialised Strata Commissioner to be established to deal with the complex issues that arise under strata legislation.

The parties to a dispute should be entitled to be legally represented. Frequently legal representation can make it quicker and easier to distil the issues and direct the Tribunal to the relevant legislation.

The requirement for compulsory mediation in section 225 of the draft Management Bill should be removed. It has been the experience of REINSW members that the regime has been unsuccessful in achieving early resolution of disputes and has generally only resulted in the postponement of decision being made in relation to disputed matters.

The legislation needs to address the issue of vexatious applicants who often make successive applications to the Tribunal in the same matter, thereby resulting in the owners corporation incurring unnecessary costs. The Institute submits that the Tribunal should be provided with powers similar to those of the Supreme Court to refuse to hear vexatious applicants and to make an order that those applicant pay the costs of the owners corporation.

Proxies

It is the Institute's understanding that the purpose of section 27 of Schedule 1 of the draft Management Bill is to prevent a developer from controlling votes at meetings of the owners corporation in a manner which would enable the original proprietor to benefit from the voting. An example of this would be where a maintenance contract benefiting the developer is executed or exclusive rights of usage by-laws are passed for the benefit of the original proprietors.

It is submitted that the section should be retained, but limited to the specific objects stated above.

The section as drafted will be a potential impediment for future owners after the developer has exited the property. For example an individual proprietor might exchange contracts for sale of their lot and the annual general meeting occurs between the time of exchange and time of settlement.

The incoming purchaser (with the consent of the vendor) may wish to be able to be represented at the meeting for items that may have a direct or indirect bearing on the subject lot (eg planting trees in front of the lot that at a later date would obscure views or an exclusive rights of usage by-law grating a right for a vehicle to park directly outside a ground floor bedroom window). Therefore the purchaser may wish to contract with the vendor to

vote in a certain manner or to arrange for a third party to be appointed proxy to vote on their behalf.

In circumstances where neither the vendor nor the incoming purchaser are able to attend the meeting, section 27 would prevent the vendor and the purchaser from being represented at the meeting.

For the reasons stated above, section 27 of Schedule 1 should be limited in application to the original proprietor until expiration of the initial period.

STRATA SCHEMES DEVELOPMENT BILL 2015

Strata renewal process for freehold strata schemes

The Institute is pleased to see that some of the amendments suggested in the Institute's earlier submission in relation to the proposed renewal process for strata schemes have been incorporated in Part 10 of the draft Development Bill.

REINSW notes with concern that the definition of "required level of support" still refers to 75% of the lots rather than unit entitlements. The definition is inconsistent with the concept and terminology used in the draft Management Bill, which in section 5 states that a special resolution of an owners corporation is where at least 75% of the value of votes cast at a general meeting are for the resolution and, for the purpose of determining a special resolution, the value of a vote in respect of a lot is equal to the unit entitlement of the lot.

It is quite possible for one owner to own 25% or more of the total unit entitlements but that might equate to less than 25% of the total units comprising the scheme.

For consistency, the Institute suggests that the definition of "required level of support" be based upon unit entitlements rather than ownership of units in the scheme.

It is submitted also that there should be provisions in the legislation dealing with the owners corporation raising funds for the purpose of considering and dealing with strata renewal proposals and winding up the strata scheme.

It is concerning to note that whilst Part 10 refers to "strata renewal", the application of the Part is not limited to old or dilapidated buildings which are nearing the end of their useful life. Considering the drastic and potentially devastating consequences this Part could have on dissenting owners, it is submitted that these provisions should be tied to the age and condition of the building.

Whilst Part 10 prescribes the mechanism for dealing with strata renewal proposals and how owners are to be compensated in the event of a collective sale, there are matters which are not addressed in the draft, including:

- what arrangements will be made to relocate residents or business owners to alternative comparable premises and, in the event that it is not possible to do so, how owners will be compensated;
- there is no provision for legal assistance for owners to properly consider their options in order to make a decision;
- there is no requirement for a re-housing or (or in the case of businesses, relocation) plan during and after redevelopment to be presented and considered at the same time as the strata renewal plan is being considered.

It is submitted that the above matters should be addressed in the legislation.

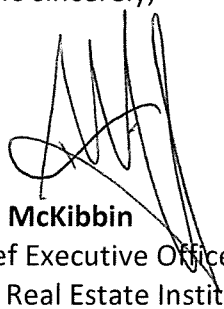
CONCLUSION

The Institute welcomes a reform and modernisation of the strata schemes management and development legislation. However such reform should result in a fair, simple to use system which takes into account the interests of its various stakeholders.

As noted above in this Submission, REINSW feels there are numerous areas in the draft Management Bill and the draft Development Bill, which still need to be addressed. In addition, the reform should take place as part of a holistic review of the housing system in NSW.

REINSW appreciates the opportunity to provide this Submission and would be pleased to discuss it further.

Yours sincerely,



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