The problem of body corporate lot entitlements

By Gary Bugden*

A recently released Queensland Government Discussion Paper on Body Corporate and Community Management seeks public comment on a number of important issues affecting home unit owners.

One issue in particular, the allocation and adjustment of lot entitlements, is likely to be sensitive and difficult for Government to deal with. This article examines the issue in an historical and cross jurisdictional context and explores possible solutions.

Historical position

Before 1997 each lot or unit in building unit and group title complexes had a single lot entitlement. These determined a lot owner's liability to pay levies, rates and taxes; their shareholding in common property and entitlement to vote on a poll at general meetings of the body corporate. In the case of home units there were no rules about how these lot entitlements were to be allocated. For most villas and townhouses they had to be allocated according to respective unimproved land values.

There were many examples of lot entitlements in home unit buildings being allocated unfairly. Once they were allocated there was little prospect of having them changed. It was therefore not surprising that in 1997 when the Government introduced the new community titles legislation that it decided to change the law relating to lot entitlements.

The 1997 changes

That legislation introduced two types of lot entitlements –

- Interest schedule lot entitlements
- Contribution schedule lot entitlements.

The interest schedule lot entitlements determine a lot owners' shareholding in the common property. They are also used to determine liability for certain rates and taxes, as well as entitlements when a scheme is terminated. There are no rules about how they should be allocated by a developer, but they usually reflect the respective values of the lots.

The contribution schedule lot entitlements determine a lot owner's liability for levies and the value of their vote on a poll at general meetings. Until recently, there were no rules about how they should be allocated by the developer. As a result, various approaches were used to make allocations and many allocations were unfair. Last year the law was changed to require them to be equal, except to the extent to which it is just and equitable for them not to be equal.

Buildings in existence when the 1997 changes occurred had their single schedule of lot entitlements converted to the two separate schedules. The lot entitlements in each of the new schedules are exactly the same as the lot entitlements in the old schedule. Any inequities were therefore preserved.

Adjustment

To deal with instances of unfairness, the 1997 legislation also introduced the right for a lot owner to apply to the District Court or a specialist adjudicator for an adjustment of one or both schedules of lot entitlements. Any adjustment to the interest schedule must be made having regard to the respective market value of the lots unless it is just and equitable to do otherwise. Any adjustment to the contribution schedule must result in the entitlements being equal, except to the extent that it is just and equitable for them not to be equal.

Other changes to the legislation last year reinforced the intention of the legislature that, except in an appropriate case, the contribution schedule lot entitlements must be equal. This intention was recognised, and to some degree reinforced, by a decision of the Queensland Court of Appeal earlier this year in *Fisher v. Body Corporate for Centre Point Community Titles Scheme 7799 [2004] QCA 214*.

A number of Court and specialist adjudicator decisions have resulted in contribution schedule lot entitlements being adjusted. In all cases this results in some lot owners paying more in levies while others pay less. Penthouse owners are often advantaged by adjustments to the detriment of owners of smaller units lower down in the building. Of more significance is the potential for hundreds or thousands more applications to be made in the case of older buildings, resulting in substantial changes to the levies paid by huge numbers of unit owners. It is therefore not surprising that this issue of lot entitlements is a matter of debate and dissention within the home unit community.

The problem for Government

The problem for Government is how to deal fairly and sensibly with the issue. An examination of the major jurisdictions within the English speaking world on the approaches to allocation of lot entitlements (or their equivalents) in condominiums, co-operative and homeowner communities is useful. It shows that all approaches are inevitably based on one of a few well settled options –

- Area
- Value
- Specific circumstances (i.e. just and equitable)
- Arbitrary allocation (by the developer).

Where the last 2 are used it is not unusual to find allocations based on equality. In the case of all options it is not unusual to find unfair allocations.

There are problems with all options. Area results in unfairness where a large balcony, excess car parking or courtyard areas are part of the lot. Value is unfair because it is susceptible to change (e.g. a unit with a spectacular view is "built out" while units above retain their views). It is also difficult and expensive to prove in proceedings for adjustment.

Justice and equity is a subjective test and one need look no further than past Court and specialist adjudicator decisions for clear evidence of this. Justice and equity is also difficult and expensive to prove. Again past decisions is evidence of this. Expert witnesses will usually be required by each party to conduct a thorough analysis of body corporate expenditure and the relationship of individual items of expenditure to the respective units. Those witnesses will usually give evidence and be subjected to the scrutiny of the Court or adjudication process.

In the end there will rarely be uniformity because of the subjective nature of the whole exercise. It is also unlikely that the legislature will be able to spell out the process in sufficient detail to achieve an acceptable degree of uniformity.

So far as arbitrary allocation by the developer is concerned, we have already had our own experience with that approach and the current provisions have their genesis in that very option.

The argument for equality

In the review leading up to the 1997 legislation equality was identified as the best and fairest solution. Indeed, for new buildings there are sound arguments in favour of equality unless, in the circumstances of a particular building, it is just and equitable for there not to be equality. In most buildings all common facilities (including lifts) contribute to the common good, even if they are not used equally by everyone. For example –

- A valuable penthouse and higher units potentially influence the value of lower units.
- Although a gymnasium or pool may not be used by a particular unit, those facilities enhance the value of that unit.
- The roof of the building shelters more than the penthouse.
- The gardens and landscaping enhance the value of the building as a whole despite the fact that the visual impact on the lower units may be greater than on the penthouse or higher units.

Furthermore, the size of a unit or its number of bedrooms is not necessarily indicative of its "usage" of common property and services –

- A 2 bedroom unit may house the same number of people as a 4 bedroom unit.
- A penthouse may be someone's holiday home that is rarely used.
- One 3 bedroom unit may be occupied by a family of 5 while another identical unit may be occupied by a little old lady.

Clearly, it is not possible to have regard to these and other similar possibilities. But they do serve to illustrate that there is an argument that, at least in the case of new buildings, equal contribution schedule lot entitlements, in the absence of special circumstances, are a fair approach. Having said that, it must also be recognised that it is an approach that departs from the principle well entrenched in Australia's taxation systems, namely that the wealthier people in the community should pay for its poorer members. Applying this principle, owners of more valuable units should pay more than owners of less valuable units – a proposition that, in itself, often proves inequitable.

The goal posts moved

The problem is more acute in the case of buildings existing at the time of the 1997 changes. Lot owners purchased their units knowing what their entitlements were and how they attracted liability for levies. Then came the 1997 amendments followed by an application to adjust their contribution schedule lot entitlements. Suddenly, they are confronted with the prospect of having to pay much higher levies. They naturally see that as unfair, particularly as those who stand to gain also purchased their units in full knowledge of the proportion of levies they were required to pay.

Other States

So, what can we learn from the other Australian states? Unfortunately, apart from the fact that respective value of lots is the preferred criteria, not much! In New South Wales there is only one schedule that determines the same rights and obligations as the 2 Queensland schedules. The way in which entitlements are originally allocated is not regulated. However, the Consumer, Trader and Tenancy Tribunal may make an order reallocating the entitlements if it considers that they were unreasonable at a relevant point in time. When considering unreasonableness, the respective values of the lots are the predominant consideration.

In Victoria the original allocation of lot entitlements on a single schedule is unregulated and there is no process for future adjustment. In South Australia, the entitlements must be allocated on a single schedule according to respective values of lots at the time the plan is registered but there is no mechanism to adjust them other than pursuant to a unanimous resolution. In Western Australia, the position is substantially the same as it is in South Australia.

Where to in Queensland?

The main options for Queensland now appear to be –

- Stay with the equality approach and provide clearer guidelines for the Courts and specialist adjudicators.
- Revert to the "respective values" approach.
- Have a split system where new schemes are treated differently to previously existing schemes.

Under a split system, schemes in existence, say when the 1997 amendments took effect, would only be liable to adjustment if there were clear inequities in the original allocation and the adjustment would not necessarily be based on the principle of equality. Schemes that came into existence after those amendments, plus new schemes, would be subject to the equality principle, which would be more clearly defined for the benefit of the Courts and specialist adjudicators.

The challenge for the home unit community is to carefully consider the options it proposes to Government during the current consultation process and the likely consequences of those options. The challenge for Government is to –

- Make the best choice possible
- Support that choice with clear guidelines
- Accept the fact that such choice will be neither ideal nor popular.

The discussion paper, *Body Corporate and Community Management: into the 21st Century* is available on the Department of Fair Trading web site at www.dtrft.qld.gov.au.

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* Gary Bugden is a leading authority on strata titles. He is the author of numerous books and papers on the subject and the former national editor of *Australian Property Law Bulletin*.