Strengths and Weaknesses of a Modular Regulatory Framework

Presented by:

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1. Historical background

1.1 Common interest subdivisions comprise both a vertical version (i.e. the strata title or condominium model) and a horizontal version (i.e. the community title or master planned communities model). Any consideration of regulatory frameworks for these subdivisions needs to recognize that the two versions overlap and, generally speaking, need to be regulated together. In the Australian context, the days in which they can be treated separately[1] have disappeared for those jurisdictions experiencing progressive real estate development.

1.2 The origin of Australian regulatory frameworks can, in my view, be traced to the United States. During the 1950's, the 1960's and beyond, the United States had a profound influence on trends in Australia. This was particularly the case with real estate development. Australian developers increasingly travelled overseas and sought to replicate the type of developments that were occurring in the trend setting States of the United States, particularly California and Florida.

1.3 We therefore need to touch briefly on the emergence and growth of communities and condominiums in the United States to understand how Australia's regulatory framework evolved.

1.4 In the United States during the late 19th and early 20th centuries public land planning was virtually non-existent. Land subdivision and its subsequent use were very much matters for the land owner. The modern concept of a dedicated residential subdivision did not mature until the early "community builders" made their mark in the 1920's. These early subdividers were effectively the land planners of their time and they achieved their objectives by creating covenants over the land being subdivided. These covenants "locked-in" the desired planning regime and also laid the foundations for the operation of the residential community going forward.[2]

1.5 The current day version of these real estate covenants is known as "*Covenants, Conditions and Restrictions*" (or "CC&R's"). They contain the land planning provisions, architectural restrictions, requirement for membership of a Homeowners Association, the community rules and the operational rules of that Association. They are tailored to the specific project which means that no 2 sets of CC&R's are necessarily the same.

1.6 Condominiums (the vertical equivalents of the master planned communities) were structured in much the same way. A Condominium Declaration is filed which establishes, regulates and mandates membership of a Condominium Association. Again, these Declarations are tailored to the particular building and no 2 are necessarily the same.

[1] As was the case in Queensland with the *Building Units Titles Act 1965 - 1972* and the *Group titles Act 1973*.
[2] Refer to "*The Rise of the Community Builders*" by Marc A. Weiss (Columbia University Press 1987) for a detailed coverage.

2. Australia's first strata title regime

2.1 Australia's first strata title legislation[3] was prompted by the need to accommodate residential apartment buildings in the growing urban metropolis of Sydney. It sought to introduce a form of US style condominium ownership which fitted in with the Torrens land title system and home financing practices of the time. The Bill for that legislation was drafted by a Sydney barrister (who went on to become Justice Else-Mitchell of the NSW Supreme Court) at the request and expense of the development company, Lend Lease. He was assisted by two officers of the Registrar General's Department at the time, Mr P. J. Grimes and Mr J. E. Moore. Valuable input was also provided by a range of real estate professionals at the time. The draft was handed to the then NSW Government which guided it through the legislative process.

2.2 That legislation introduced a new type of land subdivision under which boundaries to lots (units) were defined with reference to monuments (i.e. walls, floors and ceilings of a building) and the residue of the parcel being subdivided (the common property) being vested in the lot owners as tenants in common. A statutory form of "condominium association" with appropriate conveyancing procedures and protection for financiers of the lots was automatically incorporated upon registration of the subdivision plan.

2.3 This new strata title system was specifically targeted at the suburban "walk-up" apartment buildings that were in vogue at the time, a segment of the market in which Lend Lease was very active. The legislation was intended to replace the then popular "company title" concept which suffered from the problem of not being "bankable" from a financing perspective. Within a few years these laws were being replicated in other Australian jurisdictions and even in some overseas jurisdictions.

2.4 This "first generation" of strata laws served Australia very well. They allowed substantial suburban development to occur and provided a welcome solution to housing supply in the growing nation. But as projects became more ambitious and the challenges of communal living began to emerge it became clear that more sophisticated laws were required.[4]

3. The range and complexity of modern projects

3.1. In the 1960's and early 1970's strata titles were starting to be used extensively and the vast majority of projects being subdivided by strata plans were 3 storey residential walk-ups or mid-rise residential buildings. Some of these buildings were newly constructed but a large number were apartment building conversions, particularly in Sydney's eastern suburbs.

[3] The New South Wales *Conveyancing (Strata Titles) Act 1961*.

[4] This culminated in the major overhaul of the 1961 NSW Act in 1992; an overhaul which lead to the *Strata Titles Act 1973* (the first "second generation" strata legislation in Australia).

3.2. By the end of the 1970's and early 1980's projects became higher, larger and more complex. The range of projects expanded to include commercial, industrial and broad acre land developments. Mixed use developments were also increasing in popularity and although uses were initially confined to a mix of apartments and shops, this progressed to include offices and even such things as railway stations[5], shopping centres[6] and hotels[7]. As the years passed projects became even more complex as roads and waterways became features.[8]

3.3. During the 1980's horizontal common interest subdivisions began to appear. These involved the horizontal subdivision of land into lots and common property where a mixture of houses or other "buildings" were comprised entirely within the lots. This type of project was never envisaged by the laws of those times and a number of "solutions" were devised to accommodate the increasing complexity of projects, including:

(a) using an "overlap" (e.g. a small cupboard) between adjoining buildings so as to create 2 "stratas";
(b) using contrived "buildings" (e.g. bus shelters) from which boundaries could be defined;
(c) using conventional land subdivisions and easements with an incorporated association holding the common property and acting like a "body corporate"; and
(d) project specific legislation to accommodate the particular project.[9]

3.4. In Queensland, where projects tended to be more complex throughout the 1980's, the need for more flexible legislation was recognized. This was particularly so if a raft of project specific legislation (such as for the *Paradise Centre* and *Sanctuary Cove*) was to be avoided. The solution chosen at the time was a collection of project specific legislation, but not specific to a particular project, but rather a specific type of project. The actual legislation comprised:

(a) the *Integrated Resort Development Act, 1987*;
(b) the *South Bank Corporation Act, 1989*; and
(c) the *Mixed Use Development Act, 1993*.

3.5. The *Integrated Resort Development Act* and the *Mixed Use Development Act* relied upon the *Building Units and Group Titles Act 1980* for the administration of the bodies

[5] Such as the *Eastpoint* development at Edgecliff in Sydney, which comprises residential apartments, shops and a railway station.
[6] Such as *Eastgate Gardens* at Bondi Junction in Sydney, which comprises residential apartments, a commercial car park and a shopping centre.
[7] Such as the *Paradise Centre* at Surfers Paradise on the Gold Coast, which comprises residential apartment towers, a shopping centre and a hotel?
[8] Such as *Southbank* in Melbourne (comprising a shopping centre, car parking station, 2 office towers, a residential tower, a shopping centre, hotel and a church, with a road underneath) and *Dockside* in Brisbane (comprising residential towers, shops, restaurants, hotel and an enclosed marina).
[9] For example the *Registration of Plans (HSP (Nominees) Pty Ltd) Enabling Act 1980*, the *Registration of Plans (Stage 2) (HSP (Nominees) Pty Ltd) Enabling Act 1984* and the *Sanctuary Cove Resort Act 1985*.

corporate they created. And the *South Bank Corporation Act* substantially reproduced the *Building Units and Group Titles Act* in one of its schedules. As changes were made to the various pieces of legislation it became clear that even the multi project specific approach was not the best solution.

3.6. In New South Wales the late 1990's and early 2000's saw a spate of very complex mixed use developments which not only mixed uses but also mixed freehold and leasehold land titles.[10] This is continuing today, particularly around the shores of Sydney Harbour close to the City. *Barangaroo* is the latest such development and will comprise a large collection of commercial buildings, residential apartments, hotels, shops and restaurants, as well as extensive parklands with recreation, events and entertainment activities.

3.7. So what is the best solution? Before attempting to answer that question we need to understand that there is a spectrum of possible "solutions" and the various options fall somewhere within that spectrum.

4. The regulatory framework spectrum

4.1 At one end of the regulatory framework spectrum we have generic (one size fits all) legislation (such as the majority of Australian strata title laws) and at the other end we have specific legislation for every project (such as with the *Paradise Centre* and *Sanctuary Cove* in Queensland). The project specific legislation to some degree compares with the United States homeowner and condominium association structures. Those structures are drafted to accommodate the needs of the particular project and do not rely upon or are unduly constrained by a compulsory legislative structure.[11]

4.2 Until the mid-1990's all Australian jurisdictions (as well as all overseas jurisdictions which adopted the Australian strata system) were using the generic (one size fits all) approach. Even today that approach is almost exclusively used. New South Wales adopted community titles legislation in 1989[12] which allowed for multi-tiered body corporate structures, including a mix of strata and community title types. However, the interface to the strata titles system[13] still resulted in complexities and limitations when applying the available structures to the larger and more complex projects.

5. Problems with the generic approach

5.1 One need not look beyond Australia's experience to identify the problems with the generic approach to strata title laws. That experience has shown that it is not possible to draft a single generic law and keep it up to date as circumstances change, in a way that

[10] *King Street Wharf* at darling Harbour, *Finger Wharf* at Wooloomooloo and *Barangaroo* at City West.
[11] Although in recent years US State Governments have intervened to impose minimum requirements, particularly for consumer protection purposes.
[12] The *Community Land Development Act 1989* and the *Community Land Management Act 1989*.
[13] The development of apartments on community lots required use of the *Strata Schemes (Freehold Development) Act 1973* and the resulting body corporate was regulated by the *Strata Schemes Management Act 1996*.

successfully accommodates the huge diversity of current day projects. The more one changes the generic laws to cope with problems in one type of project the more adverse consequences those changes bring. This in turn creates the need for more changes, with the process tending to perpetuate.

5.2 The difficulty with the generic approach is obvious when one compares say a 3 story "walk-up" apartment building with something like the Gold Coast's Q1 high rise tower. They are at either ends of the regulatory spectrum. The 3 story project would have say 6 apartments with common property comprising a driveway, entrance foyer, stairwell and surrounding gardens. Q1 involves 526 apartments, a spa, restaurants, shops, observation deck, conference centre, beach club and serviced apartment facilities. The common property is extensive and packed with equipment and services which require specialized facility management skills.

5.3 It is very difficult to draft a single Act which effectively deals with the demands of these two types of projects, plus all those in between. It becomes even more difficult to draft amendments to such an Act to correct problems within one project category without creating more unintended problems within another project category. For example, to impose complex secret ballot processes on a 6 lot scheme in any circumstances would be totally inappropriate, whereas it may assist in resolving problems which are occurring in a serviced apartment body corporate structure.

5.4 But that is just one example. The areas which have proved the most difficult to regulate in a generic way are:

(a) staged development;
(b) large projects requiring development by a master developer and a number of sub-developers;
(c) mixed tenures (e.g. freehold, leasehold and occupation licenses);
(d) hotels and serviced apartments;
(e) large mixed use projects (e.g. residential and commercial uses)[14];
(f) timeshare projects; and
(g) retirement villages.

6. Problems with the project specific approach

6.1 The project specific approach will usually be one of 3 types:

(a) single project specific legislation;
(b) multi project specific legislation; or
(c) single project specific documentation.

[14] Although this is less so in those jurisdictions where an airspace subdivision and a "building management statement" can be used.

Single project specific legislation

6.2 Single project specific legislation involves an Act of Parliament for each project, such as was the case for the *Paradise Centre* and *Sanctuary Cove*.[15] From a public policy point of view, the most significant problems with that approach are:

(a) use of enabling Acts for private commercial purposes should be the exception rather than the rule;
(b) the development process becomes politicised; and
(c) there is a much higher risk of corruption infiltrating the process.

Put simply, it is bad public policy!

Multi project specific legislation

6.3 Multi project specific legislation involves an Act of Parliament which is intended to facilitate particular types of projects (e.g. integrated tourist resorts).[16] In Queensland, *Royal Pines Resort*, *Hope Island Resort* and *Sheraton Mirage Resort Port Douglas* were all developed under this type of law.

6.4 The problems with this approach are:

(a) not all projects within the particular category are the same and the inflexibility inherent in generic laws can emerge, although to a lesser degree;
(b) if the legislation is to cover every aspect of the target projects it will need to be either:
    (i) detailed, repetitive of other laws and lengthy, making it more difficult to maintain for Government[17]; or
    (ii) attached to more generic Acts to regulate common aspects, such as planning, governance and management;[18] and
(c) there is a risk of ending up with a diverse collection of Acts which may be confusing and may not operate efficiently together.[19]

Single project specific documentation

6.5 This involves the preparation of tailor made documentation to regulate the development, governance and management of each and every project (i.e. the United States approach using such things as CC&R's or Condominium Declarations). These filings can be either:

[15] The *Registration of Plans (HSP (Nominees) Pty Ltd) Enabling Act 1980*, the *Registration of Plans (Stage 2) (HSP (Nominees) Pty Ltd) Enabling Act 1984* and the *Sanctuary Cove Resort Act 1985.*

[16] For example, the Queensland *Integrated Resort Development Act, 1987*.

[17] As has proved to be the case with the *Southbank Corporation Act* in Queensland.

[18] This being the case with the *Integrated Resort development Act* and the *Mixed Use Development Act*, both of which interface to the *Building Units and Group titles Act 1980* (which still operates for the limited purpose of serving those Acts).

[19] In my opinion, there is a good argument that this is what has happened in Queensland with the *Integrated Resort Development Act,* the *Mixed Use Development Act* and the *Building Units and Group titles Act* and in New South Wales with the *Strata Schemes (Freehold Development) Act 1973*, the *Strata Schemes (Leasehold development) Act 1986*, the *Strata Schemes Management Act 1996*, the *Community Land Development Act 1989* and the *Community land Management Act 1989*.

(a) complete regulatory instruments (as is the case in the US); or
(b) partial regulatory instruments.

6.6 Complete regulatory instruments (such as CC&R's and Condominium Declarations) have the disadvantage of potentially different rules for each and every project (i.e. there is no uniformity of provisions across projects).[20] This can make life more difficult for those persons who deal with the project on a daily basis, such as managers, lawyers and even owners. In addition, the freedom offered to lawyers and developers to tailor the documents to the project is open to abuse, which opens up the need for legislative intervention to protect consumers.

6.7 A partial regulatory instrument is a compromise between the US approach and the Australian generic legislation approach. It would involve a generic law which allowed much of the operational detail for an owners corporation to be placed in a filed document (e.g. an expanded community management statement). This would allow a good deal of the operations of a project to be addressed by tailor made documentation while reserving the more essential regulatory aspects (such as consumer protection) for the law. If this is done carefully it is possible to achieve a good compromise between the two extremes mentioned above. This is the approach that was adopted in Dubai to regulate the wide range of large, complex and unusual projects of that Emirate.[21]

7. History of the modular system

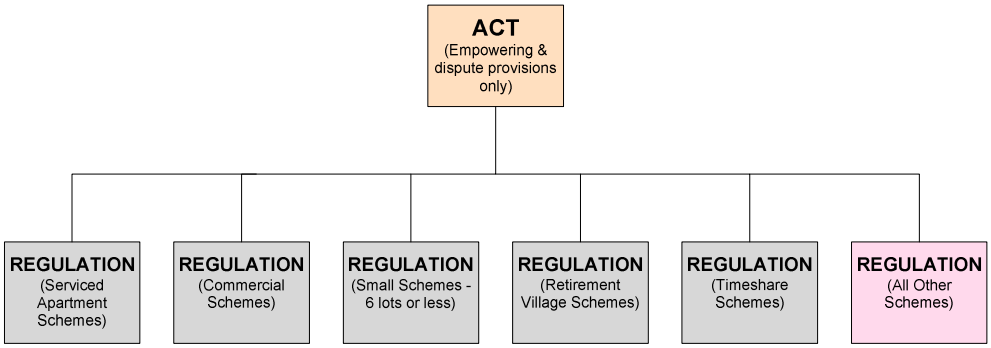
7.1 So far as I am aware the history of the Queensland modular system has never been publically documented. Yet this history is very important if one is to judge the merits of a modular approach similar to the one adopted in Queensland back in 1997. For those reasons I propose to take a little time to document some aspects of the history of the Queensland modular system.

7.2 In 1993 and 1994 the then Goss labour Government undertook a review of the *Building Units and Group Titles Act 1980*. One of the objectives was to resolve ongoing problems in the management rights sector. This resulted in the passing by the Parliament of the *Building Units and Group Titles Act 1994*, which was intended to repeal and replace the 1980 Act.[22] It was never proclaimed to commence and whilst awaiting gazettal it was almost universally criticised by every sector of the industry. The Government was at a loss to know how to satisfy the criticism but still achieve its underlying policy objectives.

[20] Although in many jurisdictions in the United States this is partly overcome by uniform legislation which covers some of the more mundane provisions (often consumer protection related) or the use of similar "precedents" by lawyers and other consultants.
[21] The Dubai *Jointly Owned Property Law* and associated Regulations and supporting instruments.
[22] This is the Act that was used by the Western Australian Government as the template for its substantial 1995 amendments to its *Strata Titles Act 1985*.

7.3 At the time, I was spending most of my time working on projects in Vietnam and Cambodia and paid no attention to the changes that were occurring in Queensland. However, I received a phone call from the head of the Land Department seeking my views as to why the Act (now passed and awaiting proclamation) was so unpopular with virtually everyone. This prompted me to read the Act, after which I formed the view that the Government could not achieve their objectives with a single generic piece of legislation. I advised the Director General that there was a solution but that solution would require the Government to repeal the 1994 Act and start again. The reaction was predictable; no Government could admit it got it wrong, repeal an Act that had just been passed and not commenced and then start again.

7.4 Expecting to hear nothing further, I was surprised when a delegation from the Department arrived at my office for a more detailed explanation of what form a new Act should take. I can clearly recall what was on my white board at the end of that meeting and it looked something like this –



7.5 The design principles discussed at that meeting were:

(a) the serviced apartment regulation would be reserved for schemes without resident owners and would allow long term management agreements and exclusively regulate them (i.e. it would be a highly regulated environment but directed specifically to facilitating tourism projects);

(b) the commercial regulation would operate like a normal company with the Board having all the powers with minimal management constraints and the general meeting having the ultimate power to replace the Board if it was unhappy;

(c) the small schemes regulation would be about 6 or 8 pages with simple motherhood statements about how the body corporate operates, obligations to merely document decisions however made and with the Commissioner acting as a safety-net if there were problems (i.e. small schemes would be legally able to operate the way they actually operate in practice);

(d) the retirement village module would provide a taxation environment similar to that available to leasehold schemes and would place appropriate powers in the hands of the village operator (the body corporate being more of an advisory body with some veto powers);

(e) the timeshare regulation would (with the agreement of ASIC) incorporate comprehensive disclosure requirements which would attract an exemption from the managed investment laws and the body corporate would become the vehicle to protect the interests of timeshare owners;

(f) the remaining regulation would replicate much of the governance and management provisions of the 1980 Act and would apply to all existing schemes, with rights to transfer in appropriate cases (thus addressing existing owner concerns about having their regulatory regime fundamentally and unilaterally changed contrary to their wishes);

(g) additional regulations could be added to accommodate more complex projects as they emerged (such as the *Sanctuary Coves* or *Brisbane Docksides*); and

(h) as problems emerge in the future in relation to a particular type of project the Government could easily (with surgical precision and usually without the delays of the Parliamentary process) amend the appropriate regulation without affecting the range of other projects.

7.6 Recognising an opportunity for something very special I also suggested that the new legislation could:

(a) cater for tiered management structures (similar to what had been achieved in New South Wales)[23]; and

(b) introduce for general use the concepts of an air space subdivision and a Building Management Statement (concepts that I had successfully incorporated into the South Bank legislation a few years earlier[24] when consulting to an earlier Government)[25].

7.7 The Registrar of Titles at the time, a Canadian by the name of Lauren Leader, was very supportive of these suggestions and that support no doubt contributed to the decisions which followed.

7.8 The Goss Government "bit the bullet" and started work, with my assistance as their external consultant, on the new modular regulatory regime. However, the final product was somewhat different to the original concept discussed in my office, mainly because:

(a) industry bodies consulted during the process (developers, homeowners and managers in particular) all had their objectives and vested interests and Government was keen to accommodate as many of their suggestions as possible;

(b) the Government itself had its own policy objectives;

[23] New South Wales achieved this by integrating provisions from the *Strata Schemes (Freehold Development) Act 1973*, the *Strata Schemes (Leasehold development) Act 1986*, the *Strata Schemes Management Act 1996*, the *Community Land Development Act 1989* and the *Community land Management Act 1989.* This was a somewhat "sloppy" solution, but the outcomes were very innovative at the time.

[24] See the *South Bank Corporation Amendment Act 1991.*

[25] None of these concepts were in the 1994 Act that was passed by the Parliament but never proclaimed to commence.

(c) just as the draft was nearing completion the Goss Government was defeated by the Borbidge Government which (fortunately) decided to continue the project but with its own policy objectives requiring inclusion;

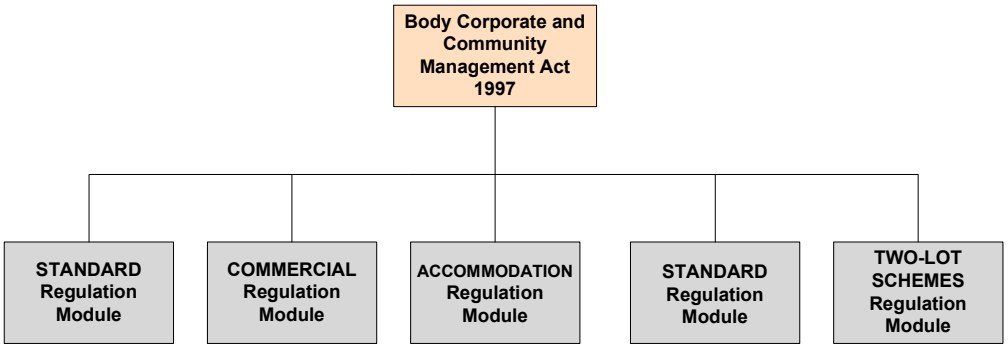
(d) the Borbidge Government was a minority government and was dependant on Ms Liz Cunningham, an independent member of the Parliament, for the passage of legislation and Ms Cunningham had her own ideas of what should be included in the legislation;[26] and

(e) the retirement village legislation was the responsibility of another Minister and that Minister wanted to do his own thing by introducing separate legislation for retirement villages; and

(f) the timeshare option was seen as being "too hard" and should be left for another time in case it delayed the program.

7.9 As if that were not enough to distort the original concept. A substantial review undertaken in 2003 resulted in the content of the 3 main regulatory modules becoming very similar and the Small Schemes Module becoming even more complex. Then, in 2008, a further substantial review brought the content of the 3 main regulatory modules even closer together and to overcome the complexity of the Small Schemes Module, a Two Lot Scheme Module was added (something that would have been un-necessary if the original concept had been followed). Queensland is now left with the content of its 3 main regulatory modules being largely indistinguishable and the content of the Small Schemes Module following on close behind. Today, one would seriously question why have the different modules at all?

7.10 So, the current Queensland modular regulatory system looks like this –



7.11 It follows that any judgment of the Queensland modular regulatory system should be cautiously undertaken in light of the history which I have briefly outlined.

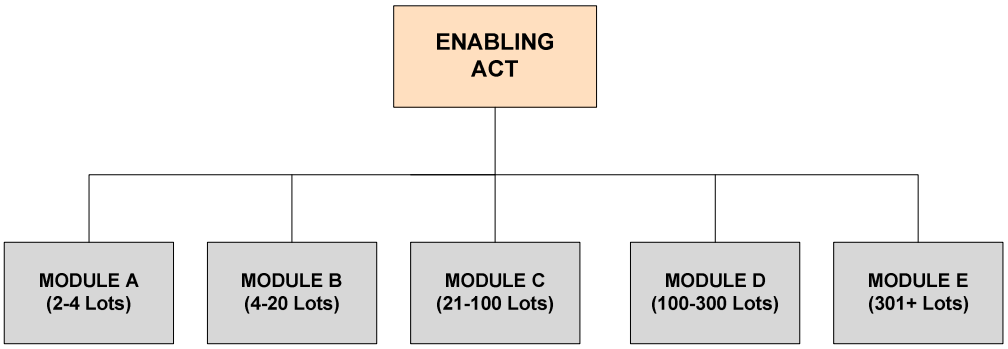
[26] Ms Cunningham is still an independent member of the Queensland Parliament at the time this paper was written.

8. Modular options

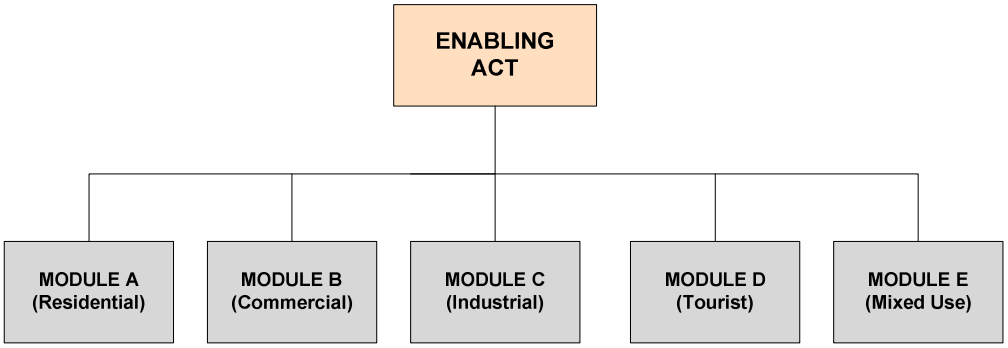
8.1 The Queensland modular regulatory system is substantially based on the way in which buildings are used. There are other options for structuring a modular system. For example, it could be based on:

- The number of lots in a Scheme
- The type of Scheme
- The type of subdivision
- A mixture of 2 or more of the other options.

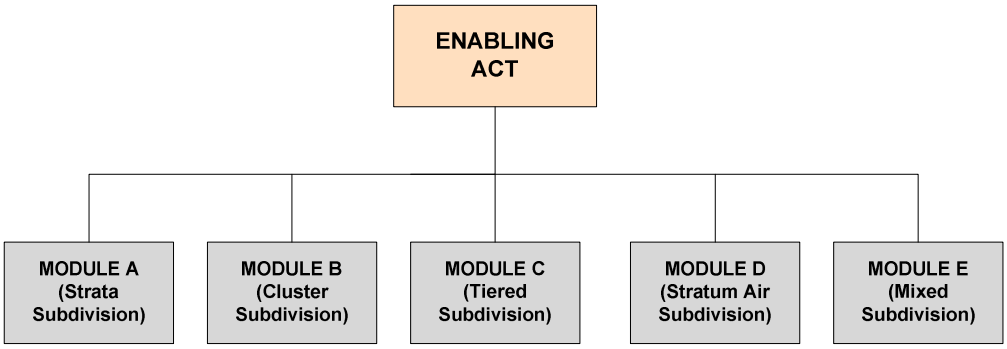
8.2 The following chart illustrates a system based on the number of lots in the Scheme. This approach assumes that the larger the scheme the more complex will be its governance and administration.



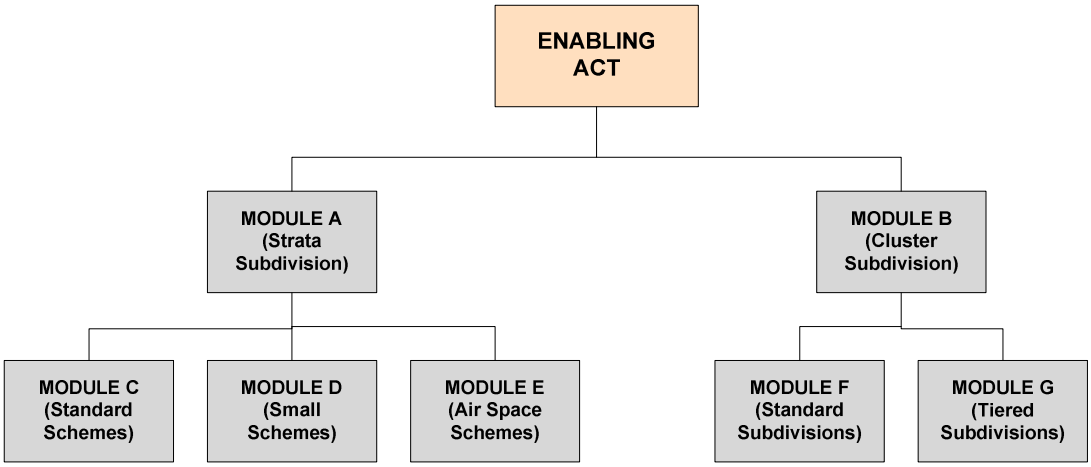
8.3 The following chart illustrates a system based on the type of Scheme –



8.4 The following chart illustrates a system based on the type of subdivision –



8.5 A system based on a mix of the above options has the potential to be very flexible but it is likely to be complex and repetitive. This is illustrated by the following example which has 2 layers of modules – the top layer relating to the basic subdivision type (vertical and horizontal) and the bottom layer related to the complexity of the particular buildings or communities.



9. Strengths of the modular approach

9.1 The principal strengths of the modular regulatory system are:

(a) the approach to governance and management can be varied from module to module according to the type of project being regulated;
(b) a project can be placed in the most appropriate regulatory environment;
(c) amendments to the Act can be kept to a minimum because the content that is most likely to require change is contained in the modules;
(d) if there is a problem with a particular type of project the relevant module can be changed without any impact on the other modules (thus minimising any "knock-on effect" for other projects);
(e) there is the ability to avoid separate legislation for such things as timeshare, retirement villages and mobile home parks;

(f) if a new type of project arises a new module can be added without affecting any of the existing modules; and
(g) the change can be made outside the normal parliamentary process (because of the use of regulations to house the detail).

9.2 The modular approach can become even more flexible if it is combined with the use of a statutory instrument (such as a community management statement) to regulate the detail associated with governance and management of the project, thus allowing for the "tailoring" of those things to the specific needs of the project.

10. Weaknesses of the modular approach

The principal weaknesses of the modular regulatory system are:

(a) the placement of a large amount of material in regulations that would normally be in the Act itself (this being a compromise on normal or purist legislative policy in a common law jurisdiction);
(b) the need to refer to multiple sets of regulations rather than a single set;
(c) the size of the final package (i.e. the number of pages), due to the repetitive nature of much of the material in the modules; and
(d) complexities of public administration, particularly where multiple Government Departments may need to be involved in aspects of the administration.

11. Conclusions

The following conclusions can be drawn from the discussion above:

- In many jurisdictions real estate projects are too large, complex and diverse to be successfully regulated under a single generic piece of legislation.
- Laws regulating common interest subdivisions need to be capable of being "adjusted" quickly and on a regular basis in a way that targets the problem being addressed while minimising adverse impacts beyond that problem (i.e. without causing a "knock-on effect").
- The strengths of the modular regulatory approach far outweigh the weakness of that approach
- The current Queensland model, while structurally sound, is not a good model to emulate because of the similarity of the content of the various modules.
- The use of statutory instruments (such as a community management statement) to house much of the scheme administrative material is a good alternative, particularly if it forms part of a modular regulatory system.

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