Reform of Lot Entitlements in Queensland

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In its approach to lot entitlement reform the Queensland Government, consistent with its recent changes to the Regulation Modules under the *Body Corporate and Community Management Act 1997*, appears about to throw the baby out with the bath water.

The proposal is to revert to the pre-1997 arrangements for allocating lot entitlements, although it is not clear at this stage whether the dual system of "Contribution Schedule lot entitlements" and "Interest Schedule lot entitlements" is to be replaced by a single schedule.

The Minister's explanation

In a recent Press Release of 19 February 2009 (sic) the Minister, The Hon Peter Lawlor MP stated:
"*... lot entitlements in a 'standard format plan' - such as some townhouse-type complexes - would be set in proportion to the unimproved value of the land. For a 'building format plan' - typically used for multi-storey developments - developers will have to set lot entitlements by some legislative guidelines but there could be scope for them to factor in market conditions and values of property*."

According to the Minister, the Government is trying to achieve a situation where the owner of a ground floor one bedroom unit would have lower levies than a larger unit with better views and higher value. The Government believes this will be a fairer system for **most** unit owners.

All this suggests that Queensland is to revert to the old value based one set of lot entitlements. This is not only "winding back the clock", as some commentators have pointed out, but it is also a display of short sighted electoral knee-jerking at its worst.

The options

With some 50 years experience behind us with lot entitlement allocations, spanning many countries, the main options for allocating lot entitlements are very clear. They are:

1. A totally unregulated environment (as existed in Queensland under its original *Unit Titles Act 1964*).
2. An equal allocation across all lots.
3. Value of the respective lots as at a fixed date (usually the date of registration of the plan).
4. Area of the respective lots.
5. An allocation based on "just and equitable" principles (usually interpreted to mean in proportion to the extent to which individual lots draw upon the financial resources of the body corporate).

The approach in the *Body Corporate and Community Management Act 1997* ("**BCCM Act**") was for equal allocation across all lots (option 2 above) unless it was "just and equitable" to

use another approach (option 5 above). The following examination of the various options demonstrates that each one has its problems and, while there is a best practice approach, there is no perfect solution.

The unregulated approach

This approach (option 1 above) relies upon the developer deciding the best way to allocate the lot entitlements. Experience under the original Queensland *Unit Titles Act 1964* shows that "area" and "value" were the most common approaches used, although there existed numerous examples where developers made the allocations to serve their own interests at the expense of other lot owners. The most common example of this was the allocation of a nominal entitlement to a penthouse that was to be retained by the developer - thus ensuring low levies for the penthouse when compared to all other lots. This approach has generally been discarded by all major jurisdictions around the world.

Equal allocation

This approach (option 2 above) assumes that all lots on a plan derive exactly the same benefit from their membership of the body corporate. The vast majority of Queensland cases where lot entitlements were re-allocated following a careful cost/benefit analysis by a Specialist Adjudicator or the District Court provide overwhelming evidence that this is not always the case. Indeed, the results in those cases support an argument that equal allocations are unfair in most instances.

Respective values

This approach (option 3 above) does not seek to achieve an equitable outcome. It applies the principal that those most able to afford to pay should pay the greater proportion. The first problem is that the value of the lot is no indicator of capacity to pay. A wealthy bachelor in a ground floor one bedroom unit may have greater capacity to pay than a widowed pensioner in a two bedroom unit higher up in the building who is asset rich but income poor. The second problem is that of changing values. This approach to lot entitlement allocation, of necessity, must use a "base date" at which values are determined - usually the date of registration of the plan. However, respective values change over time in a range of circumstances, including improvements to lots (such as major expensive renovations) and views or amenity being impeded by adjoining development.

Area

This approach (option 4 above) at first sight appears to be a reasonable alternative. However, an examination of the cases decided by the New South Wales Strata Titles Board and subsequent Tribunals for re-allocation of unit entitlements under section 119 of the old *Strata Titles Act 1973* (NSW) and section 183 of the *Strata Schemes Management Act 1996* (NSW) would suggest otherwise. In the 1960's and 1970's it was common in New South Wales for unit entitlements to be allocated on an area basis. The inequity of this approach led to many of the cases referred to above. A common complaint was that a large 1 bedroom unit was subsidising a 3 bedroom unit of similar size where the 3 bedroom unit had higher occupancy and therefore higher usage of common property. Balcony size, as a proportion of the total area, was another common issue. A small 1 bedroom ground floor unit with a huge balcony or courtyard often had a similar unit entitlement to a 3 bedroom unit higher in the building.

Just and equitable

This approach (option 5 above), by its very nature, produces the most equitable outcome. It involves an examination (on a line by line basis) of all costs associated with the body corporate and the allocation of those costs to the various lots based on the most appropriate formula. Relevant formulae includes allocation by area, equally, number of bedrooms or actual calculation (e.g. square meters of glass in a lot for window cleaning costs). In very general terms, the allocations are then totalled and reduced to a percentage or other rounding to come up with the actual lot entitlement. This exercise is undertaken by a cost analyst or quantity surveyor and although the methodology is sometimes subject to argument, the outcome is usually the most equitable reasonably obtainable.

The Queensland problem

If, in theory, the Queensland approach produces the most equitable outcome, then what is the problem that has lead to such a dramatic proposal for change by the Queensland Government? The answer is not clear from the Minister's Press Release, although it is not difficult to see where the Queensland reforms of 1997 went wrong. The mistake was the inclusion in the BCCM Act of the right for any lot owner to make an application to have the lot entitlements changed to conform to the new allocation principles. These applications were almost inevitably successful and usually resulted in a substantial shift in the distribution of liability for levies. Those who were on the receiving end of higher levies (many of whom were least able to afford them) complained bitterly. A common argument was that everyone in a building purchased knowing how expenses were to be shared and it was unfair that these known arrangements should be changed at the behest of a single lot owner who stood to gain financially (often significantly).

With the benefit of hindsight, the reforms of 1997 were right in that they produce the most equitable outcome and prevented past abuse of the system of lot entitlement allocations. However, they should not have been made "retrospective" by allowing applications for re-allocation of lot entitlements. Instead, they should have only allowed specialist adjudicators and the District Court to change lot entitlements to correct obvious abuses by developers under the earlier legislative provisions, such as the allocation of a nominal lot entitlement to a penthouse.

The solution

The solution is not what the Government now proposes. That will only deprive post 1997 projects, including new projects, of the most equitable system available. Assuming that the Government is under sufficient political pressure to justify a radical, although less radical, approach and also assuming that it is not philosophically driven by the "rich should pay for the poor" principle, the best solution in the opinion of this author would be to:

1. Leave intact the current dual entitlement regime for both existing buildings and new projects (because this is essential to achieve future equity, particularly in the larger and more complex projects for which it was intended to facilitate).
2. Allow bodies corporate to reverse the re-allocations made by specialist adjudicators and the District Court under the BCCM Act, or preferably, allow those re-allocations

to be reviewed by the Queensland Civil and Administrative Tribunal and reversed in appropriate cases where they have resulted in hardship.

3. Require contribution schedule lot entitlement allocations for future projects to be supported by a certificate by an appropriately qualified professional stating -
    - the approach used for the allocations (i.e. equal or "just and equitable");
    - in their opinion it is the most appropriate approach for the particular project; and
    - in the case of the "just and equitable" approach, they are satisfied that the allocations have been properly made having regard to the extent to which the various lots draw upon the financial resources of the body corporate.
4. Strengthen the off-the-plan disclosure provisions in section 213 of the BCCM Act so that purchasers are fully aware of how their liability for levies will be based.
5. Allow the Queensland Civil and Administrative Tribunal to correct past abuses of lot entitlement allocations while preserving as much as possible the existing position of lot owners.

Unlike the current proposal by the Government, this solution will be more appropriate for its objective (as stated by the Minister) to "*underpin the growth of apartment living in Queensland, which more and more people are turning to each year and which is needed to cater for our rapidly growing population*". It will more aptly do this by facilitating the larger and more complex projects that need these modern mechanisms to be properly structured from a management and operational perspective.

Inherent further problems

If the Government does proceed with its current proposals, then there will be the potential to create further problems, such as:

- The re-entrenchment of some or all of the abuses of the past.
- Changes to allocations in post 1997 buildings and complexes to the detriment of many who have purchased in those buildings or complexes or leaving those allocations intact but out of sync with the vast majority of other buildings and complexes (i.e. creating a two tier system, one equitable and the other not).
- An adverse impact on post 1997 re-allocation purchasers (i.e. purchasers who have acquired their units after a re-allocation with the expectation that the lot entitlements would not change again).
- Adjustment of levies, including unpaid instalments already levied.
- Administrative complexities for body corporate managers, including the possible need for changes to computerized management systems.
- Interfering with the rights and expectations of purchasers of off-the-plan properties that are still under construction.

Conclusion

It is alarming to see how inexperienced the Government and its policy advisors are in their approach to reform of lot entitlement allocations. They clearly have no appreciation of the history of lot entitlements, either in Australia or overseas, during the past 50 years. Nor do they have an understanding of the operational requirements of the large and complex

projects recently completed or currently being built or in the planning stages, not to mention the next generation of projects that will inevitably be modelled on current world development trends.

To “wind the clock back” in the way currently proposed by the Government will almost certainly be the equivalent of “throwing the baby out with the bath water”. For the sake of the baby (i.e. future projects), the Government should re-examine the current proposals.