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The Manager
Fair Trading Policy
NSW Fair Trading
PO Box 972
PARRAMATTA NSW 2172

31 January 2014

Dear Sir/Madam

SUBMISSION FROM THE REAL ESTATE INSTITUTE OF NEW SOUTH WALES ON THE STRATA SCHEMES MANAGEMENT BILL 2014

We refer to the Strata Schemes Management Bill 2014 and **enclose** the Submission prepared by The Real Estate Institute of New South Wales.

Please contact the writer on (02) 8267 0513 should you have any queries in relation to the Submission.

Yours faithfully

Timothy McKibbin
Chief Executive Officer

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Dear Sir,

REVIEW OF THE STRATA SCHEMES MANAGEMENT ACT 1996

We are informed that other industry organisations were provided with a copy of the proposed changes to the Draft Government Bill (**Draft Bill**) on 24th December, 2013 calling for submissions and that the last day for submissions is Friday 24th January, 2014.

It is unfortunate that the Real Estate Institute of New South Wales (**REINSW**), which is the peak industry body, was omitted from receipt of the Draft Bill. In any event, we have sourced a copy of the Draft Bill on 21 January 2014 and, on first reading, whilst many changes address problems previously identified by the industry not covered by the current Act, there are a number of the proposed changes which have not at any time been canvassed with the industry, and are conflicting with other sections of the Draft Bill. As a result, the Draft Bill in its current form is technically deficient and unworkable for the purpose of practical application.

The proposed adoption of the Draft Bill in its current form introduces additional compliance costs which can only result in substantial increases in disputes as well as accompanying increases in administrative costs to strata scheme lot owners.

At the outset, it was the understanding of the REINSW that the intention of legislative amendments was to address current administrative issues of concern, reduce red tape and as a result reduce the cost of administration of strata schemes for lot owners as well as simplify the law into plain English.

New South Wales has previously been viewed as a world leader in the field of community living administration. It was understood that the Draft Bill would meet the high quality standards necessary for proper governance of the increasing medium and high density developments encouraged by Government policy in New South Wales, enabling the proper governance of community living for current and future generations.

Unfortunately, due to lack of industry consultation, the Draft Bill in its current form falls extremely short of meeting these criteria.

With this in mind we make the following initial comments and may, once we have had reasonable time to review the Draft Bill, follow up with an additional submission and recommendations:

Definitions

It took the industry and the public more than a decade to become accustomed to the 1996 changes in terminology that had previously been accepted for 35 years.

A further change in terminology from "executive committee" to "strata committee" and the introduction of new undefined concepts of "minor or cosmetic work" and "internal space" (section 113) and "bias" (section 211) are new terms and concepts which will invariably result in unwanted confusion and a substantial increase in disputes.

It is the position of the REINSW that the terms "minor or cosmetic work", "internal space" and "bias" need to be properly defined or removed from the Draft Bill.

Division 2 – Management of Strata Schemes

11. Strata Scheme charter

The proposed introduction of a strata scheme "Charter" is a concept which has not previously been raised in discussions with the REINSW and is apparently intended to be unenforceable as the Draft Bill makes it clear that it cannot form part of a strata scheme's by-laws.

The REINSW does not agree to the introduction of a Charter when it is nothing more than an unenforceable management guideline. Accordingly, our position is that this section should be removed from the Draft Bill.

DIVISION 3 – Office Holders of owners corporation

15. Owners Corporation to appoint officers

The current system of the strata committee electing the chairman, secretary and treasurer is a time honoured and well understood system which is used in board rooms and Parliament where the elected group/party (in this case the strata committee) determines the office bearers or, in the case of Parliament, the Premier or Prime Minister.

This proposed change, from a universally accepted system of appointment to one which would be unique to strata schemes, serves no particular purpose (other than to cause confusion) and provides no tangible benefit to the owners corporation.

In addition, the requirements of section 15(5) will result in unnecessary additional cost and time delays in the issue of annual general meeting notices, which may further delay the convening of annual general meetings.

The current system of nominations at the meeting has been working well since the introduction of strata schemes legislation in 1961.

The imposition of an additional layer of time-consuming compliance, together with the associated costs to strata schemes administration, has not been raised previously as an issue and is totally unwarranted.

The REINSW is opposed to the implementation of these proposed changes as the current time honoured system is well understood as is the election of the strata committee at the annual general meeting.

17. Persons who are not eligible to be officers of owners corporation

(a) This proposed amendment does not allow owners absent from strata committee meetings to be represented by their strata or property manager. Also, a strata or property manager who may not necessarily be the strata or property manager of the subject strata scheme (they may be a relative or friend) would not be able to represent an absent owner on the strata committee.
(b) Strata and property managers often own lots in strata schemes they manage. This proposed amendment is unworkable and impractical because it precludes them from membership of the strata committee notwithstanding that they own a lot in the scheme.
(c) Under these circumstances this section prima facie is in direct conflict with proposed section 24.

We note that section 17 imposes restrictions on strata and property managers which do not provide any consumer benefits or outcomes and are not reflected in regulatory documents applicable to other property professionals.

The REINSW is opposed to the proposed statutory denial of the right of:
(a) strata managers and property managers who own lots in strata schemes to be members of their own strata committees; and
(b) absentee lot owners to be represented on the strata committee by their chosen representative regardless of whether that representative holds a licence or certificate under the Property Stock and Business Agents Act 2002 (NSW) (**PS&BAA**).

21. Acting Officers

The REINSW is opposed to this section (as currently drafted) on the basis that the strata committee has no transparency in relation to the identity of the appointed acting officer. Prior to the consent of the strata committee pursuant to this section, the members need transparency with respect to the nominated individual to ensure that there are no ulterior motives with their nomination and/or subsequent appointment.

22. Vacation of office of officer

Section 22 makes it mandatory for the strata committee to fill a vacancy.

No provision is made to leave the position vacant where there is no other person willing and/or able to accept an appointment.

The REINSW considers this section needs to take into consideration this common problem and suggests that the appointment to fill the vacancy should be at the discretion of the strata committee.

24. Original owner to exercise officers functions before appointment of officers

This section has the potential to be in conflict with Section 17 where the strata or property manager is a lot owner and/or the original owner.

The REINSW is of the opinion that section 17 and/or section 24 needs reviewing to give proper effect to the intention of the sections and to take account of the possibility that the strata or property manager may also be the original proprietor.

DIVISION 4 – Meetings of owners corporation

26. First AGM must be held within 2 months after initial period

Proposed Section 26(3)(b)

The REINSW does not agree with the proposal to notify a tenant (who has no financial interest in the strata scheme) of the first or for that matter any meeting.

This matter has not been raised in previous consultation.

A tenant has no financial interest in the building, may only be a resident for a short period of time, has not been granted a right to vote and can therefore only be an impediment to the proper management of the strata scheme and the owners right to deal with their property as they determine.

The REINSW opposes this proposal as it will, once again, unnecessarily increase costs to the strata scheme.

27. Matters to be determine at first AGM

The expanded agenda has addressed most of the industry's concerns with the exception of whether a strata scheme is to be registered for GST purposes.

Where the annual levies raised are less than $150,000, strata schemes may choose not to be registered. However, where levies are in excess of $150,000, it is a mandatory requirement to be registered which will necessarily be reflected in the levies raised. Accordingly, the REINSW is of the opinion that this matter should be incorporated into the first annual general meeting agenda.

Insurance Commissions (S27& S63)

Much discussion has taken place on this matter in the light of its history and manner in which insurance commissions have substantially subsidised strata management base fees at no additional cost to the strata scheme.

Section 63 requires (amongst other things) strata managers to disclose commissions that have been received in the past 12 months and that are expected to be received in the next 12 months. Section 27 and Schedule 1 also requires insurance commissions to be approved for the next 12 months.

This will result in additional paperwork, time and cost to every strata scheme for every general meeting even though the information is already disclosed in agency agreements. Further, the changes will necessarily be accompanied by an increase in base management fees to allow for the additional time in preparing the information and additional meeting time (which is usually at an afterhours rate) to address the matter.

Whilst the REINSW supports the disclosure of insurance commissions, the listing of the matter for determination each year with the strata schemes option of denying the receipt of the commission without an accompanying right to raise base management fees is untenable, particularly where the agency agreement takes no account of the proposal and

therefore has no provision to adjust annual management fees until the current contract term (which is usually three years) has expired.

The REINSW understood from previous dialogue that there would be a provision in the legislation to provide strata managers with the opportunity to increase base management fees or alternatively a service fee under current contracts to compensate for situations where a strata scheme denies the insurance commission being paid to the strata manager.

This provision has been omitted from the Draft Bill and will have severe consequences on the viability of a substantial section of the strata management industry with the probability of failure of many businesses as a result.

This section imposes restrictions on strata managers which do not provide any consumer benefits or outcomes and are not reflected in regulatory documents applicable to other property professionals.

The REINSW position is that section 27(k), section 63(3) and section 9(h) of Schedule 1 should be removed from the Draft Bill.

Part 3- Division 1

Section 42. Members of strata committee

Section 42(1) has been introduced without industry or consumer consultation. It would remove the current statutory limitation on the number of members of the committee which may, in the case of larger strata schemes, result in several hundred committee members.

Further, the REINSW does not support the representation of tenants on strata committees because to do so would cause conflicts in situations where tenants have no financial interest in the strata scheme.

The REINSW considers that the effect of this section is problematic and would benefit from a review.

44. Persons who are not eligible to be elected to strata committee

This section fails to indicate where a person becomes ineligible for appointment, such as the non-payment of levies after being elected and whether the member's right to vote as an elected member is automatically terminated for any meeting they attend until the levies are paid in full.

The REINSW is of the opinion that this section needs to be reviewed to more accurately reflect the intention of the policy.

45. Tenant representative

As the majority of units (particularly older units) are rental units, it would appear that it is intended that there be a tenant representative on most strata committees in NSW. However, it is not clear what the purpose is of having a tenant as a non-voting member on the strata committee.

The REINSW opposes the appointment of a committee member who does not own a lot in the strata scheme or who is not a representative of an owner of a lot in the strata scheme. The ability of tenants to be represented on the strata committee has the potential to cause conflicts, particularly where a tenant has a separate agenda to the owners. For that and other reasons mentioned above, the REINSW does not believe tenants should be represented on strata committees.

54. Term of appointment of strata managing agent

Section 54(1)

The imposition of maximum 3 year contracts is a restriction on a strata manager's free right to trade as well as their right to contract, which is not imposed in other industries or upon other property professionals (eg rental management agreements with landlords, on site managers and caretakers). The result will be that strata clients are prevented from negotiating a beneficial long-term contract, which may be more economically viable to all parties and financially beneficial to the strata scheme.

If this proposal is implemented, management fees will necessarily be raised to take into account the probable short-term nature of the management service. There are significant initial set-up costs associated with the management of a strata scheme which are recovered over the term of an agreement and, if the appointment terms are short, these initial up front establishment costs will need to be recovered over the shorter period. That will create a commercial environment more prone to the churning of clients and the lowering of service levels within the industry and increasing costs.

It is interesting that section 71 allows the possibility for a caretaker to be appointed for a period of 10 years, followed by a further 10 year term.

The introduction of any mandatory period, whether 3 years or otherwise, with no holdover clause also raises commercially impractical logistical problems.

In situations where, for whatever reason, the annual general meeting cannot be, or is by circumstance unable to be, convened within the fixed term period, a strata manager may be in breach of the PS&BAA. The PS&BAA prohibits and provides for fines on a licence holder providing a service where there is no contract with the principal. If the contract has expired, the strata manager would not legally be able to prepare and issue notices, receive levies, pay contractors or provide any services whatsoever after the fixed expiration date. The strata scheme would no longer have a strata manager to manage its affairs unless or until the strata committee arranges to convene a general meeting to address the problem.

This section imposes restrictions on strata managers which do not provide any consumer benefits or outcomes and are not reflected in regulatory documents applicable to other property professionals.

The REINSW is opposed to the imposition of fixed maximum contract terms and is of the belief that holdover clauses are required to ensure agency agreements are current until general meetings are able to be convened to address the issues raised in the Draft Bill.

The REINSW is also of the opinion that the proposal to eliminate holdover clauses is an unnecessary restriction of trade. The PS&BAA and paragraph 3 of Schedule 14 to the *Property, Stock and Business Agents Regulations* 2003 (NSW) already provide for a minimum notice period before which the strata scheme may terminate the relevant agency agreement during a subsequent fixed term, and the proposal will create additional administrative compliance problems and increased costs to strata schemes.

61. Breaches by strata managing agent

Section 61(1)

There is no exception in the Draft Bill for the strata manager where an owner, the owners corporation or an alternate third party causes or contributes to the strata manager's failure to execute a delegated duty.

For instance, the strata manager may be delegated the obligation to arrange a fire compliance certificate but may be prevented from finalising an inspection through no fault of their own because it cannot arrange access to a lot. As a result, the time for compliance passes and a fine may be issued under this section through no fault of the strata manager.

The REINSW is of the opinion that there should be a range of reasonable exceptions incorporated into this provision, including to take into account matters (outside the control of the strata manager or strata scheme) that prevent the strata manager from discharging their delegated duty where time parameters are involved.

Section 61(2)

Under this section the receipt of something no matter how minor by an employee of a strata company such as a promotional pen, chocolates, cup of coffee, a bottle of wine as a Christmas present, a lunch to discuss a client's contractual requirements etc will be an offence, even if that minor gift was not requested by the strata manager.

Whilst the intent is to deter gifts of a significant nature such as overseas holidays etc where the gift is attributable to a specific strata client (which is not disputed), the REINSW is of the opinion that "minor gifts" of no particular consequence should be subject to exemption as the matter of corruption is adequately dealt with under Part 4A of the Crimes Act 1900 (NSW).

There needs to be a clear distinction between the ability of strata managers to receive minor gifts and services in their ordinary course of interaction with people in the market and the ability for them to receive material gifts and services which are designed to influence their decisions in relation to the management and administration of a strata scheme. Whilst the REINSW supports measures to deter the latter, it opposes the complete abolition of the receipt of gifts and services, particularly where minor gifts and services are given to strata managers in the ordinary course of their interaction with the market (for instance, it would not be beneficial if the strata manager could not accept a cup of coffee or other minor benefit in the ordinary discharge of their duties).

63. - Provision of information about money received

Section 63(3)

Whilst it is possible to advise strata clients of the details of commissions which have already been agreed upon when entering into a management contract, that will create additional administrative work on the part of the strata manager, the cost of which will need to be recovered, there will also be substantial additional administrative work and costs involved in preparing and providing estimates of any commissions likely to be received in the next 12 months and what the likely management fee would be with and without the receipt of insurance commissions.

In addition, as insurance premiums can and do vary significantly from year to year depending on the individual strata schemes' claim type, rate and general claims made throughout the year on a world-wide catastrophe basis with insurers, estimates would generally be based upon averages. An individual strata schemes' position may vary significantly from year to year as a result of specific circumstances and claims made. Therefore, estimates are based on industry average and can easily be significantly different from the reality of the specific circumstances of individual strata schemes.

As insurers are unable to provide estimates for future premiums until reinsurance premiums are determined, the probability of a strata manager (who is not an insurance expert) being able to provide accurate figures is at best unlikely and, as a result, may at times be misleading which raises the possibility of a claim for unintentionally providing grounds for an action for false and misleading information pursuant to section 65(3).

The ramifications of this section are unnecessarily onerous and will result in significant increases in administrative costs by strata managers which will need to be recovered by an increase in base management fees or, alternatively, strata managers will increase base fees and not renew their positions as authorised representatives.

If strata managers are not authorised representatives, they will not be able to deal with insurance claims, as they would be in breach of the Financial Services Reform Act 2001 (Cth) (FSRA) which prohibits the provision of any financial service (and dealing with insurance claims is a financial service) by anyone who does not hold a licence or is not an authorised representative under the FSRA.

This will result in insurance brokers (who are not set up to deal with claims maintenance) benefiting from the commission even though they do not provide the claims service required by the strata committee because they would not have the intimate knowledge of the property or administrative infrastructure to do so.

In view of the increased:

(a) red tape;
(b) compliance cost;
(c) work;
(d) potential for litigation; and
(e) costs for strata schemes,

the REINSW is opposed to the introduction of this section as a mandatory requirement.

87. Liability of persons other than owners for contributions

We are unable to comment on this section until the relevant form/certificate is available. There needs to be a form of communication between the parties for this section to have effect in practice.

88. Interest and discounts on contributions

Prior to 1996, the system worked well with no discount regime and a penalty rate for levy arrears of 20%.

Whilst not in widespread use, the introduction in 1996 of a 10% discount for levies paid prior to the due date resulted in:

(a) the reduction of penalty interest from 20% to 10%, with a further 10% discount for prepaid levies (effectively providing the same 20% differential); and
(b) an overly complicated management system adopted by very few strata schemes that requires sophisticated accounting and budgeting to allow for the worst case scenarios where every owner obtains a discount for every levy payment.

For those strata schemes adopting this option, the main area of dispute has arisen over the word "paid" because proprietors may pay prior to the due date (eg by cheque) but the funds are not received into the strata schemes account until after the due date. For example, if a levy is due on a Friday and the cheque is posted on a Thursday, not received by the strata manager until the following Monday and then banked on a Tuesday, a proprietor will still be seeking a discount notwithstanding the funds were neither received nor banked prior to the due date.

The REINSW is of the opinion that:

(a) the word "paid" should be replaced with the word "received" to minimise disputes of the type which are currently common ; and
(b) those strata schemes that resolve not to adopt the discount system be provided with the opportunity to adopt an alternative system whereby a 20% penalty is payable for late payment thereby placing both systems on equal footing but providing a more easily managed and very effective late payment penalty system for late payment but no levy discounts being provided (which had previously been incorporated into the 1961 and 1973 Acts but omitted from the 1996 Act). At present, the two levy collection options are not on an equal footing but should be.

96. Requirements for Financial statements

Current industry standard software is not set up to deal with accrual accounting which is an arbitrary form of accounting subject to substantial interpretation in application to provide a "true and fair view" of the state of the strata schemes accounts and that form of accounting is not understood by the majority of owners, whereas cash accounting is generally well understood by those not trained in accounting.

Accrual accounting requires the decision of parameters as to what extent accruals will apply. As there are no parameters detailed in this section to determine the extent to which accrual accounting should be applied to the annual accounts accrual accounting is highly subjective in its interpretation.

This undefined change in accounting requirements will result in the need for wholesale changes in industry standard software packages at substantial cost to the industry. That will take a substantial amount of development time and the cost will necessarily flow on to strata scheme clients in the form of additional administration costs for the preparation, implementation and subsequent auditing of accounts.

It is the opinion of the REINSW that strata schemes should be given the option of:

(a) adopting cash or accrual accounting systems; and
(b) if adopting an accrual accounting system, the extent or expenditure items applicable to accrual accounting.

113. Work by owners on common property that does not need special resolution

The concept of "minor or cosmetic work" and "work that is not minor or cosmetic" is not simple to define. Work that might appear to be minor or cosmetic in nature often impacts on common property. The distinction between what is minor or cosmetic work and what is not needs to be closely reviewed and assessed by experienced professionals in the industry.

163. Valuation to be obtained for the purpose of insurance

Five years is far too long to wait to have a valuation for reinstatement of the building having regard to building costs escalations.

The REINSW is of the view that 5 years should be reduced to 3 years as the cost of the valuation is small compared to the potential losses claimed under insurance and the ramifications of an "averaging clause" being triggered in the case of a major loss being sustained.

167. Strata managing agent to obtain quotations

There are many cases where a strata managing agent is not involved in the obtaining of insurance quotes, for instance, where a broker has been engaged by the owners corporation but may suggest that certain insurances be considered. Further, there are some cases where only one or two quotes can be obtained because of prior claims history.

This requirement:

(a) is unreasonable;
(b) unnecessary where a third party is dealing with the strata schemes insurances;
(c) in some cases, is impossible to comply with; and
(d) will only add to administrative costs which will be ultimately borne by the owners corporation.

The REINSW is opposed to this blanket requirement which has been introduced without regard for the circumstances where a strata manager may not be dealing directly with the strata schemes' insurances or, where that is the case, a strata manager may not be able to obtain more than one or two insurance renewal quotes as a result of prior claims history (and there are plenty of current examples).

198. Obligation of original owner to obtain building inspection report

Residential buildings of three storeys or less are currently covered by the Home Owners Warranty (HOW) insurance but properties in excess of three stories are currently exempt from that warranty.

The relevant sections in the Draft Bill appear to address the problem of a lack of warranty for buildings higher than three storeys by imposing an additional cost on all developments in NSW.

Considering the lack of development in NSW over the past decade as a result of increased construction and development imposts (red tape) arising from local, state and federal government levies and taxes, an additional layer of costs can only be detrimental to encouraging developers to undertake new developments.

In the REINSWs view, it would be more beneficial to remove from the proposed Draft Bill the requirement for additional and an overly complicated level of red tape and to amend the governing Legislation to require that all new buildings in NSW be subject to HOW insurance.

201. Failure to arrange further inspections

If Division 2 of the Draft Bill remains, this section should clarify who is to pay for the further report referred to in this section as it is not evident in the current wording.

231. Order for appointment of strata managing agent

Section 162 of the current Act provides for the appointment of a strata manager by a Tribunal in several circumstances, including where the strata scheme has failed to perform one or more duties. However, the proposed section 231 only appears to permit a Tribunal to make an appointment where the strata scheme is not functioning or is not functioning satisfactorily.

The wording needs to either revert to the original section 162 wording or be reworded to address this potential anomaly.

Schedule 1 Part 2

9. Additional matters to be included in notice of agm

Section 9(h)

As abovementioned, the receipt of commissions is a matter which is negotiated at the time of engagement and clearly detailed in the agency agreement prior to its execution.

This agenda item will only complicate the management process, prolong meetings unnecessarily for no particular benefit to the strata scheme resulting in additional costs to the strata scheme and inconvenience to lot owners.

The REINSW position is that the section should be removed from the proposed Legislation.

GENERAL

Vexatious Applicants

The proposed amendments have failed to address situations where an owner/owners or occupiers are vexatious applicants who make continual applications to the Tribunal, often on the same matter, resulting in unnecessary costs being incurred by the owners corporation.

The REINSW is of the opinion that the Tribunal should be provided with the similar powers as the Supreme Court to refuse to hear vexatious applicants and a provision should be introduced to specifically allow for all costs whatsoever incurred by the strata scheme in defending such actions whether heard or withdrawn prior to a hearing.

Winding up of strata schemes where 75% of owners agree to sell to a developer

This matter has been canvassed for over a decade and has not yet been addressed in the current proposed amendments.