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Airspace Development Structures

An Australian Perspective

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1. Introduction

- 1.1 Multi-use developments range from a small neighbourhood building containing 2 or 3 uses to large Greenfield developments that are more akin to a new suburb. They can also involve subdivision on a horizontal plane (such as *Sanctuary Cove* on Queensland's Gold Coast) or subdivision on a vertical plane (such as *Quay West* in the Sydney Rocks area) or a combination of both (such as *King Street Wharf* at Sydney's Darling Harbour).
- 1.2 The component uses also vary from project to project. A typical urban development may involve all or any of the following uses:
- (a) retail;
 - (b) commercial;
 - (c) residential; and
 - (d) entertainment.
- 1.3 A typical Greenfield site may involve all or any of the following uses:
- (a) neighbourhood shops;
 - (b) commercial office precinct;
 - (c) hotel;
 - (d) recreation facilities (e.g. golf course);
 - (e) marine facilities;
 - (f) residential precincts with various housing mixes –
 - (i) free standing;
 - (ii) villas;
 - (iii) apartments; and
 - (iv) townhouses.
- 1.4 This paper deals with typical urban redevelopments that involve a mixture of uses. They may involve anything from a single site to an entire city block. They may involve a complete demolition of existing improvements or the preservation and redevelopment of existing buildings. The common feature is that the completed project has 2 or more component use areas. In turn, this almost inevitably leads to some form of subdivision on a vertical plane. These subdivisions are known by various names throughout Australia, but in simplistic terms they are "airspace" subdivisions. This paper will provide an overview of how these projects are structured from a legal perspective.
- 1.5 This paper is not concerned about the Greenfield type project, nor with projects that only involve subdivisions on a horizontal plane. In some ways these projects are simpler than the urban redevelopments, although many of the structuring principles that need to be applied to "vertical" projects are equally applicable to the "horizontal" projects.
- 1.6 This paper deals with the following topics:
- What are the big picture objectives, and why?
 - What is an airspace subdivision?
 - Disposal of airspace lots.
 - Early airspace projects.

- Available legal mechanisms.
- Main problem area – the basement.
- Structuring objectives.
- Structuring principles.
- Management of the legal process.
- Staged development.

2. The big picture objectives

2.1 The big picture objectives when structuring these projects are to:

- (a) create a harmonious management environment for all owners and occupiers in the project; and
- (b) enhance the value of the commercial components of the project.

To a large degree the first objective is an essential aspect of achieving the second objective.

2.2 Creating a harmonious management environment requires attention to 3 areas:

- (a) the way in which the component use areas are subdivided and titled;
- (b) the type of management structures that are put in place; and
- (c) the way maintenance responsibility is allocated among the various component use areas.

2.3 These 3 areas are important because residential owners and occupiers have fundamentally different objectives and aspirations than those of the owners and occupiers of the non-residential areas. Therefore if the chosen title and management structure puts the residential and non-residential people in the same decision making environment, it will be almost inevitable that conflict will result. Of course, in complex building situations it will not always be possible to avoid some form of joint decision making. In those circumstances, the objective is to minimise the need for joint decision making by making each group as independent of the other as possible. For example, the residential group should not make decisions about things such as retail signage and the commercial group should not be involved with the rules for use of the resident's recreational facilities.

2.4 The cost of services and building maintenance should be dealt with fairly. Generally speaking, residential people will be more sensitive to costs because they are not usually tax deductible and they directly impact on the family budget. Furthermore, the cost of some commercially related services are often much higher than the corresponding residential services (e.g. security, rubbish removal, cleaning and electricity). If any of these higher costs find their way to the residential group, then there will be conflict. Of course, this conflict has the potential to be disruptive to business and impact adversely on profitability.

2.5 Many institutional investors carefully scrutinise potential investments in mixed use projects. They are concerned to ensure that:

- (a) their investment will not be adversely affected by a disgruntled residential group;
- (b) their asset is as independent as possible from the residential component; and
- (c) they are not subjected to a residentially orientated dispute resolution process.

This means that they will usually be concerned to ensure that they are not involved in an owners corporation structure with a residential group. Indeed, some institutional owners actually have a policy against buying assets that are part of a residential owners corporation structure.

- 2.6 If the commercial components of the completed project are not attractive to institutional investors, then this can reduce the size of the market for and impact on the value of those components. Therefore, when structuring these mixed use projects lawyers and other consultants need to ensure that the likely market sensitivities of institutional investors are taken into account.

3. Airspace subdivisions

- 3.1 Airspace subdivisions are simply the subdivision of land above the surface of the ground. They can also include subdivision below the surface of the ground. They are not dissimilar to a strata title subdivision, except that the subdivisional techniques used for airspace lots are usually different. In New South Wales and Victoria these types of subdivisions are known as “stratum subdivisions”. In Queensland they are known as “volumetric subdivisions”. So far as I know, there are no special terms used in the other states. The survey techniques used in Queensland are also a little different to those used in other states.
- 3.2 All airspace subdivisions start with a conventional land lot. They are almost inevitably Torrens title, but in theory at least, in New South Wales they could be old system title land. In New South Wales the title can be either freehold or leasehold, whether in public or private ownership. In Queensland, leasehold land at South Bank can be subdivided by means of the stratum subdivision approach. It is different to land in the remainder of the state.
- 3.3 This conventional lot is then subdivided, but instead of the lines of subdivision being on a horizontal plane on the surface of the ground, they are above and/or below the ground, usually limited in height and depth with reference to standard height datum. The airspace lots are “cubic spaces”, although they are rarely precisely cubic in shape. They usually comprise a substantial collection of cubic spaces with a variety of shapes and sizes. The lots often extend to the ground and even below the ground into underground basements.
- 3.4 The boundaries of airspace lots usually relate to parts of a completed building, although in some jurisdictions there is no need for a building to be in existence for an airspace subdivision to be undertaken. This means that the subdivision can be undertaken before or after the building is completed. Where possible, subdivision before completion of the building should be avoided. This is because it is near impossible for a builder to build precisely to surveyed boundaries within a building and a further subdivision is usually necessary to adjust boundaries. Unless statutory boundary adjustment mechanisms are in place (such as those that exist in Queensland’s South Bank legislation) the process of adjusting titles, easements, mortgages, etc. is very difficult.
- 3.5 In Queensland, airspace subdivisions are called volumetric subdivisions. They are undertaken using a volumetric plan of survey. This is defined as a “*plan of survey using 3*

dimensionally located points to identify the position, shape and dimensions of each bounding surface". While this sounds similar to airspace plans in other jurisdictions, there is one important difference. In Queensland, there must be a "base lot" intact after the volumetric lots have been defined and this base lot remains as a standard (non-volumetric) lot. This adopts a Canadian approach rather than the conventional Australian approach.

4. Disposal of airspace lots

- 4.1 Once a stratum lot has been created it is capable of being separately disposed of whether or not it comprises part of a building. If the stratum lot comprises a separate component use area of a building (e.g. a shopping centre), then it would normally be disposed of as a single lot without further subdivision. However, it may be further subdivided by a strata plan so that individual shops can be sold.
- 4.2 If a stratum lot relates to a residential component of a building (e.g. a home unit tower), then it will almost inevitably be further subdivided by a strata plan so that the individual home units can be sold. In practice, it is common for some stratum lots to be further subdivided by a strata plan while others are disposed of without further subdivision. The resulting management structure will be illustrated later.

5. Early airspace projects

- 5.1 The major Australian jurisdictions have a number of examples of early airspace projects. However, an analysis of these projects shows that they were achieved using different legal mechanisms to those commonly used today. This is because modern airspace subdivision mechanisms did not arrive in Australia until the late 1980's, early 1990's.
- 5.2 In New South Wales, the most significant early projects were:
- *The Connaught* (Sydney City) – where the YWCA building and a mixed use tower were built as a single structure to be subsequently separated into 2 airspace lots, one of which was strata subdivided. This project was notable by the fact that it was unoccupied for nearly 10 months while a subdivision solution was found. The solution involved a strata subdivision of the whole building and a subsequent subdivision of the common property to "extract" the YWCA building from the strata scheme.
 - *Eastgate Gardens* (Bondi Junction) – where a shopping centre, public car park and 2 residential towers were subdivided by a strata plan with a similar exercise being undertaken as that for the Connaught to extract the shopping centre and the carpark.
 - *Eastpoint* (Edgecliff) where the Edgecliff railway station was built as part of a large mixed use building and a resumption process was used to extract the railway station from the strata scheme.
- 5.3 In Queensland, the best example is the *Paradise Centre* on the Gold Coast. It comprises 3 airspace residential strata schemes, 2 ground based retail components and one ground based hotel component. This project had to be undertaken with the help of project specific legislation.

- 5.4 In Victoria, the best example is the *South Bank* redevelopment. It comprises a shopping centre, hotel, 2 office towers, a church, a large car park and a residential tower. This project was so complex that even the new Victorian *Subdivision Act 1988* at the time could not cope with its demands. Again, project specific legislation had to be passed to help resolve the problems.

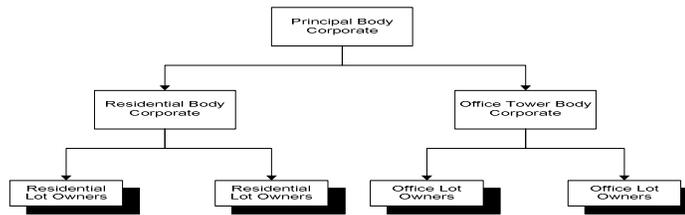
6. Available legal mechanisms

- 6.1 The main legal mechanisms used for airspace developments are:

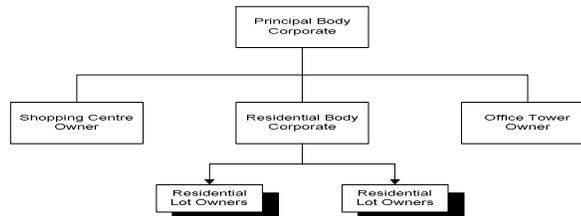
- Stratum subdivisions
- Strata management statements
- Building management statements
- Tiered body corporate structures (in Queensland only)
- Easements
- Inter-body corporate agreements
- Development covenants/public positive covenants
- Umbrella agreements.

Stratum subdivisions have already been explained, but the other mechanisms require some explanation, particularly as they are not all available in all jurisdictions.

- 6.2 Strata management statements are statutory instruments that bind all owners and occupiers within a strata scheme. They contain a range of management related provisions and to some degree their contents influence the way in which a particular strata scheme is managed. They are available in New South Wales and Queensland. The rights and obligations they contain run with the land.
- 6.3 Building management statements are statutory instruments that bind all owners and occupiers of lots specified in the statement. In Queensland, those lots can be either airspace lots comprising a single title (e.g an office building) or an airspace lot “hosting” a strata scheme (e.g. a residential home unit tower). In New South Wales there will not be a strata scheme if there is a building management statement because a strata management statement (which operates in much the same way) will be used. These statements set up contractual arrangements for the management of the entire building. They effectively take the place of an owners corporation and often provide for a committee to administer the management arrangements.
- 6.4 Tiered owners corporation structures are used in Queensland to separate commercial and non-commercial components of a building. Typically, an owners corporation or body corporate is established to administer the whole of the project and subsidiary bodies corporate are established to administer particular components of the project. The following diagram illustrates such a structure:



- 6.5 Again in Queensland, in some cases particular components (e.g. shopping centre and office tower) will not themselves have a body corporate but will still be a member of the overall body corporate. The following chart illustrates such a structure:



- 6.6 In New South Wales and Queensland the building management statements can contain “easement like” provisions. These are not generally accepted in New South Wales and as a result in that State easements are the preferred mechanisms to create rights in respect of services, equipment and access. In Queensland, the legislative provisions are more certain and there is less reliance on easements and more of a tendency to include easement like rights in building management statements. In the other States easements are the only real mechanisms available.
- 6.7 Because of the number of easements likely to be involved in a complex mixed use project they need to be thoroughly identified and carefully documented. This applies irrespective of whether they are incorporated as easements or rights in a building management statement.
- 6.8 Inter-body corporate agreements are creatures of statute in Queensland. Section 118 of the *Body Corporate and Community Management Act 1997* and its regulation modules recognise the ability of a body corporate to enter into an agreement with another body corporate about the use of real and personal property. In an appropriate case this can be a useful mechanism in a complex mixed use scheme. In some states it is possible for an owners corporation to expand its powers to give itself the power to enter into such agreements.
- 6.9 In some jurisdictions local governments can secure compliance with development conditions by imposing a form of covenant on the title to the land. The best example is the public positive covenant regime in New South Wales, but Queensland has a similar (although more restrictive) statutory regime. These mechanisms can play an important part in the structuring of mixed use projects, particularly where a large building is being subdivided and town planning constraints need to be preserved.
- 6.10 To a large degree umbrella agreements have been made redundant by building management statements. They effectively serve the same purpose as a building management statement. Of course, they will still be useful in those jurisdictions where building management statements are not available. There may also be circumstances where it is better to use an umbrella agreement in preference to a building management statement. The real problem with umbrella agreements is the need to obtain a deed of covenant every time one of the parties disposes of their lot. Umbrella management statements will also be useful where the site is particularly large and is divided into discrete development stages.

7. Main problem area – the basement

- 7.1 The basement is usually the most complex aspect of mixed use buildings and causes the most problems for lawyers and surveyors. Some of the reasons for this are:
- (a) the need to allocate separate parking areas for the various component use areas;
 - (b) the need to provide access over common driveways to the various parking areas;
 - (c) most of the building’s equipment is located in the basement;
 - (d) a wide range of services run through the basement (usually in divergent locations);
 - (e) loading docks and garbage compactus facilities are located in the basement and are usually shared facilities;
 - (f) basement security is an important issue to most occupants of the building;

- (g) day to day operation of the basement can be complex; and
- (h) fire safety mechanisms in the basement must be shared to avoid the need for expensive fire isolation measures.

7.2 Basement problems are even more serious where the building is being developed in stages. This can often introduce the need for temporary car parking areas to be allocated to particular component use areas pending the construction of their permanent car parks. It can also require early occupants, including bodies corporate that are no longer controlled by the developer, to agree to easement adjustments and new easements as the stages progress.

7.3 There is no simple solution to basement issues. The basement must be carefully analysed from the earliest stages of the project and the structuring principles that I will outline shortly must be carefully applied. If you are a lawyer or consultant with limited experience with these types of projects, you should consider getting assistance, particularly if a staged development is involved.

8. Structuring objectives

8.1 When undertaking the structuring of mixed use projects involving a single building structure there are a number of objectives that must be kept in mind at all times. Every effort should be made to achieve these objectives and if for some reason they cannot be achieved it is important that the developer is aware of the situation and the possible consequences. It is best for the surprises to occur up front rather than half way through the project, or worse still, when the building is complete (as was the case with *The Connaught*).

8.2 The structuring objectives are:

- Ensure that all arrangements between component use areas are fair and sensible.
- Maximise the marketability of the commercial and retail components.
- Provide for separate decision making for each of the residential and non-residential groups.
- Create a harmonious management environment that functions well for each component use area and well for the overall building.
- Allow for maximum flexibility for the developer.
- In the case of staged projects, protect developer control throughout the development period.

9. Structuring principles

9.1 Just as there are structuring objectives that must be kept in mind, so too are there a number of structuring principles that must be kept in mind. Some of these principles can be easily achieved. Others may involve significant cost to the developer. Where the costs are unacceptable, then alternate solutions need to be found.

9.2 The structuring principles are:

- ***Design solutions are the best solutions.*** For example; it is best to have a separate residential foyer than an arrangement where residents having the benefit of an easement to enter their lifts from the main entrance to a shopping centre. This

principle requires issues to be addressed at the earliest stage of the project. It also requires relevant consultant input (including legal) throughout the design process. The project manager needs to be aware of when legal input is required.

- ***Where possible each component use area should be separately serviced.*** This will not always be possible, either because of government regulation (e.g. fire safety) or costs. However, all consultants should be given this as a clear objective and where additional cost is involved, that should be identified and a decision made as to whether the cost is warranted having regard to other solutions that may be available.
- ***Where possible services should be arranged together.*** There is nothing more complex from a legal perspective than to have service lines in the basement running in all directions across the entire ceiling area. It is often easy to keep them together so that their location can be easily identified for easement or contractual purposes.
- ***Keep equipment and facilities under the footprint of the component use area that they service.*** This allows ownership of the equipment and facilities to vest in the person that is dependant upon their use. It also makes responsibility for maintenance very clear and minimises the need for easements for access.
- ***Where these cannot be kept under the footprint, they should be kept in clusters and the clusters should be kept as close as possible to the footprint.*** This makes it easier to provide physical access, although it does not resolve ownership, easement and maintenance issues.
- ***The location of items that are commonly used should determine ownership.*** But ownership is to be distinguished from use rights and maintenance responsibility.
- ***Usage estimation should be undertaken during the design and construction phase rather than being left until the building is complete.*** These estimates are needed to allocate responsibility for maintenance costs. The calculations can be complex and may take some time. If they are left until the last minute they can delay registration of documents and settlement of residential sales.
- ***Minimise the number of owners corporations.*** Despite the temptation, and the advice of some strata managing agents, you should not use more owners corporations than is absolutely necessary. They often complicate rather than facilitate management and they certainly add to the cost of levies. They can be a marketing negative.
- ***Keep the local government in the loop at all times.*** This way you will avoid surprises and delays. Remember, these projects present special problems for local government and these problems need to be addressed in a co-operative and co-ordinated way, otherwise the path to project completion will be very rough.
- ***Consult on a regular basis with Land and Property Information or relevant titles office.*** At the beginning of the project, consult with them about the proposed approach. Where possible ensure that all plans and documents are pre-examined.

9.3 To effectively apply these principles you need to be involved in the early design and project planning process. Project managers who are experienced with these types of projects know this and will require involvement in any event. However, less experienced project managers may need to be convinced of the necessity for this.

10. Management of the legal process

10.1 The importance of managing the legal process will be appreciated from what has been said so far. But what is the best way to manage that process? The answer will depend, to some

degree, on the complexity of the project and the experience and competency of the project manager. Some project managers are well aware of the importance of the legal process while others believe it is something that can be attended to towards the end of the construction phase.

10.2 The following are suggestions to help manage the legal process:

- ***Ensure that the project manager appreciates the importance of the legal process in these types of projects.*** If there is any doubt, the issues, timings and potential problem areas should be explained to both the project manager and the developer. If this does not work, ensure you get an informed release from responsibility, because the chances are that something will go wrong.
- ***Plan the title, subdivision and management structure early.*** In this way all of the consultants can be informed how the completed project will function and how this will impact on what is required of them. It will also assist the developer in determining reliable cash flow timings.
- ***Meet with consultants early in the planning process.*** This is your opportunity to explain how the completed project will function and what is required of them. They also need to understand what problems can occur if someone lets the team down.
- ***Prepare and distribute a consultant's brief.*** Because of the importance of having consultants organized it is important not only to explain things face to face, but also to prepare and distribute a brief. In the case of some consultants a special brief may be required.
- ***Monitor progress with regular meetings with project manager/project team.*** Because this must be a team effort the team must meet from time to time. The project manager should ensure that meetings are held at the appropriate time. In the case of the more complex projects, during the final stages, weekly meetings are not uncommon.
- ***Prepare, update and distribute a legal program.*** This will ensure that everyone is aware of what is required and when. I recommend Microsoft Project for this purpose. It also assists the project manager to monitor the level of legal fees. Sometimes the project manager will work the legal program into the main project program.
- ***Prepare, update and distribute legal checklists.*** These are important during the final stages of the project. They ensure that little (and sometimes big) things are not overlooked. Many a project has been delayed because a critical document (e.g. financier's consent) was not sought or prepared in time.
- ***Draft documents early and distribute copies.*** There is nothing like a draft document to help you focus on everything that is missing. It also helps other consultants to understand exactly what is required and when. Don't be concerned about blank spaces – the more the better because they show what work needs to be done.
- ***Use a web site as a repository.*** If the project is large enough to warrant it, set up a web site and have all documents, programs, checklists, etc. (legal and non-legal) copied to it. Drawings and reports can also be included. This allows consultant team members to obtain direct access to all materials and it eliminates huge amounts of copying and distributions.

10.3 The costs involved in managing the legal process can be an issue for some project managers and developers. They need to understand why this is necessary and how the smallest

oversight can delay settlement of sales, thus costing substantial penalties. There is no better example than *The Connaught* where over 200 home units and a number of shops were unable to be sold or settled until a solution could be found to a simple problem that was not addressed during the planning and construction stages of the project.

11. Staged developments

11.1 Depending on the jurisdiction, staged development can be undertaken in one of 3 ways:

- (a) using a multi-tier body corporate structure;
- (b) by contractually binding early purchasers to a staged subdivision arrangement; or
- (c) using a statutory development contract (which is a mechanism in the New South Wales legislation).

11.2 The first option is not available in New South Wales because the *Community Land Development Act 1989* cannot be used to subdivide a building. The problems with the statutory development contract, which is also a New South Wales mechanism, are such that it should only be used with great caution, namely it:

- only applies within a strata scheme; and
- is a relatively inflexible staged development mechanism.

11.3 Victoria is the easiest jurisdiction for using a contractual staged development approach, because it has the simplest subdivision and body corporate legislation. New South Wales and, particularly Queensland, have cluttered their legislation with restrictions on the body corporate and original owners to the extent that it has become a real art form to undertake a contractually based staged development in those states.

11.4 The following matters need to be watched when using a staged development approach:

- Start with a well defined staging program and management structure.
- Make a full disclosure in sale contracts.
- Reserve the right in sale contracts to make changes to the staging program and, if necessary, the management structure, in certain defined circumstances.
- Bind early purchasers to tolerate reasonable construction activity in the vicinity of their properties. This is particularly important where the title is leasehold and “quiet enjoyment” covenants are implied by legislation and the common law principles of “derogation of grant” apply.
- Build in an exit strategy in case the viability of the project changes during the development period. (Although this may not be possible in every jurisdiction.)
- Prepare explanatory material for purchasers so that they understand precisely what is planned. This material can form part of a mandated disclosure document or be a separate document issued to purchasers. The principle is that it is easier to bind purchasers if they have been told the full story and they openly commit to the process.
- Capture voting rights where possible. Both proxies and powers of attorney should be used.
- Where possible use a development deed to bind the owners corporation to the process. (Be careful to ensure that the owners corporation has the power to enter

into such a deed.) This can increase the stakes for purchasers who may be tempted to frustrate the developer's attempts to implement the staging program.

- Carefully review the relevant state legislation to identify any possible constraints to the process and, where possible, build in to the documentation ways to address those constraints.
- Ensure that the developer understands the risks associated with a staged development, particularly the risk of encountering a rogue purchaser.

11.5 Finally, management of the legal process is particularly important where the development is staged. Special regard should therefore be had to the management suggestions that I made earlier.

12. Summary

12.1 Multi-use developments are becoming more common and this trend is likely to increase. They bring with them special issues and need special attention from lawyers and other consultants. The larger and more complex projects of this type are particularly difficult to handle from a legal perspective and a very organized approach is essential.

12.2 The successful structuring of these projects requires:

- (a) a thorough understanding of the relevant subdivision and strata legislation;
- (b) careful planning of the staging program and management structure;
- (c) an understanding of the available legal mechanisms in the particular jurisdiction;
- (d) a clear understanding of what is to be achieved (i.e. the structuring objectives);
- (e) application of the basic structuring principles for these types of projects;
- (f) full disclosure and clear explanations to purchasers;
- (g) a competent team of consultants committed to teamwork;
- (h) consultation with local government and relevant agencies (e.g. the titles office); and
- (i) competent management of the legal process.

12.3 Staged development adds to the complexity and the way in which a staged project is structured will depend upon the mechanisms available in the particular jurisdiction.

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