Department of
Justice and Attorney-General

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Management Rights in Community Titles Schemes

Discussion paper for consultation

Office of Regulatory Policy

Queensland Government

Management rights in Community Titles Schemes

Foreword

Management rights are the letting agent and caretaking services which private businesses provide to many of Queensland's 40,000 community management schemes on a contract for service basis.

Developers typically sell the management rights during the original owner control period as part of the economy of the development and before governance responsibilities transfer to the body corporate.

This practice has become an issue for many lot owners who are of the view that long term contracts for services may be sub-standard, overpriced, or inappropriate for many schemes. There are also claims that there is an increasing corporatisation of the management rights sector and that this, together with rapid turn-over in ownership and a significant increase in the value of management rights contracts in the past decade, has led to predatory and unconscionable conduct.

Other stakeholders disagree with these claims and are of the view that management rights arrangements in Queensland are generally working well and that lot owners in schemes under management rights arrangements are actually better off than those in self-managed schemes.

These various stakeholder perceptions and claims should be subject to some objective examination.

The *Body Corporate and Community Management Act 1997* (BCCM Act) has been amended several times to re-balance the needs and rights of bodies corporate and lot owners, and developers and management rights operators.

It is important to ensure community titles schemes remain an affordable and attractive accommodation and investment option across Queensland.

This discussion paper seeks to identify those issues associated with management rights in community titles schemes under the BCCM Act and to provide remedies if or as appropriate where there is real evidence that the regulatory framework might be out of balance.

Submissions from all parties interested in this issue are invited as the first step in a review process designed to find the best regulatory balance between the respective needs of the wider sector and individual lot owners.

The Honourable Paul Lucas MP

Attorney-General,
Minister for Local Government
and Special Minister of State

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1.1 Executive Summary

'Management rights' are arrangements where a business has a contractual relationship with the body corporate of a community titles scheme to provide a combination of caretaking and letting agent services, with the 'resident manager' or employee licensed to act as a resident letting agent living onsite.

Management rights businesses provide critical services to both the residential and tourist accommodation sectors.

It is a significant business sector in Queensland. Queensland is expected to increase its reliance on community titles schemes to meet development, housing and accommodation needs, and it is vital that the legislation governing these schemes remains relevant and appropriate.

Since the commencement of the *Body Corporate and Community Management Act 1997* (BCCM Act), management rights arrangements have been a source of significant discussion amongst community titles sector stakeholders, and the subject of several amendments to the Act.

This discussion paper is intended to initiate a dialogue about the current state of management rights in Queensland, in light of recent concerns about the establishment and operation of these arrangements, and to inform options for Government consideration to promote better regulation and confident investment in Queensland's community titles sector.

The paper discusses the effectiveness of legislative obligations on developers as original scheme owners when establishing management rights for a scheme, their somewhat contentious role in profiting from their sale, and explores measures which might address current concerns.

Community titles schemes often involve a mix of ownership priorities, and scheme characteristics are not always aligned with scheme use. The impact on these factors on conflicts centred on management rights are explored, and some measures to address these are proposed for comment.

The defining characteristics of the management rights business model and the market for management rights are discussed, alongside concerns about the impacts of rising costs on lot owners. Although, it must be recognised that many of these costs to lot owners are beyond the control of resident managers or even bodies corporate (for example, rates, insurance, electricity, water and waste collection).

Finally, the legislative protections, powers and remedies provided to bodies corporate and their lot owners are summarised, and feedback sought from stakeholders regarding improvements to the regulatory framework which applies to community titles schemes as they relate to caretaking and letting agent services.

1.2 How to make a submission

Interested individuals and organisations are invited to make written submissions in response to this discussion paper. Submissions will be made publically available on the Department of Justice and Attorney-General website unless marked 'IN CONFIDENCE'.

- Please send submissions to:

  Email: managementrightsreview@justice.qld.gov.au

  -or-

  Mail: Management Rights Review

  Office of Regulatory Policy

  Department of Justice and Attorney-General

  Locked Bag 180

  City East, QLD, 4002

- Submissions will be received until 8 May 2012.

- Copies of the *Body Corporate and Community Management Act 1997* and the regulation modules can be obtained at:

  www.legislation.qld.gov.au

1.3 The need for discussion

There are over 40,000 community titles schemes in Queensland, with an estimated property value of at least $70 billion[1] generating yearly letting revenues of around $2 billion.

More schemes are planned and under development. The Queensland population is expected to grow from 2.8 million to 4.4 million by 2031, and under current regional plans most of the housing needs must be provided within existing growth boundaries. In Brisbane alone this includes the establishment of 138,000 of the required 156,000 new homes. The higher density housing provided by community titles schemes will be critical to this effort. Similarly, future tourism accommodation needs will continue to rely heavily on community titles developments.

Management rights are a feature of many medium to large community titles schemes in Queensland. The term 'management rights' refers to arrangements where a business contracts with a scheme's body corporate to provide a combination of caretaking and letting agent services, with a manager licensed to act as a resident letting agent living onsite.

The BCCM Act defines 'management rights' as the letting agent authorisation, any associated service contract, any interest in a lot used for conducting the business, and rights to use common property for the purpose of the business. The legislation refers to the person operating management rights as a 'caretaking service contractor', but this paper will use the industry standard 'resident manager' for clarity.

Management rights in community titles schemes have emerged from a cottage industry in the 1970s, to a now multi-billion dollar industry, with somewhere between 2500 and 3000 of these businesses in operation[2]. Management rights are a common feature of larger schemes with lots offering tourist accommodation, but they are by no means restricted to such schemes. Rights are sold by scheme developers, and are able to be re-sold by existing rights holders.

Since the commencement of the BCCM Act, management rights arrangements have been a source of significant discussion amongst community titles sector stakeholders, and the subject of several amendments to the BCCM Act. Stakeholders and commentators have over time focussed on issues such as:

- the effects of long contract terms on body corporate governance
- increases in lot ownership costs and reduced investor returns
- high rate of re-sale of management rights agreements
- 'windfall' gains from sale of agreements
- appropriate settings for transfer fees
- the requirements of licensing and on-site residency for resident managers
- corporate management rights business models
- issues with the dual service role provided by resident managers

In other service sectors, consumers and service providers can more easily seek out new arrangements if problems arise, or if more attractive options become available. While the legislation provides for service contracts to be reviewed and renegotiated under particular circumstances, some lot owners (as members of a body corporate) and management rights holders feel 'bound' by typically long-term contracts and issues of investment and property ownership associated with those contracts.

While it may be desirable from some perspectives to seek out a 'fresh start' solution to perceived problems with management rights, the key requirement of the legislation and any potential adjustment is that it balance the rights and needs of all stakeholders.

Retroactive changes to the legislation impacting on existing businesses would have a substantial impact on the market, and could make many businesses unviable. Unless carefully constructed, changes targeted purely at future arrangements might see a split in the market for businesses operating under different requirements, with expected impacts on business values and workable business models.

Just as the tens of thousands of investors and owners have a substantial personal and financial stake in their schemes and the community titles sector as a whole, there is no doubt that existing management rights businesses represent a similar commitment by not only business owners and operators, but also financiers, and allied professions. Industry stakeholders believe that any significant changes to the current regulatory framework for management rights would have a substantive impact on the sector.

All stakeholders in the community titles sector should be mindful that body corporate legislation must provide a legislative framework that ensures the ongoing viability of community titles schemes, and the sustainability of the sector as a growing source of business, investment, tourism, accommodation and residency opportunities.

1.4 The management rights industry in perspective

The Australian Resident Accommodation Managers Association (ARAMA)[3] and other sources estimate there are between 2500 to 3000 management rights businesses operating in Queensland. It is not possible to accurately describe historic growth, however it is likely that the industry continues to grow, as rights are created for new schemes, and existing contracts are not typically allowed to expire. At this time it is also not clear how many of these businesses are operating as serviced strata arrangements that come under the managed investment scheme provisions of the *Corporations Act 2001* (Cwlth), to which certain provisions of the BCCM Act do not apply[4].

In Queensland, ARAMA has at least 900 members, managing over 43,000 lots with an aggregate value of at least $12 billion. They collect an estimated $330 million in holiday letting revenue and $290 million in longer term letting revenue yearly. ARAMA estimates there are 70,000 lots managed across all management rights businesses. Assuming similar revenue rates and unit values for ARAMA members and non-members, the management rights industry in Queensland manages lots worth around $20 billion, with yearly letting revenue of over $1 billion.

Management rights businesses potentially receive total revenue from letting activities of over $100 million each year, assuming an average 9.75% commission (averaged 7.5% for permanent, 12% from holiday[5]). Total income from caretaking activities may range between $56 million and $84 million (caretaking incomes of $800 to $1200 per lot per year[6]). Resident managers often provide other services to lot owners and residents, which would amount to millions of dollars in additional annual income.

Management rights businesses typically sell in a range between $0.2 and $6 million. The total value of management rights arrangements in Queensland ranges from around $2.5 billion to $6 billion[7]. Several hundred businesses are sold each year, with the average transfer period for a business estimated to be every

three years[8]. Conservatively, business transfers may involve outlays of $600 million or more each year[9].

1.5 Legislative comparisons

Every Australian State and Territory has legislation that provides community living options where people hold not only individual title for a lot or property, but also share collective ownership of common property. The legislative approaches taken by the States are similar in regard to collective ownership of common property, the establishment of governance structures such as the body corporate and committees, and the creation of rules specific to the scheme such as by-laws.

However the Queensland legislation is relatively unique in the way that it approaches the regulation of letting agent and caretaking services. These businesses developed and emerged in Queensland quite early. This was in part due to the characteristics of the Queensland market and the prevalence of schemes offering short term tourist accommodation owned by individual investors or part-time occupiers. The Queensland legislation was put in place to regulate an existing and growing management rights industry, and an established set of industry practices.

The growth of management rights businesses in other States has been limited most likely due to a combination of legislative and market characteristics. The BCCM Act and the *Property Agents and Motor Dealer's Act 2000* (PAMDA) were formulated to accommodate and arguably foster a sizeable management rights industry. It is likely that this imperative was not shared by other jurisdictions.

There is a modest management rights industry in New South Wales of around 200 businesses. The legislation there prevents developers from entering into caretaking agreements that extend beyond the first annual general meeting of the owner's corporation, which reduces developer capacity to sell long term contracts for large sums. The legislation does not provide protections for financiers. The owners corporation, the equivalent of a body corporate, is able to profit from the sale of these agreements and negotiation of extensions. Management rights are being actively marketed to owners corporations as a way to bolster their funds. The contract term limit in New South Wales is 10 years.

Victorian legislation does not recognise either letting agents or caretakers and is silent on the issue of management rights. There are around 25 such businesses in the State despite a large community title sector, but the industry is growing. The recent relaxation of estate agent licensing requirements may be assisting growth, as there is no low requirement resident letting license category in Victoria. There are no contract term limitations, and no protections for financiers of management rights businesses.

The remaining States each have total numbers of management rights businesses in the range of 5-25. Western Australian legislation includes a 5 year termination right for service contracts entered when any one owner had majority control of the body corporate, and no protection for financiers. This limits the viability of high-value Queensland style management rights businesses. In South Australia, a community corporation, the equivalent of a body corporate, can revoke a delegation of its functions at any time regardless of contractual agreements, and the legislation provides no protection for financiers. This combination would appear to limit the viability of management rights arrangements.

Q.1 *Are there benefits to be gained from further exploring legislative approaches taken by other jurisdictions?*

2 The establishment of management rights

2.1 Role of the developer as original owner

The development of new community titles schemes is vital to the growth, health and sustainability of the community titles sector as well as to the needs these schemes serve in the wider community. It is critical that community titles legislation does not unreasonably restrict development through unnecessary regulatory burden or impacts on potential returns. At the same time, it is critical to ensure the development process is sensitive to the long-term needs and sustainability of a scheme.

At the establishment of a scheme, the developer of the scheme is the "original owner" of scheme lots and effectively controls the scheme until more than half of all scheme lots are sold. Management rights are usually put in place by the developer as body corporate during this original owner control period. It is uncommon for a body corporate to install management rights once the original owner control period has ended, although the legislation does accommodate this option.

2.2 Developer sales of management rights agreements

It is common practice for developers to profit from sale of management rights agreements. This has been a source of significant and long-standing concern for some stakeholders in the community titles sector.

For developers the sale of management rights may be important to the viability of a project, and the magnitude of expected returns. Financiers may factor in any future sale of management rights into early funding decisions. The contribution to the net return on development may be as high as 15%. Returns from management rights sales range from "bread and butter", to "icing on the cake"[10].

The early engagement of a resident manager is also proposed to provide certainty for off the plan purchasers, particularly investor owners who are assured their lot will be available for letting as early as possible.

The most contentious feature of this primary market[11] for management rights is that the participants in the sale are the management rights businesses and the original owner. This sale involves not only the sale of the resident manager's lot or other property[12], but also the sale of a caretaking agreement and letting authorisation between the management rights business and a body corporate.

Some argue that the sale of management rights agreements by developers removes the capacity of lot owners to exercise control over the decision to establish a management rights agreement, or negotiate costs, duties and length. The body corporate of lot owners will be bound and serviced by long-term contractual arrangements, and so should be able to choose whether to enter them. The BCCM Act does provide newly established bodies corporate the right to review agreements arranged by the developer, as is discussed in section 2.5.

The prospect that the proceeds of management rights sales should return to the body corporate has been raised in past discussions of management rights. The BCCM Act specifically prevents bodies corporate from receiving such proceeds[13]. As discussed in section 1.5, the New South Wales legislation, in contrast, does not prevent owners corporations from profiting from the sale of comparable caretaking agreements.

Q.2 *Are sales of management rights agreements by developers critical to the viability of development projects, and if so, why?*

Q.3 *What are the arguments for and against a body corporate receiving the proceeds of a management rights sale?*

2.3 The Arrow decision

It should be noted that the BCCM Act is silent on the question of whether original owners should or should not be able to receive the proceeds of management rights sales. The legal position as to whether a developer can accept consideration for selling management rights or whether accepting consideration would not be 'acting in the best interests of the body corporate' as required by the BCCM Act, is untested.

Any such legal challenge is likely to be informed by the 2007 NSW Supreme Court decision of *Community Association DP No. 270180 v Arrow Asset Management Pty Ltd & Ors* [2007] NSWSC 527 (Arrow Decision). The Arrow Decision held that a fiduciary relationship exists between a developer and a body corporate, and that a developer owes a body corporate a fiduciary obligation not to profit from contracts for the sale of management rights without proper disclosure to the body corporate of the profit. A fiduciary obligation is a legal or ethical relationship of confidence or trust regarding the management of money or property between two or more parties.

Q.4 *Does the level of disclosure by developers in relation to management rights agreements match the perception they owe a fiduciary duty to the body corporate, and should it?*

2.4 Developer obligations – agreement terms

The contractual terms of management rights arrangements are relatively static. These terms will have a sustained impact on the services provided to lot owners and the body corporate, and the costs of those services.

The interests of developers and the body corporate may not always align. There are perceptions that developers put in place agreements based on what lot owners can feasibly support through levies, and what will provide a sufficient income for the resident manager, rather than what is most appropriate for the scheme. Research in the area has highlighted these potential mismatches between developer motivations and the needs of the body corporate and its lot owners[14].

Some industry stakeholders promote the concept that the appropriateness of management rights agreements depends largely on the size of a scheme: for example 25-30 lots is seen as sufficient for management rights to be put in place, as it provides the resident manager a viable letting pool[15,16]. Others claim this approach as a type of 'failed logic' and that the prevailing rationale for putting agreements in place should be that the scheme requires a resident manager to function optimally[17].

The body corporate legislation provides that the developer (as original owner) must exercise reasonable skill, care and diligence and act in the best interests of the future body corporate when engaging a resident manager[18]. The BCCM Act provides that a penalty of 300 penalty units ($30,000) may be imposed for such a breach. A person asserting the breach may take court action and seek the award of a penalty, and compensation for loss or damage.

Q.5 *In practice, do the existing responsibilities, penalties and redress mechanisms for management rights establishment by the original owner ensure that such agreements are appropriate for the scheme?*

2.5 Review of agreements established by the original owner

The BCCM Act[19] provides a 'honeymoon' review mechanism for service contracts arranged by the original owner/developer, so that parties to these service contracts have an opportunity to ensure that they are appropriate.

A service contract is eligible for review after the original owner period has ended, while the service contractor is still engaged, and within a defined review period. In most cases, the review period will be a minimum of three years from the beginning of the contract term. A service contract may only be reviewed once in this manner[20].

The review must be in the form of written advice, provided by an appropriate, independent person. The terms of the contract that set out the functions, powers or remuneration of the contracted party are eligible for review. The legislation sets out a comprehensive list of criteria that must be addressed by the review. Parties to the review may seek an order from either a specialist adjudicator, or the Queensland Civil and Administrative Tribunal (QCAT) to resolve a review dispute.

The intent is to ensure that contracts established between a body corporate controlled by the original owner, and the service contractor, are fair and reasonable once the body corporate is no longer under original owner control, and the scheme and service contract are both in operation.

Q.6 *Is this review mechanism an effective way to ensure service contracts entered into by developers are fair and reasonable?*

2.6 Transitional management rights agreements

New South Wales legislation allows original owners to create and enter into caretaking agreements[21], but also provides that such agreements expire upon the holding of the first annual general meeting of the owner's corporation (body corporate), at which time at least a third of the lots in the scheme are no longer controlled by the original owner[22]. At that time a new agreement may be entered into upon decision of the owners corporation.

This "transitional" mechanism is based on a policy position that the owners corporation should be able to exercise a substantial degree of control over the agreements it is bound by, once no longer under original owner control.

Queensland has a well-established management rights industry, where the price of a business and its financing viability are based largely on an assumption that the long-term contracts underpinning them are renewable and saleable for the life of the scheme. Transitional management rights arrangements would be a substantial departure from this model.

However if it is assumed the management rights model is an appropriate and effective way to provide caretaking and letting services for community titles schemes, as is routinely claimed [23], re-engagement should be common. Alternatively a transitional arrangement might create business opportunities for new service providers.

Q.7 *Would this type of "transitional" requirement work in Queensland, and why or why not?*

2.7 Choice of regulation module

The original owner is responsible for choosing a scheme's regulation module. While the body corporate may subsequently change regulation module, this does not alter the terms of an existing management rights agreement[24].

The Standard Module is the default module for a community titles scheme[25]. It is primarily designed with owner occupancy and long-term residential needs in mind, and limits the length of management rights contracts to 10 years.

The Accommodation Module is designed for schemes mainly offering long or short-term lease or letting, typically holiday accommodation, and it puts a 25 year limit on contracts. Management rights agreements for schemes registered under the Accommodation Module are potentially more valuable and easier to finance due to this longer contractual term.

ARAMA states that the majority of schemes under management rights arrangements operate quite successfully at a term which is far less than the maximum allowable under the relevant regulation modules.

A scheme can be validly registered under the Standard or Accommodation Module based not only on actual use of lots, but also historic or intended use, and without requirements for any particular scheme facilities, lot types, or building code in place. This flexibility allows the usage of scheme lots to evolve or emerge over time without requiring a change in module.

Maximum term length, one of the key aspects of a management rights agreement is largely dependent on the original owners/developers' choice of regulation module. As discussed, there are obligations backed by penalties that must be met by original owners entering agreements on behalf of the body corporate. However the legislation does not place particular obligations on the original owner in relation to the choice of regulation module.

Q.8 *Are developers generally choosing appropriate regulation modules for schemes? If not, how could this be addressed?*

3 Scheme and stakeholder characteristics

3.1 A purpose statement?

The objectives of the BCCM Act recognise that the lots in a scheme will seldom be used for a single, uniform purpose. It is commonplace for schemes to serve the potentially conflicting needs and interests of investors, owner occupiers, holiday makers, short-term tenants, permanent tenants, and resident managers.

Some stakeholders in the sector believe that community titles schemes that are conducive to management rights generally have a well-defined purpose or identity, and have the facilities, services, regulation module, building classification, and management obligations and duties that align with that purpose[26]. The potential for conflict may be heightened where there is poor fit between factors such as scheme characteristics, the nature of management rights in place, and lot owner priorities for scheme use.

Some believe there is a need for some additional identification of scheme purpose or identity to avoid such problems. Clashing perceptions about scheme use and purpose may result from a lack of clear information provided to purchasers about the

prevailing or intended use of a scheme. While a 'purpose statement' may not assist reduce conflict in current schemes, it might benefit future schemes.

Q.9 *Is there merit to schemes being required to have a statement of purpose or identity? How might it be used, and what effect could it have?*

3.2 Changing regulation module

A body corporate may act to change the regulation module applying to its scheme[27]. Concerns have been raised that inappropriate changes from Standard Module to Accommodation Module may be sought by resident managers, through lobbying investor owners in particular, or relying on lot owner disinterest or an amenable committee. These types of issues have on occasion led to applications for dispute resolution where some lot owners question the outcome or process of changes.

Change of module is a significant step for a body corporate. The legislation requires an explanatory note for such motions be included in a prescribed form[28] . This explains the effects of the proposed change, caution lot owners to carefully consider the differences between modules, and set out those key differences.

As discussed in the section on developer obligations, the regulation module governs the maximum allowable term of a management rights arrangement. A change from, for example, the Standard Module to the Accommodation Module is potentially of great benefit to a resident manager, as it will generally increase the value of the business. Similarly, a change in regulation module can also benefit lot owners and increase the value of the real estate.

Q.10 *Are the current arrangements for changing regulation modules adequate to ensure appropriate regulation modules are chosen for schemes?*

3.3 Occupiers, investors and resident managers

Resident managers typically provide two key services to a community titles scheme and its lot owners: caretaking and letting. The performance of these services may be driven by competing motivations, and the importance of these services to lot owners will depend on their ownership priorities. This may also lead to conflict not only between owners and management rights holders, but between different groups of owners. Disputes may arise from body corporate decisions and the actions of individuals or groups to influence them.

Investor owners and owner occupiers may differ in their concerns about the level and quality of service that should be provided by a resident manager. There are suggestions that owner occupiers expect a higher level of routine maintenance to common property. Investor owners are often removed from the scheme, and their awareness of the day-to-day conduct of the resident manager may be minimal.

However, there are also perceptions that owner occupiers are less likely to want to spend additional money on scheme or lot refurbishment and maintenance, while investors are more likely, particularly where it is tax deductible. An attractive scheme increases the income earning potential of an investment lot. That being said, an attractive scheme can also increase the appeal for real estate capital gain for all lot owners in a scheme.

Investor owners may choose to remove their lots from the letting pool to reside in the scheme, allow an outside agent to let their unit out, or sell to an owner occupier. This could limit the potential letting income for resident managers, and consequently may

affect the relationship between the lot owner, tenant and the resident manager. Alternatively, lots once used for permanent residency may become attractive opportunities for short-term accommodation, to the benefit of the lot owner and the resident manager as a letting agent but the perceived detriment of owner occupiers and other long term residents.

Researchers have looked at the relationship between resident managers and lot owners in tourism focused schemes[29,30]. These investigations identify potential moral hazards and conflicts of interest that may arise from the nature of management rights arrangements. This research highlights how lot owners are a diverse group and the interests of resident owners and investor owners often do not align. It describes the substantial control over investor returns exercised by resident managers that potentially affects their relationship with investor owners. And it points to potential moral hazards, as developers have an incentive to create management rights arrangements favouring the resident manager, while owners have a disincentive to take actions that might impact on their relationship with the resident manager.

Q.11 *Are these types of tensions between owner occupiers, investor owners and resident managers common to conflicts involving management rights? If so, are there ways to address them?*

3.4 Flexibility or restricted use?

The BCCM Act is built on policy that places great importance on the flexibility of lot usage in schemes. For example, the BCCM Act specifically prohibits a by-law from restricting the use of a lot for any lawful residential purpose, preventing transfer or dealing with a lot, or discriminating between types of occupiers.

It could be argued that allowing lot use restrictions based on the applicable regulation module or building type would be an appropriate way to reduce conflict in schemes. This would be a significant departure from the current 'spirit' of BCCM Act, and might have broader consequences.

Efforts by local governments to restrict maximum rental terms in certain areas to address tenancy needs coincided with drops in property values and impacts on financing availability for lot purchases[31]. Values in one area were estimated to drop by up to a third following short-term accommodation restrictions[32].

Restrictions on lot use could be implemented through changing the requirements for application of the existing modules, a new module, or change in scope of by-law prohibitions. A tourism scheme module would be encouraged by some. Research on the use of community titles schemes for tourism accommodation highlights the potential inefficiencies and conflicts inherent in some schemes that mix permanent residency and short-term accommodation[33]. However, a new regulation module would not address the concerns of stakeholders in existing schemes.

Q.12 *What might be the potential advantages and disadvantages of allowing lot use restrictions, and how could this be implemented?*

Q.13 *Is there a need for an additional regulation module? What needs would it address, and what characteristics would it require?*

The Building Code of Australia (BCA) provides for different building classifications based on their use and risk. Different building classifications require compliance with different fire safety and access requirements. However the body corporate legislation

does not rely on the BCA or its classifications in regard to choice of regulation module.

There are concerns about the use of class 2 buildings for holiday, serviced apartment, or otherwise short-term accommodation. These types of use are appropriate for class 3 buildings. Owner occupiers who object to other scheme lots being used for short-term tenancy are perhaps most concerned about this issue.

Class 2 buildings have relaxed requirements in regard to disability access, fire safety and water and energy efficiency, in recognition that occupants will typically be long-term residents aware of the nature of the building and facilities, and paying for utility usage. Class 3 buildings are intended for use as short-term, non-dwelling accommodation, and have more stringent access and safety requirements.

In 2008, the former Department of Infrastructure and Planning released a draft guideline on the 'Meaning of class 2 building classification under the Building Code of Australia', which intended to clarify that buildings used for short-term accommodation not be classed or approved as class 2 buildings. However, this guideline has not progressed beyond a draft stage.

At present, there are clear perceptions that lot owners may let out their lots on a short-term basis if they so desire, and management rights businesses in many cases operate short-term letting in class 2 buildings under the Accommodation Module. Changes might impact significantly on both investor owners and management rights operators. Costs associated with building conversions from class 2 to class 3, if viable, might be considerable.

Changes might also lead to a loss of flexibility or higher development costs in future schemes if lot or scheme usage is restricted by building class. There might also be issues of body corporate liability for the actions of lot owners, despite the body corporate having no power to ensure compliance by lot owners with the BCA.

Q.14 *Should building classification be used to restrict choice of regulation module, lot usage, and/or the nature of management rights arrangements allowed? How might this be done, and what effect would it have?*

4 The management rights model and market

4.1 Key characteristics

Developers established the role recognisable today as resident manager more than 40 years ago. Having an onsite caretaker and letting agent with a personal stake in the scheme ensured by lot ownership was seen by developers as an effective way to provide low cost management for a scheme. This was aimed more at providing a service to attract purchasers than creating a management rights product for sale[34].

Licensing regimes emerged for letting activities, culminating in the resident letting agent provisions of PAMDA. As the concept became more popular, a market emerged for off the plan sale and the re-sale of management rights businesses. Due to the rising value of management rights, financing became a necessity, and dedicated management rights financing businesses and specialists within the major institutions began to focus on the market.

The majority of management rights businesses are heavily reliant on financing. Financiers offer flexible loans of up to 60-70% of the business component and 50-

90% of the property component. There are claims that the costs of loan servicing in some cases exceed the caretaking remuneration received[35].

The price of the business component of a management rights business is based on a multiple of estimated net operating profit. The multiplier is set based on scheme characteristics and market conditions. The multiplier approximates the number of years required to recover the cost of the business component excluding extra purchase costs[36], and not taking finance costs into account. Based on some standard industry figures, the financing costs for a business purchased with a loan of 70% of business and property value and a multiplier of five will account for around half of the net operating profit.

4.2 Lot ownership and usage rights

Management rights businesses generally own a lot or lots in a scheme, often with title or occupation authority to an office or reception area. The concept that an effective resident manager is a lot owner, investor, resident and stakeholder in a scheme is widely promoted, although there is no legislative requirement for lot ownership. Lot owning resident managers are voting members of the body corporate, and all resident managers are non-voting members of the committee.

The letting agreement and/or the by-laws of the scheme allow the resident manager to operate a sole resident letting agency within a scheme. As by-laws attached to a particular lot may only be changed by consent of the lot owner, they provide substantial protection for letting rights when used for this purpose[37].

The legislation defines the management rights as the letting agent authorisation, any associated service contract, any interest in a lot used for conducting the business, and rights to use common property for the purpose of the business. When either a body corporate, or a letting agent, seeks to transfer the rights, all associated elements are included in the transfer. This includes the transfer of any interest in a lot used for the business even where it is not owned by the business, as provided by the requirement for a lot owners deed to be in place[38].

The legislation also empowers the body corporate to acquire and lease part of the common property for use as a letting agent's premises and/or residence[39]. This type of arrangement does not appear to be common.

The property owned as part of a management rights business contributes to the cost of the agreement, and the associated financing demands. Some have expressed concerns that high business values and associated finance costs negatively impact the industry and the schemes it manages. The ownership of vital scheme property by the management rights business may also contribute to the difficulties faced by bodies corporate seeking to transfer or terminate a management rights agreement.

Q.15 *What are the advantages and disadvantages of management rights businesses owning scheme lots? Are there other approaches that could be explored?*

4.3 Letting arrangements and licensing

The licensing criteria and requirements of conducting a letting agent business are provided by PAMDA. A management rights business operating as a letting agent requires at minimum either a corporate or individual resident letting agent licence; in any case there must be an agent residing on site who is appropriately licensed. The licensing criteria include some probity elements and the completion six training modules. Licensing also requires body corporate approval. Letting appointments are

at the discretion of individual lot owners, and the requirements for these are also governed by PAMDA.

A letting agent may also rely on a real estate agents licence under PAMDA. A letting agent with a real estate agent licence is not required to reside in the scheme, unless there are contractual terms of the letting agreement with the body corporate requiring residency. An estimated 20% of ARAMA members hold real estate licenses.

Some stakeholders query the licensing requirements for resident letting agents; specifically the requirement that licensees reside on site. It has been suggested that an employee or night-manager could reside on site rather than the licensee subject to the body corporate approving the arrangement. However it is the licensee who has completed training modules required for license eligibility and undergone probity checks.

Q.16 *Are the licensing requirements for letting agents appropriate?*

Many management rights businesses operate in schemes that provide accommodation to holiday makers and tourists. Resident managers in these schemes need to have the necessary skills and systems to handle this type of letting activity. Resident managers often also provide additional services to their guests. As ARAMA publications emphasize, many resident managers are the 'face' of their scheme to visitors, and play a vital role in ensuring their stay is an enjoyable one. Resident managers can use their local knowledge and have materials on-site to assist with tours and travel advice, may arrange bookings for guests, and liaise with marketers and booking agencies.

Some stakeholders with an interest in the tourism sector question whether many residential managers have sufficient training, skills or experience for the demands of the role. Many resident managers who purchase rights are entering a property management role for the first time. Business endeavours typically carry a degree of risk, and most management rights purchasers would be well aware of serious financial commitment that their business entails. However, in community titles schemes the degree to which a management rights business succeeds or fails has wider impacts.

Q.17 *Are the current licensing and other suitability requirements for resident managers sufficient to ensure they will be effective in the role? Is there a place for additional requirements in general, or for specific scheme types?*

4.4 The corporate rights model

In the last decade the industry has seen an increase in corporate management rights operations, where larger companies own the rights for several medium to large schemes, and install licensed employees as resident managers. There are likely to be around 100 schemes and 7500 scheme lots under corporate management[40].

Corporate operators bought management rights to some schemes at relatively high prices[41] on the Gold Coast, and the perceived impact on management rights values and the sustainability of the market for management rights has been cause for some concern. Other matters such as disputes over the trade marking of scheme names by management rights holders, and the transparency of booking fee and commission arrangements have emerged.

Management rights is often described as a 'people business'. While there is no compelling reason why employees cannot provide services equivalent to those

provided by owners, there are perceptions that employees without a substantial stake in a scheme will be less effective in the resident manager role. There are also concerns about accountability and lack of authority where employee resident managers must defer to their supervisors rather than being empowered to resolve matters themselves.

Corporate operations might be expected to benefit some schemes due to economies of scale ensuring more cost effective operation, competitive rates, and increased returns to investor lot owners. However this does not match claims of diminishing returns in some schemes under corporate management, with investment returns as low as 2%, and 60% of letting income going to the management rights business[42], and Court actions over letting charges.

Q.18 *Are there issues specific to the operation of management rights under the corporate model that require attention?*

4.5 Market competition

The market for management rights businesses itself appears to be relatively competitive. Multipliers used to determine business values vary in response to industry trends, locale, and scheme characteristics[43]. At the time of writing there were 954 management rights businesses listed for sale by one online management rights brokerage site[44], although some of these may be double listings by different brokers. This suggests there is a high level of activity in the market.

The legislation poses some potential barriers to competition. Licensing requirements restrict entry for some participants. The body corporate is provided the right to approve management rights transfers, although it can only withhold approval based on limited criteria as discussed in section 5.2.6. The body corporate powers to terminate or force the transfer of an agreement also potentially impose restrictions on competition through devaluing businesses.

These aspects of the body corporate legislation are in place to provide vital consumer protections for bodies corporate. The transfer provisions are based largely on elements of the Managed Investment Scheme provisions of the *Corporations Act 2001* (Cwlth) at the suggestion of the development and management rights industries[45]. This managed investment model was modified to provide a greater degree of security for management rights holders. Indeed some industry commentary suggests that the level of regulatory control exercised over the industry is one factor which has ensured its success.

Q.19 *Does the body corporate legislation unduly restrict competition in the management rights market, and if so, how?*

4.6 Service competitiveness

While there is apparent competition in the market for management rights, the extent to which bodies corporate and lot owners actually participate in or derive benefit from that competition needs to be considered.

There are substantial financial flows in the management rights industry resulting from sale and transfer of management rights agreements. Some of this value reflects the efforts and investment of resident managers performing their roles, or developers putting contracts in place and returns on associated property. However there is also an argument that much of it derives from costs incurred by lot owners beyond those

to be reasonably expected for the service received; in effect that lot owners subsidise the profits of the management rights industry.

When dealing with management rights bodies corporate do not have the decision-making power typical of consumers. In the majority of relevant schemes, the caretaking aspect of a management rights agreement is installed for the body corporate as a binding arrangement for up to 10 or 25 years. Since bodies corporate cannot effectively negotiate terms with resident managers in the market for rights, or 'shop-around', they are excluded from any real competitive process.

When the earliest management rights arrangements were put in place in the 1960's and 1970's, it was believed that one of the benefits of on-site residential management was that it was more efficient and cheaper than off-site management, because it was subsidised by letting income[46]. There are stakeholders who question whether this is still the case.

The costs of caretaking provided by resident managers may substantially exceed the costs of similar services provided by outside services. As a resident manager typically lives on site their ready availability, for example in the case of an emergency, and personal stake in the scheme may be a benefit to be offset against this higher cost [47] . Similarly, their interest in letting success may motivate performance of the caretaking role.

There are reports of schemes where rights have been allowed to expire and subsequently put out to tender, which in one case resulted in substantial cost decreases (44 to 66%) while performance of duties remained satisfactory. Conversely, there are also reports of schemes where the body corporate has incurred additional costs and come to the conclusion that the expiring of management rights has resulted in more costs.

In addition, there are also reports of schemes where the resident manager has relatively onerous duty requirements for the income received and needs to take work outside the scheme to achieve sufficient income, as well as resident managers willing to re-negotiate contracts where scheme operating costs become a serious issue.

The legislation places a duty of care on the original owner when entering into agreements as discussed earlier, and it also requires resident managers through the codes of conduct to supply goods and services at competitive prices as discussed in 5.1. The perceived escalation of costs associated with management rights is of concern to the Unit Owners Association Queensland (UOAQ) and many individual lot owners. Estimates provided by these organisations place caretaker remuneration and fees for management rights at between 30 to 40% of body corporate levies payable by lot owners.

The remuneration payable to a resident manager for their caretaking function is typically indexed to CPI so that it increases regularly to keep pace with inflation. There are some contracts where the increase is by CPI or a set percentage, whichever is higher, with 5% suggested by some examples. Assuming starting remuneration of $100,000 in 2000, by 2010 a contract with a yearly 5% percentage increase would result in an additional $25,000 in remuneration compared to CPI indexed increases.

Some managament rights contracts provide for market reviews of remuneration every three or five years. This type of remuneration adjustment might be expected to introduce an element of competition, and is promoted by some industry stakeholders [48] . Changes to remuneration based on an analysis of market

requirements may be more appropriate than those based on fixed rate compounding increases.

Q.20 *Is indexing caretaker remuneration above CPI levels common, and is it appropriate? Are there other periodic adjustment indexes in use?*

It is difficult to assess the impact of management rights agreements on costs of community title lot ownership compared to detached housing ownership from non-partisan sources. Existing surveys or reporting requirements do not consider factors such as whether a scheme has management rights, or the costs of these arrangements. It is believed that only 70,000 of the almost 380,000 lots throughout Queensland (that is, 20 %) are under management rights and their impact on more general statistics is limited.

Letting agent's incomes are largely quarantined from the impact of costs associated with letting as their commission is based on rentals before costs; that is revenue, not profit. Some stakeholders have concerns that when the costs of secondary services such as room cleaning are factored in, returns from letting to lot owners are small, and have been diminishing over time. Where there are real or perceived impediments to arranging viable alternative letting arrangements these concern may be heightened. However, ARAMA asserts that units managed by a resident manager can achieve a greater rental rate than one managed by an outside letting agent.

The body corporate legislation is largely silent on the mechanics of how letting agents perform and charge for secondary services, but does provide a code of conduct for letting agents prescribing certain actions and behaviours, and proscribe others as addressed in section 5.1. Provisions governing specific matters such as trust accounts and maximum commissions are provided by the PAMDA and regulations.

Q.21 *Is there evidence to suggest that services provided by management rights businesses are not sufficiently competitive?*

Q.22 *Do bodies corporate or lot owners have significant 'bargaining power' in relation to service costs?*

5 Protections, remedies and obligations

The BCCM Act provides powers, remedies, and procedures which a body corporate may employ to address serious problems with the service and behaviour of resident managers, or simply to re-negotiate such matters as the remaining term of a contract. The legislation provides these mechanisms in addition to any termination clauses, remedies or performance requirements provided by management rights contracts.

It should be noted that some of provisions of the BCCM Act do not apply to schemes operating as serviced strata arrangements which fall under the Managed Investment Scheme provisions of the *Corporations Act 2001* (Cwlth) and its associated instruments. These include all provisions governing the forced transfer of letting agent rights by the body corporate. In such schemes agreements between the letting agent and each owner must contain terms to allow a majority of the unit owners in the letting pool to force transfer of the rights to a nominated new operator.

5.1 Codes of conduct

The three conduct codes in the BCCM Act were put in place to ensure that letting agents, caretakers and voting committee members conduct themselves appropriately

within schemes. The codes underpin code contravention notices, which can be issued by bodies corporate to address inappropriate actions, and are also relied upon by bodies corporate in exercising their rights to force a transfer of management rights in the event there is continuing non-compliance.

5.1.1 The code of conduct for body corporate managers and caretaking service contractors

A resident manager must comply with the code of conduct for body corporate managers and caretaking service contractors[49]. The provisions of the service contractor code are taken to be included in the terms of the contract providing for the engagement, and if there is an inconsistency between a provision of the code and another term of the contract, the provision of the code prevails[50]. Failure to comply with the code can result in termination or forced transfer of a management rights contract (see further sections).

The code sets out both prescribed and proscribed forms of conduct in relatively general terms, including:

1. Knowledge of BCCM Act, including code
2. Honesty, fairness and professionalism
3. Skill, care and diligence
4. Acting in the best interests of the body corporate
5. Keeping body corporate informed of developments
6. Ensuring employees comply with BCCM Act and code
7. Fraudulent or misleading conduct
8. Unconscionable conduct
9. Conflict of duty or interest
10. Goods and services to be supplied at competitive prices
11. Body corporate manager to demonstrate keeping of particular records

There are existing concerns about the practices of some resident managers that may not be in compliance with parts of the code. For example, there are concerns about costs of services provided by resident managers that relate to the requirement under the code that goods and services be supplied at competitive prices, and issues of service quality which relate to skill, care and diligence.

Similarly, there are allegations that some resident managers engage outside contractors or tradespeople on favourable terms in exchange for undisclosed monetary rewards (‘kick-backs’ or ‘back-handers’). However, ARAMA disputes this allegation, stating that they are not aware of any resident manager who has been found to be doing this.

The code sets standards of conduct; it does not in itself provide remedies to address contraventions. Enforcing the code requires that bodies corporate are reasonably able or willing to act on perceived contraventions through contravention notices and the transfer provisions.

Q.23 *Does the code sufficiently set out the general requirements of conduct for caretaking service contractors, particularly given the nature of the body corporate powers that rely on its terms?*

Q.24 *Is there evidence of conduct negatively impacting on schemes that falls outside the coverage of the code?*

5.1.2 The code of conduct for letting agents

A resident manager must comply with the code of conduct for letting agents[51]. Failure to comply with the code can result in termination or forced transfer of a management rights contract (see further sections). The code was added in 2002, and together with the code of conduct for body corporate managers and service contractors establishes standards of conduct that reasonably should be expected of caretaking service contractors. Caretaking service contractors are defined under the BCCM Act as a service contractor who is also a letting agent; that is, a typical resident manager.

The code sets out both prescribed and proscribed forms of conduct for letting agents in relatively general terms, including:

1. Honesty, fairness and professionalism
2. Skill, care and diligence
3. Acting in body corporate's and individual lot owner's best interests
4. Ensuring employees comply with BCCM Act and code
5. Fraudulent or misleading conduct
6. Unconscionable conduct
7. Nuisances
8. Goods and services to be supplied at competitive prices

Resident letting agents are also required to comply with the restricted letting agency practice code of conduct under the *Property Agents and Motor Dealers (Restricted Letting Agency Practice Code of Conduct) Regulation 2001*[52] in relation to their letting appointments with individual lot owners. This requires them to act in the best interests of their clients, and sets out requirements and offences relating to letting agent conduct in engaging clients, property management, uses, disclosure and recording of information, publicising the code of conduct and other business requirements. However, these requirements are not linked to powers of the body corporate in relation to management rights.

There are existing concerns about the extent of conduct that may not comply with aspects of the codes. For example, there are concerns about costs of secondary services such as cleaning provided by resident managers that relate to the requirement under the BCCM code that goods and services be supplied at competitive prices.

There may be resident managers that engage in practices likely to be contrary to both requirements of the code, and the PAMDA legislation. There are some concerns about alleged practices whereby letting agents move existing tenants unnecessarily from lot to lot within a scheme to generate a letting commission. There are suggestions that some letting agents may let out lots without recording the tenancy and without reimbursing the lot owner[53]. Other concerns have been raised about proper use of advertising funds, entry and exit reports, and interfering with the sales of units to ensure that owner occupiers do not buy into the scheme.

The code sets standards of conduct, but the capacity of the body corporate to seek remedies and address contraventions relies on the use of code contravention notices and transfer provisions. The effectiveness of the enforcement provisions in turn rely upon bodies corporate being reasonably able or willing to act on perceived contraventions.

A lot owner can revoke the appointment of the resident manager to act as the lot owner's letting agent at any time as long as the lot owner complies with the required

period for giving notice of the revocation provided under the PAMDA legislation, and instead use an outside letting agent[54].

Q.25 *Does the code sufficiently set out the general requirements of conduct for letting agents, particularly given the nature of the body corporate powers that rely on its terms?*

Q.26 *Is there evidence of conduct negatively impacting on schemes that falls outside the coverage of the code?*

5.1.3 The code of conduct for committee voting members

The code of conduct for committee voting members[55] applies to committee members who are voting members under the terms of the regulation module applying to the scheme. The code sets out both prescribed and proscribed forms of conduct for committee voting members in relatively general terms, including:

1. Commitment to acquiring understanding of Act, including this code
2. Honesty, fairness and confidentiality
3. Acting in the best interests of the body corporate
4. Complying with Act and this code
5. Nuisance
6. Conflict of interest

The code of conduct for committee voting members was introduced by amendments to the BCCM Act in 2007, to address stakeholders concerns about the conduct and expertise of committee members. Bodies corporate can enforce the code through breach notices and removal of committee members by body corporate decision[56].

Q.27 *Does the code sufficiently set out the general requirements for committee voting members, and are the arrangements for removal of committee members appropriate?*

5.2 Powers of the body corporate

5.2.1 Code contravention notices

The BCCM Act empowers bodies corporate to issue code contravention notices where the body corporate believes a letting agent has contravened either of the relevant codes[57]. Decisions about issuing code contravention notices are made by ordinary resolution decided by secret ballot.

The code contravention notice provided must state that the body corporate believes that the person has contravened either the code of conduct for letting agents or the code of conduct for body corporate managers and caretaking service contractors, name the provision in question, and give the person a reasonable period in which to remedy the contravention.

The notice must also notify the person that the body corporate may issue a transfer notice without further notice if the contravention is not remedied or if the body corporate reasonably believes that further contravention has occurred after the notice was received.

Q.28 *Are the triggers and requirements for code contravention notices appropriate?*

5.2.2 Forced transfer of management rights

The body corporate may require the transfer of the letting agent's management rights where the letting agent has failed to comply with a code contravention notice, or where the body corporate believes the letting agent has contravened a code after being given a notice[58]. The transfer of any interest in a lot used for the letting business is required even where it is not directly owned by the business, as provided by the requirement for a lot owners deed to be in place[59]. The lot owner's deed provisions were added to the BCCM Act by amendments made in 2002, and only apply to letting agents authorised after the section commenced in 2003. Given the high rate of transfer of management rights, many letting agents would now be operating under these requirements.

The letting agent must transfer the letting agent's management rights for the scheme within nine months if a ground exists for the body corporate to require the transfer and the body corporate has decided that the transfer is required and has provided written notice of the transfer to the letting agent[60].

The letting agent must transfer to a person approved by the body corporate, and the body corporate must act reasonably and as quickly as practicable. The process of approval is limited to a consideration of the person's character, financial standing, and competence, qualifications and experience. Approval must not be unreasonably withheld.

If the letting agent fails to transfer the management rights as required, the body corporate committee must choose a replacement letting agent at a sale price based on valuation, auction or tender. The body corporate can recover reasonable costs incurred in obtaining a price from the proceeds of sale.

The 'honeymoon' review mechanism under the BCCM Act for management rights agreements entered into by the original owner were discussed in section 2.5. The BCCM Act also provides bodies corporate with the option to similarly review service contracts (caretaking contracts) when acting under the forced transfer provisions[61]. Where review advice provides how the contract's reviewable terms should be changed to ensure they are fair and reasonable, the contract terms to be transferred include those changes.

The forced transfer mechanism is intended to provide a body corporate with an effective means to replace a resident manager where they have contravened either of the codes of conduct and failed to remedy that contravention. In essence, it allows a body corporate to 'move-on' an unsuitable resident manager. It would be reasonable to expect that resident managers would be adverse to the idea of a forced sale of their rights at a time not of their choosing, and be motivated to adhere to the codes.

Management rights arrangements generally represent substantial investments that rely in part on the remaining contract term. For this reasons, the BCCM Act requires that if less than seven years remain on contracts subject to forced transfer by the body corporate, the contracts are effectively extended to nine years to make them saleable[62]. However, some stakeholders have suggested that this term extension, by increasing the value of the business, may actually reward a resident manager who is forced to transfer their business. Conversely, some stakeholders argue that a term extension may also reward the scheme and help it attract a better quality resident manager than the one who was moved on.

Q.29 *How often are the forced transfer provisions used, and are they working appropriately as a means to 'move-on' unsuitable resident managers?*

5.2.3 Remedial Action notices

The regulation modules allow bodies corporate to issue remedial action notices[63] where it believes a service contractor has:

- Engaged in misconduct or gross negligence in carrying out the functions under the engagement
- Failed to carry out duties under the engagement
- Contravened either of the relevant codes of conduct, if the person is also a letting agent (a caretaking service contractor)
- Failed to comply with disclosure requirements for body corporate contracts with associates

Similarly, a remedial action notice may be issued where a letting agent has:

- Engaged in misconduct or gross negligence in carrying out the functions under the authorisation
- Failed to carry out duties under the engagement
- Contravened the code of conduct for letting agents, or either code of conduct if they are also a service contractor
- Failed to comply with disclosure requirements for body corporate contracts with associates if they are also a service contractor

A remedial action notice must state that the body corporate believes the person has acted in one of the specified ways, and provide sufficient detail to identify the relevant actions, duties not carried out, or aspect of the code contravened. The notice must state that the person has fourteen days to remedy the action or carry out duties, and that if this is not done the body corporate may terminate the caretaking engagement or letting agent authorisation, whichever is applicable.

Q.30 *Are the triggers and requirements for remedial action notices appropriate?*

5.2.4 Termination of engagements

The Standard, Accommodation and Commercial Modules provide that a body corporate may terminate a person's engagement as a service contractor, or authorisation as a letting agent under either the terms of the BCCM Act, by agreement, or under the engagement or authorisation.

Under the BCCM Act where the body corporate acts on the forced transfer provisions the body corporate can terminate the letting agent authorisation if the letting agent fails to transfer the management rights as required[64]. There is no corresponding termination power for the caretaking or service contract element of the management rights.

A body corporate may also terminate either service contractor engagements or letting authorisations for a range of causes related to probity under each of the relevant regulation modules[65]. These include conviction of a serious offence, carrying on a business supplying services to the body corporate or lot owners that is contrary to law, or transferring management rights without body corporate approval. Decisions are made by way of ordinary resolution with a secret ballot.

Letting agreements or service contracts may be terminated where a remedial action notice is issued and the person fails to remedy the action or carry out duties within the required fourteen day period[66].

Where a body corporate acts under any of the termination mechanisms, it may face problems arranging either new caretaking or letting agent services if property required for the operation of these services are owned by the management rights business[67]. As these terminations do not involve the transfer of management rights, there is no obligation on the resident manager to sell or otherwise relinquish ownership of scheme lots.

Q.31 *How often are the provisions of the BCCM Act or regulations providing termination powers used, and are they working appropriately?*

The BCCM Act provides certain protections for financiers of management rights arrangements where the body corporate seeks to act to terminate those rights[68]. Where a contract for management rights is under a recognised financing arrangement and grounds exist to terminate the contract, the body corporate must notify the financier of the right to terminate, and allow 21 days for the financier to respond prior to terminating the contract.

The body corporate may not act to terminate the contract if the financier provides written notice to the body corporate that they are acting under the contract in place of the contractor, or have appointed a person as receiver. A person authorised to act for the financier as a receiver must not be an associated of the contractor, and must be approved by the body corporate.

Q.32 *Do the financier protection provisions relating to termination of financed contracts provide appropriate protection for financiers, while also allowing bodies corporate to appropriately exercise termination rights?*

5.2.5 Contract term extension and renewal

At any time, the body corporate may grant an extension of the term of management rights agreements, up to a maximum equivalent to the term limitation. For example, after three years of a ten-year agreement under the Standard Module, the body corporate can extend the agreement by three years so that the remaining term is ten years[69]. The body corporate may subsequently amend the engagement to include a right or option of extension or renewal (a subsequent right or option) only if the subsequent right or option is for not longer than five years.

Based on existing discussion, management rights holders routinely approach the body corporate for contract extensions or options in a practice known as ‘topping up’ an agreement. As the remaining term of a contract directly impacts on its value, this is seen as a way of not only managing risk of expiry, but also ensuring re-sale value and financing viability.

There are suggestions that bodies corporate grant such requests almost by default. It is also suggested that it is extremely rare for a body corporate to vote against such requests, particularly in holiday letting schemes or schemes where a majority or many of the lot owners are investor owners who rely on the resident manager to let out their units[70]. However under the legislation there is no obligation on the body corporate to grant extensions or options.

There are concerns that the extension of rights is often a prelude to the sale of the rights, resulting in a ‘windfall’ gain for the resident manager and the body corporate

being required to engage with a new management rights holder. However, a resident manager seeking an extension may be simply exercising a right or attempting to refinance over a longer term.

The practice of requesting approval to extend contract terms on the face of it would seem to provide a body corporate, or particular lot owners, with a corresponding opportunity to attempt to re-negotiate contract terms currently of concern. However, it is not apparent if this is a common occurrence, and there might be contractual or legislative factors which provide real impediments.

The BCCM Act specifically prevents a body corporate from seeking or accepting the payment of an amount, or the conferral of a benefit for engagements or extensions to contracts[71]. These restrictions on financial gain or consideration were introduced to prevent the charging of 'premiums' or 'key money' for contract extensions or renewals as was described to occur under the previous legislation. Current arrangements allow businesses to achieve contract extensions or renewals that increase business value and long-term security at little or no cost to the business.

A body corporate may also renew an expired agreement based on existing or re-negotiated terms, by entering into a new management rights agreement. The restrictions on considerations similarly apply, however the body corporate may recover reasonable costs associated with preparing an agreement, and fair market value for any entitlements conferred; for example rental of body corporate equipment or common property. There is no business value associated with an expired agreement; the sole value is in any scheme property owned by the management rights holder. Therefore, the creation of a new agreement is a discretionary act on the part of the body corporate that provides a substantial financial benefit to a re-engaged management rights holder.

Where a body corporate seeks to engage a new resident manager upon expiry of an existing agreement, there may be difficulties in arranging residential and/or office lots for the new manager if the previous management rights holder wishes to retain property on title. While the forced transfer provisions of the BCCM Act require the transfer of the complete management rights business including property used to conduct the business, this is not the case where rights have expired.

The body corporate has the capacity to acquire a lot in the scheme as common property for the purpose of leasing it to a letting agent or service contractor as residence and office, however where an agreement has expired, there is no mechanism to compel the previous rights holder to sell property on title that was associated with the business. It is uncertain whether contractual elements of management rights arrangements may provide this mechanism in some cases.

Q.33 *Do extension requests and agreement renewals provide a viable opportunity for bodies corporate to re-negotiate terms?*

Q.34 *Is there a trend towards more bodies corporate seeking to allow management rights agreements to expire, or have them terminated?*

Q.35 *What difficulties might bodies corporate face where rights expire or are terminated, and how could these be addressed?*

5.2.6 Approval of transferees

A body corporate is provided a number of powers under the BCCM Act and regulations to approve the person to whom a management rights arrangement is transferred by the current owner.

Where transfer is initiated by the current rights holder, the Standard and Accommodation Modules contain provisions to the effect that a person's rights under an engagement as a body corporate manager or service contractor, or under an authorisation as a letting agent, may be transferred only if the body corporate approves the transfer[72]. This approval may be through resolution of the committee, unless it is a restricted issue, or by ordinary resolution of the body corporate. The body corporate may have regard to the character of the transferee and related persons, the financial standing of the transferee, the proposed terms of the transfer, the competence qualifications and experience of the proposed transferee including training received or likely to be received, and any matters the body corporate may have regard to under the engagement or authorisation.

The body corporate must decide whether to approve within 30 days of receiving the information reasonably necessary to make the decision. Approval may be given on the condition that the transferee enters into a deed of covenant to comply with the terms of the engagement or authorisation. The body corporate must not unreasonably withhold transfer, or require a fee or consideration other than reimbursement for expenses reasonably incurred in relation to the application. This is one of the few elements of the BCCM Act relevant to management rights associated with a monetary penalty for offences (50 penalty units).

Where the body corporate acts under the forced transfer provisions, the transferee if chosen by the letting agent, must be approved by the body corporate[73], and similar requirements and factors the body corporate may have regard to apply.

Where a financier chooses to appoint a person to act in place of a contractor for a financed contract which the body corporate would otherwise be able to terminate[74], the body corporate is similarly required to approve the person appointed. The characteristics of the person that may be considered are the same as described above, as are the restrictions on withholding approval or requiring fees.

Q.36 *Do the provisions governing approval of transferees provide bodies corporate with sufficient capacity to ensure the suitability of rights holders and resident managers?*

5.2.7 Transfer fees

Under the Standard and Accommodation Modules, when a body corporate approves a transfer of management rights within two years of the initial contract date with the transferor, a transfer fee is payable to the body corporate. If the period between transfer approval and contract date is less than one year, the fee is 3% of the amount representing fair market value for the transfer. The fee is 2% for eligible transfers past the one year period. The fee does not apply if a financier is acting under a power of sale over the contract, or if the transferor is acting for reasons of genuine and unforeseeable hardship.

Transfer fees recognise a need to provide protection or compensation for bodies corporate from excessive rates of turnover of management rights ownership, for example where businesses might be bought and sold on a short-term speculative basis. The additional burden of frequent changes in management rights ownership is

unlikely to benefit a scheme, and impacts on effectiveness of service provision in terms of consistency and stability.

The transfer fee arrangements were changed substantially in 2008 through the remaking of the regulation modules. Prior to that time, re-negotiation or renewal of contracts by a management rights holder effectively reset the calculation for the transfer period. The transfer fee arrangements were changed at least partly in response to industry concerns that the manner in which the fee was calculated penalised management rights holders in the practice of topping up their agreements or those arranging new agreements prior to sale.

Q.37 *Do transfer fees applying to early transfers provide appropriate protection or compensation for bodies corporate?*

Transfers of management rights are viewed by some stakeholders as providing a windfall gain for the management rights holder, particularly in cases where contract terms have been extended prior to sale, or where new agreements have been put in place, both of which increase business value. It is reasonable that management rights holders seek a net positive return from their investment. However, where the body corporate agrees to extend contract terms and the management rights holder has not disclosed their intention to sell the potential for conflict is obvious. This may also impact on the relationship between the body corporate and the transferee.

It may be worthwhile to consider ways to address issues of high rates of ownership turnover, based on review of agreements. Parties to engagements or authorisations could be provided the ability to review these contracts in the event of a transfer of rights. This review could operate in the same manner as the 'honeymoon' and forced transfer review options. This might address some concerns that transfers benefit management rights holders at the expense of lot owners, and assist in ensuring arrangements are competitive. As discussed earlier, there are few drivers of competition in the relationship between bodies corporate and resident managers.

Q.38 *What might be the advantages and disadvantages of allowing management rights transfers to trigger an optional review of contracts?*

5.3 Dispute resolution

A dispute in relation to management rights is typically a 'complex dispute' as defined in the BCCM Act. This includes disputes arising out of a review, transfer of management rights, contractual matters, and review of exclusive use by-laws associated with management rights arrangements[75]. Dispute resolution may be sought either through the QCAT, or a specialist adjudicator of the Office of the Commissioner for Body Corporate and Community Management (the Office of the Commissioner).

The BCCM Act was amended in 2007 to expand the options for resolution of these types of disputes[76]. The amendments effectively vested parallel jurisdiction in the then Commercial and Consumer Tribunal (now replaced by QCAT). Before that disputes were exclusively determined by a specialist adjudicator.

The QCAT appeals tribunal is the appropriate forum for appeals on questions of law in regard to complex disputes[77]. QCAT may subsequently refer questions of law or transfer proceedings to the Court of Appeal, and parties have the right to make an appeal from QCAT to the Court of Appeal.

Specialist adjudicators are given powers under the BCCM Act to make an order that is "just and equitable in the circumstances (including a declaratory order) to resolve a dispute, in the context of a community titles scheme". QCAT is empowered to deal with matters relating to the dispute under the terms of the BCCM Act. Both must observe the rules of natural justice, but neither is bound by rules of evidence. The intent is to provide efficient and effective dispute resolution for parties in dispute. Orders may be enforced through application to the Magistrates Court for specialist adjudication, or application to the Supreme Court for QCAT decision.

Conciliation through the Office of the Commissioner may be appropriate where a resident manager is one of the parties in dispute, but the dispute does not centre on management rights, and is therefore not a complex dispute. Similarly, QCAT is able to order all parties to a dispute to attend mediation or a compulsory conference for the purpose of resolving a dispute where the nature of the dispute allows this.

Q.39 *Are the dispute resolution arrangements for complex disputes involving management rights appropriate, and if not, what changes could be considered?*

5.4 Information disclosure

A common legislative approach to providing consumer protection where complex and important transactions are involved is to ensure consumers have information needed to inform their decision making. This is often the case where market based solutions are unlikely, and the property market is a prime example[78]. The success of information disclosure relies on information being both useful, and used. Research findings highlight potential failures in disclosure regimes where the information supplied is irrelevant or difficult to apply[79].

For sales of proposed lots, that is, off the plan sales, a seller must provide a disclosure statement to a buyer before a contract for sale is entered into. The disclosure statement must include the terms of the proposed engagement of a caretaking service contractor, the estimated cost of the engagement to the body corporate, the proportion of the cost to be borne by the owner of the proposed lot and must include the terms of the proposed authorisation[80]. Where the disclosure statement is inaccurate and the buyer would be materially prejudiced if compelled to complete the contract as a result of the inaccuracy, the buyer may cancel the contract prior to settlement[81].

For sales of existing lots, a seller is required to provide to a buyer the amount of annual contributions fixed by the body corporate payable by the owner of the lot concerned. Caretaking costs will be part of this total, but there is no requirement for specific disclosure of the nature or terms of management rights agreements. Where the disclosure statement is inaccurate and the buyer would be materially prejudiced if compelled to complete the contract as a result of the inaccuracy, the buyer may cancel the contract prior to settlement[82].

For sales of either proposed or existing residential lots, PAMDA[83] requires that sellers attach an information sheet (BCCM Form 14) to contracts of sale, and must give the prospective buyer a clear statement directing their attention to the information sheet. Failure to do so provides the buyer with a right to cancel the contract prior to settlement under the BCCM Act[84]. For sales of non-residential lots the BCCM Act introduces a similar requirement[85].

The information sheet outlines the nature of community titles schemes, the duties of a body corporate, and the responsibilities of lot owners. The information sheet also encourages due diligence on the part of the buyer, suggesting appropriate searches

to conduct and matters to investigate. In particular the sheet suggests buyers check for any agreements the body corporate may have entered into, for example, caretaking, letting, body corporate management or lift maintenance.

In addition to these disclosures directly relevant to management rights, there are other requirements under the collective law relevant to property sales in general. There is also a large body of information that is relevant to a sale, and the value and characteristics of a property, but is not formally included as part of any disclosure regime, although some elements are mentioned in the information sheet described above. This information, available from up to 25 different sources, includes but is not limited to rates levies, zoning, resumption plans, body corporate records, property insurance cover, and a variety of safety compliance issues.

The appropriateness of disclosure requirements relevant to management rights, and the need for changes in this area, needs to be considered against the already large volume of information relevant to lot purchasing decisions.

Q.40 *Are the disclosure requirements for proposed lots in a scheme working to ensure that buyers are adequately informed about the characteristics, costs and benefits of management rights agreements for the scheme? (Why/why not?)*

Q.41 *Are the disclosure requirements for existing lots in a scheme working to ensure that buyers are adequately informed about the characteristics, costs and benefits of management rights agreements for the scheme? (Why/why not?)*

6 Stakeholder views

There is a wide range of distinct and varying views among stakeholders about the current regulatory arrangements around management rights. These views range from the current regulatory framework being “in balance” to requiring major change that include:

- limiting management rights contracts to a maximum of three years, with the contract term to be renewed or tendered by the body corporate at the end of the three years;
- prohibiting extension or topping up of contracts;
- providing that the onsite caretaker residence/office can not be sold as part of the management rights, but instead be on common property and be made available for exclusive use to the successful tender of the management rights contract; and
- providing that conversions from the Standard Module to the Accommodation Module to allow management rights holders to access 25 year agreements are prohibited and or must be reversed.

In summary, the fundamental issue is about the merit of retaining the status quo or, benefits or costs which might flow from major changes to the existing regulatory settings.

A key issue is that letting and maintenance arrangements in Queensland reflect industry development patterns which have emerged as a consequence of Queensland’s particular economic history and unique geography. The community titles sector in Queensland has had an important role in providing tourism accommodation which has resulted in an unusual mix of owner investment and owner occupier arrangements which has created favourable conditions for the management rights industry.

A key policy question is the extent to which changes to the regulatory framework would have net positive or negative effects and whether the current regulatory framework is too heavily weighted in favour of the management rights sector and is adversely affecting the affordability of units and community living as a lifestyle option?

Q.42 *Is there a need for major change? If so, what are your views on the proposed changes outlined above? Are there alternative options for the regulatory framework for management rights that should be considered?*

7 Notes on provisions or other issues

It is acknowledged that stakeholders may have concerns about management rights which are not specifically addressed in this paper, or may wish to raise issues about the construction or operation of individual provisions not specifically dealt with.

Q.43 *Are there other issues relevant to management rights, or specific provisions, that should be addressed?*

8 Concluding remarks

The BCCM Act, in creating a category of complex dispute that is largely concerned with disputes about management rights, recognises issues in this area are seldom simple, and problems are often difficult to resolve. This paper aims to deal with the highly complex and sometimes contentious topic of management rights in a way that allows all stakeholders to contribute their perspectives.

Any future action on the issue of management rights will rely on a thorough assessment of the balance of expected outcomes across all stakeholders in the community titles sector. Submissions to this paper will be critical to that assessment process. Thank you for your contribution.

9 Endnotes

1 Assuming 370,000 lots and $200,000 lot value. Some lots are actually separate scheme layers, so there may be some double counting in the total lot figure; however the average lot value is conservative.

2 ARAMA, the representative body for many small to medium sized management rights businesses estimated 2500 to 3000 in 2009, and numbers may have grown since that time. Other estimates (e.g. Management Rights Pty Ltd - http://www.managementrightsnsw.com.au) are as high as 4000.

3 Formerly QRAMA, the Queensland Resident Accommodation Managers Association.

4 For example BCCM Act Chapter 3 Part 2 Division 8 Required transfer of letting agent's management rights.

5 Rates from Management Rights and Motel Finance Pty Ltd – mrmfinance.com.au

6 As above 5

7 Assuming 2500 to 3000 businesses, average value of $1.0 to 1.6 million.

8 Management Rights Pty Ltd
http://www.managementrightsnsw.com.au/pdf/Management_Rights_The_New_Millenium.pdf

9 Assuming a transfer rate of once ever four years.

10 Guilding, C., Ardill, A., Warnken, J., Cassidy, K. & Everton-Moore, K. (2006) Investigation Of The Strata Titled Tourism Accommodation Sector In Australia, CRC for Sustainable Tourism, ISBN 1 920704 88 4.

11 Primary in the sense that it is for the sale of new management rights arrangements by the original owner/developer, in contrast to the secondary market for sale of operating management rights arrangements by their current holders.

12 This may be criticised where the nature of the lot sold (e.g. a reception area) impacts on the potential for outside letting agents to operate, or restricts future alternative options for lot owners.

13 Unless, in the case of letting authorisation, the original owner did not establish a letting agreement, and the original owner period has ceased. A body corporate may also recover reasonable expenses associated with formulating agreements, or receive amounts associated with provision of services/facilities to the resident manager (rental or lease of additional facilities).

14 Ardill, A., Fredline, L., Guilding, C., Warnken, J. & Noakes, S. (2005) Community Titled Accommodation Used For Visitor Purposes In Queensland, CRC for Sustainable Tourism, ISBN 1 920704 07 8

15 Strata 3 Group - http://www.strata3.com.au/developersfaqs.htm#faq4.5

16 Stewart, H. (2006). Ensuring correct deployment of management agreements. Strata and Community Title in Australia for the 21st Century III Conference.

17 As above 16.

18 Section 112 BCCM Act

19 BCCM Act Chapter 3, part 2, division 7 Review of terms of service contracts

20 For contracts for a term longer than three years, the review period is the longer of: three years after the start of the term, or one year after the annual general meeting next held after the original owner control period ends. For contracts of three years or shorter, the review period is the shorter of: the period of the term, or the period ending immediately before the contract is first extended or varied.

21 These caretaking agreements are comparable to the caretaking aspect of management rights agreements, and are limited to 10 year maximum terms.

22 Modified vote weighting rules prevent original owner control of the owners corporation at this time, unless through exercise of proxies held.

23 Suitability in terms of size, identity and ownership.

24 Section 128 BCCM Act

25 If the circumstances required for the scheme to be eligible under the chosen regulation module do not exist.

26 As above 16.

27 Maximum of once per financial year.

28 BCCM Form 19

29 Cassidy, K., Guilding, C. and Warnken, J. (2008), Identifying Effective Strata Title Governance And Management Models For The Provision Of Tourism Accommodation.

30 Guilding C., Ardill, A., Fredline E. and Warnken, J. (2005) An agency theory perspective on the owner / manager relationship in tourism-based condominiums, Tourism Management, 26(3) 409-420.

31 As above 16.

32 As above 16.

33 Ardill, A., Everton-Moore, K., Fredline, L., Guilding, C. & Warnken, J. (2004), Community titles reform in Queensland: A regulatory panacea for commercial, residential and tourism stakeholders. Qld Lawyer 25(13).

34 As above 16

35 As above 16.

36 Typically around 5% of purchase price.

37 Report of the financial reporting panel – Oaks Hotels and Resorts Limited (ASIC determination report)

38 Section 116 BCCM Act.

39 Section 40 BCCM Act

40 In 2009 ARAMA estimated there were around 100 schemes under corporate rights arrangements. The industry has seen entries and exits since that time. The estimate of lots under corporate management assumes each scheme has 70% of lots in a letting pool of 40 to 50 units. At present, Mantra Group and Oaks Hotels and Resorts alone manage a total of 73 schemes in Queensland.

41 Business ‘multipliers’ of up to 6.

42 “MFS : Time to take stock” Herdlaw http://assets0.herdlaw.com.au/downloads/MFS.pdf.

43 “Management Rights Valuations Revisited” thepropertymanager.com.au http://www.thepropertymanager.com.au/content/cms/management+rights/3555286/

44 Management rights online business listings for Queensland - thepropertymanager.com.au.

45 Body Corporate And Community Management And Other Legislation Amendment Bill 2002.

46 As above 16.

47 “Real Estate and the Saleability of Your Business” Small Myers Hughes. http://www.smh.net.au/Publications_1.html

48 “Legal considerations with financing management rights” Griffith Parry. http://www.gplaw.com.au/Home/News/tabid/84/articleType/ArticleView/articleId/17/Legal-Considerations-With-Financing-Management-Rights.aspx

49 Schedule 2 BCCM Act

50 Section 118 BCCM Act

51 Schedule 3 BCCM Act

52 Section 119 PAMDA

53 As above 30.

[54] Section 114 PAMDA
55 Schedule 1A BCCM Act

56 Section 101B BCCM Act, Sections 34,35 BCCM (Standard Module) Regulation

57 Section 139 BCCM Act

58 Section 138, 140 BCCM Act

59 Section 116 BCCM Act

60 Section 140, 141 BCCM Act

61 Section 147, BCCM Act.

62 Section 146, BCCM Act

63 Section 131 BCCM (Standard Module) Regulation – the qualifying actions are provided separately for service contractors and letting agents, but for resident managers providing both functions they effectively overlap.

64 Section 145, BCCM Act

65 Section 130, BCCM (Standard Module) Regulation

66 Section 131, BCCM (Standard Module) Regulation

67 As above 30.

68 Section 126 BCCM Act

69 Section 119 BCCM (Standard Module) Regulation

70 As above 37.

71 Section 113 BCCM Act

72 Section 122 BCCM (Standard Module) Regulation

73 Section 141 BCCM Act

74 Section 126 BCCM Act

75 Sections 133, 149A, 149B, 178 BCCM Act.

76 Body Corporate and Community Management and other Legislation Bill 2006.

77 *Queensland Civil and Administrative Tribunal Act 2009*

78 Christensen, S., Duncan, W. & Stickly, A. (2009). Behavioural Biases and Information Disclosure Laws Relating To Residential Property Sales: Narrowing The Gap Between Existing Laws And Calls For Future Reforms. QUT Law and Justice Journal, 9(2).

79 As above - 78.

80 Section 213 BCCM Act

81 Section 217 BCCM Act

82 Section 209 BCCM Act

83 Section 386A PAMDA

84 Sections 206A and 213A BCCM Act

85 Section 206 BCCM Act