

Final Report of the Body Corporate Review

A review of effectiveness and efficiency of the *Subdivision Act 1988* and Subdivision (Body Corporate) Regulations 2001 as they relate to the operation of bodies corporate.

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Statement from the Minister for Consumer Affairs

In September 2003 the former Minister for Consumer Affairs, John Lenders MP, announced a review of body corporate law. This review was led by Helen Buckingham MP, Member for Koonung Province, assisted by Consumer Affairs Victoria.

The review has involved an extensive consultation process, including the publication of an Issues Paper in October 2003, a bodies corporate seminar and the release of a Future Directions Paper in March 2004, two full rounds of public submissions and a significant number of stakeholder consultation meetings.

This final report puts forward proposals based on this consultation process. In particular the report has recommended a new legislative regime for bodies corporate. Given the size of such a change, feedback from stakeholders was that an exposure draft of any new legislation would be beneficial, and this has also been a recommendation of the review. The Government has responded to this by releasing an exposure draft of proposed legislation in conjunction with this final report.

The Government is committed to building cohesive and caring communities, in which harmonious residential and business communities are supported, rights protected and disputes minimised. The proposals in this final report give effect to this commitment.

I would like to thank the individuals and organisations who made submissions or participated in consultations. As we move forward with the proposals we will continue to engage with stakeholders.

I would also like to thank Helen Buckingham MP for her work in conducting the Review.



MARSHA THOMSON MP
Minister for Consumer Affairs
20 December 2005

Terms of Reference

“The Bracks Government is committed to building cohesive and caring communities: communities which are good places to live and work in, communities where rights are protected, where disputes are minimised and where people have access to the courts and appropriate dispute resolution mechanisms when needed.

1. Identify the changing nature and role of bodies corporate in Victoria, having particular regard to:
 - the varying nature and size of subdivisions creating bodies corporate and
 - the growth in the number of multistorey subdivisions
2. Examine the effectiveness and efficiency of the *Subdivision Act 1988* and Subdivision (Body Corporate) Regulations 2001, having particular regard to:
 - the need to provide for the secure and prudent management of body corporate funds and
 - the need to minimise disputes and to provide appropriate dispute resolution mechanisms
3. Identify whether non-legislative options are available that would improve the effectiveness and efficiency of the legislative framework governing bodies corporate.
4. Make recommendations on the need for amendments to the *Subdivision Act 1988* and Subdivision (Body Corporate) Regulations 2001.
5. Identify the costs and benefits to the community of any non-legislative options and any recommended amendments to the legislative framework, and examine how costs arising from the recommendations could be met.”

Executive summary

A body corporate is a legal entity designed to facilitate decision making and management for lot owners in a subdivision. Without the regulatory framework, the owners as 'tenants in common' would require a 100 percent agreement for each and every action.

In 1988, the majority of bodies corporate were under five lots and were self-managed. By the start of the new millennium, large tower developments were becoming common in the city, and medium size developments were expanding throughout the suburbs of Melbourne and regional areas of Victoria.

In September 2003, the then Minister for Consumer Affairs, John Lenders MP commissioned Helen Buckingham MP to conduct a review of the *Subdivision Act 1988* as it relates to the creation and operation of bodies corporate.

An Issues Paper was distributed and submissions were invited in October 2003. To assist the consultation process, the Issues Paper asked 38 questions on specific issues seeking to draw out comment on possible alternative options and to identify the effectiveness and efficiency of the current legislative framework governing bodies corporate.

A large number of submissions were received and highlighted a wide range of issues with the current body corporate regulatory scheme, including disputation, the rising diversity of bodies corporate and the operation of body corporate managers.

On 2 February 2004, the Terms of Reference for the review were amended to broaden the scope of the review (the revised Terms of Reference are provided above).

Following this in March 2004 a bodies corporate seminar was held with the launch of a Future Directions Paper. This resulted in a further round of submissions, plus an extensive consultation process with a range of stakeholder meetings.

From this feedback, and further consultation with key stakeholders, the following proposals were developed.

Summary of proposals

Proposal 1: Enhanced legislation

It is proposed that new legislation be developed to provide for more modern regulation of the operations and management of bodies corporate.

Proposal 2: Clarify the ability to take legal proceedings

It is proposed that the new legislation clarify when the body corporate is able to take legal proceedings on behalf of the members and the processes and circumstances for this.

Proposal 3: Clarify role and responsibilities

It is proposed that the new legislation clarify that the body corporate is responsible for the management, repair and maintenance of easements, and shared infrastructure services whether or not they are on common property or lots to ensure that buildings are safe and properly maintained.

Proposal 4: Adverse possession

It is proposed that the legislation clarify that a lot owner cannot claim adverse possession of the common property.

Proposal 5: Owners corporation

It is proposed that it is clarified that a body corporate created under the *Subdivision Act 1988* is a collection of the owners of the lots and that it be called an "owners corporation" in the new regulatory framework.

Proposal 6: Two lot subdivisions

It is proposed that the new legislation enable two lot subdivisions to be exempted from certain requirements under the legislation.

Proposal 7: Information and advice

It is proposed that appropriate information and advice be provided by Consumer Affairs Victoria (CAV). The specialist information and advice would consist of telephone advice, printed and web based information in the form of information sheets and guidelines.

Proposal 8: Improving record keeping and disclosure

It is proposed that the new legislation clarifies the records that are required to be kept and made available and provide for a 'body corporate register' of essential matters.

Proposal 9: Improving disclosure

It is proposed that the disclosure of information be improved for prospective purchasers of units in bodies corporate.

Proposal 10: Improved body corporate certificate

It is proposed that the body corporate certificate contain brief details of key matters, such as fees paid, special levies struck and paid, insurance, maintenance plan, proposed works, contingent liabilities, leases and licences, any legal proceedings.

It is proposed that the body corporate certificate be made available within 14 days of receipt of the application, be attached to the section 32 statement made under the *Sale of Land Act 1962*.

Proposal 11: Appropriate dispute resolution mechanism

It is proposed that the legislation sets out a multi-tiered dispute resolution process as follows:

- first tier: dispute avoidance. This should including information and advice on internal communication and grievance procedures, as well as internal dispute resolution for bodies corporate, with a default process set out in model rules
- second tier: access to a low cost dispute resolution process. It is proposed that CAV provide conciliation for body corporate disputes and, as necessary, referral to the Victorian Civil and Administrative Tribunal
- third tier: the Victorian Civil and Administrative Tribunal (VCAT). It is proposed that VCAT consider more complex technical and legal issues relating to the operations of bodies corporate.

Proposal 12: Protection of body corporate funds through better book keeping

It is proposed that legislation introduce:

- a requirement for the body corporate to record all transactions of income and expenditure and assets
- a provision requiring the preparation of annual budgets to be sent out with the notice of the annual general meeting.

Proposal 13: Protection of body corporate funds through better Accounts and audits

It is proposed that legislation:

- introduce a requirement that the body corporate operate a bank account in the name of the body corporate
- clarify that body corporate funds be held on trust

- enable standards of accounting for prescribed classes of bodies corporate to be set out in model rules
- enable audits of accounts and require audits of accounts for prescribed classes of bodies corporate.

Proposal 14: Protection of body corporate funds through better funds management

It is proposed that legislation:

- enable the establishment of a separate maintenance fund and budgeting to raise sufficient monies to provide for the maintenance plan
- require the establishment and management of a maintenance fund for prescribed classes of bodies corporate
- enable internal expenditure approval procedures to be set out in the model rules
- provide a relatively simple and straightforward process for fee or debt recovery.

Proposal 15: Improved asset management

It is proposed that the powers of the body corporate be expanded to enable:

- improvements and upgrades to common property by special resolution
- maintenance and repairs to easements and services in lots
- preparation of maintenance plans on the estimated cost of repair or replacement for major items and the expected life of those items

It is further proposed that prescribed classes of body corporate be required to prepare maintenance plans.

Proposal 16: Clarification of insurance provisions

It is proposed that the regulatory framework be amended to provide greater protection for consumers by:

- clarifying what is required to be insured
- enabling bodies corporate to take out additional insurance by an ordinary resolution
- requiring prescribed bodies corporate to have sufficient replacement and reinstatement insurance cover for the building.

Proposal 17: Prescribed classes of body corporate

It is proposed that the legislation create a flexible mechanism for providing for specific regulation of certain bodies corporate. The legislation should allow for the prescribing of additional requirements for certain classes of bodies corporate, for example for large bodies corporate.

Proposal 18: Improving rules

It is proposed that the legislation should improve the operation of body corporate rules by:

- expanding the power for the body corporate to make rules
- ensuring that bodies corporate lodge consolidated rules when lodging rules
- stating that body corporate rules will be unenforceable if they unfairly discriminate against the owner of a lot or occupier or are inconsistent, limit a right or avoid any obligation under the Act or regulations or other law
- producing updated model rules.

Proposal 19: Enforcement of body corporate rules

It is proposed that the power for the body corporate to enforce rules should be set out in the legislation. The enforcement of rules will require notice of rules, notice of the breach and enforcement through VCAT.

Proposal 20: Conduct principles

It is proposed that general principles of conduct be introduced into the legislation. This should cover the body corporate, the committee, the body corporate manager and the holder of a proxy. It should also include a duty on the developer to act in good faith and exercise a degree of care and diligence and to make reasonable efforts to pursue any remedies under the building contract regarding the common property.

Proposal 21: Facilitating decision making

It is proposed that an interim resolution mechanism be introduced for special resolutions. The interim resolution process should be as follows:

- a special resolution may be made by postal or electronic ballot
- if a 75 percent majority in favour is not received, but 50 percent are in favour and not more than 25 percent against, then the decision is an interim decision
- the interim decision process then applies which requires sending of minutes and notice of the interim decision within 14 days of the meeting

- an interim decision becomes a decision of the body corporate if no petition is received within 29 days.

It is proposed that there be no change to the definition of a unanimous resolution.

Proposal 22: Avoiding the legislation

It is proposed that the legislation explicitly state that any clause in a contract will be unenforceable if the clause is inconsistent with or limits a right or avoids an obligation under the Act. It is proposed that there be a prohibition on requirements to give away proxies.

Proposal 23: Fairer allocation of lot entitlements and lot liability

It is proposed that the basis of the initial allocation of lot liabilities and lot entitlements are to be explained in the plan of subdivision.

Proposal 24: Clarifying the constitution and powers of committees

It is proposed that the constitution, duties, functions, powers and responsibilities of committees be set out in the Act and enable the committee to be delegated powers and duties of the body corporate to facilitate effective management.

Proposal 25: Meeting procedures

It is proposed that the legislation clarify that bodies corporate must:

- keep full and accurate minutes
- not act on an interim decision for 29 days from the date of the interim decision
- send minutes to members within 14 days of the Annual General Meeting (AGM).

Proposal 26: Registration of body corporate managers

It is proposed that all body corporate managers be registered. It is proposed that the Business Licensing Authority administer the registration of body corporate managers and create a public record of:

- current contact details of professional body corporate managers (currently required to be recorded on each plan of subdivision)
- current details of professional indemnity insurance (currently required on the initial form appointing a professional body corporate manager).

Proposal 27: Clarifying the appointment and removal of a body corporate manager

It is proposed that legislation provide more detail on the process to appoint and remove a manager.

Proposal 28: Funding

It is proposed that funding of the specialist body corporate information, advice and dispute resolution should be provided by a combination of manager's registration fees, application fees, penalties and funds from the Victorian Property Fund. It is proposed that manager's registration fees, application fees and penalties be paid into the Victorian Property Fund.

Proposal 29: Further consultation

It is proposed that an exposure draft of any proposed legislation be made available to provide further opportunities for community and key stakeholder consultation.

Introduction

Why review bodies corporate law?

The regulatory framework established under the *Subdivision Act 1988* ("the Act") provides a mechanism for the setting up, management and operation of a body corporate. The Act regulates for such things as the procedures for operating a body corporate, and how the body corporate deals with common property.

The separate legal entity of a body corporate is a mechanism to make it easier for owners of common property to make management decisions. Without the regulatory framework, the owners as 'tenants in common' would require a 100 percent agreement for each and every action.

Bodies corporate structures are used in residential developments (for example, apartment blocks), commercial developments (for example, shopping centres) and industrial and/or agricultural developments (for example, vineyards).

Bodies corporate are common in Victoria, with approximately 65,000 bodies corporate comprising 480,000 lots. They play an important role in property ownership for a significant number of Victorians.

The regulatory framework established under the Act provides great benefit to the community; however it is important that legislation continues to reflect changes in the marketplace and the community, and the evolving needs and values of consumers and members of the community.

Timely evaluation of legislation and its administration ensures that they remain relevant and effective. The need to review the current regulatory framework has become more important with the growth of multi-storey towers creating bodies corporate.

The purpose of this report

This report is the culmination of a review process initiated in September 2003. Since the initiation of the review, Helen Buckingham MP, assisted by Consumer Affairs Victoria (CAV), has undertaken a detailed consultation process, including the release of an Issues Paper and a Future Directions Paper and two rounds of public submissions.

A note on nomenclature

Throughout this report reference is made to the 'regulatory scheme' or 'regulatory model'. This term is used to refer to the full package of legislation, regulations and

orders that make up a full regulatory scheme, as well as the information provision, dispute resolution and other compliance material that is an integral part of any regulatory scheme. Where specific reference is made to the Subdivision (Body Corporate) Regulations 2001 then that will be made clear in the text.

Background

Legislative framework

The Minister for Consumer Affairs has responsibility for the following parts of the *Subdivision Act 1988*:

- Part 5
- Section 38 and
- Section 43 (insofar as it relates to Part 5 and section 38).

Part 5 of the *Subdivision Act 1988* provides for the creation of bodies corporate and the management of and dealings with common property. Section 38 of the Act provides for the resolution of disputes relating to bodies corporate and section 43 relates to the power to make regulations.

The *Subdivision Act 1988* was made at a time when most subdivisions consisted of approximately four residential lots and most bodies corporate were self managed. It was anticipated that if the legislation and regulations were silent and the members could not agree, then legal advice and contractual arrangements would be sufficient to clarify each owner's rights and obligations.

In addition, separate legislation was created to deal with a small number of complex subdivisions because the body corporate created under the *Subdivision Act 1988* was too restricted in the extent of its powers. For example:

- *South Yarra Project (Subdivision and Management) Act 1985*
- *Southgate Project Act 1994*
- *Docklands Act 1991*
- *Como Project Act 1994* and
- *Bayside Project Act 1988*.

Growth in scope and number of bodies corporate

In 2004, the numbers of own-your-own units, flats and apartments have increased dramatically in Victoria, particularly with the advent of multi-storey residential towers in Docklands and the Melbourne CBD. The role of the body corporate has also become more technical and complex.

The submission from the City of Melbourne stated that its Development Activity Monitor records indicate there are 230 new residential projects planned, under construction or mooted. It is estimated that these projects will result in more than 20,000 new dwellings being completed over the next five to ten years in the City of Melbourne alone.

From information received from stakeholders, bodies corporate are now being created to manage common property in relation to:

- two lot residential units
- flats, units and apartments
- high-rise towers
- industrial land and industrial complexes
- hotels and holiday apartments
- retirement villages
- complex mixed-use retail and residential units
- shopping centres and markets
- car parks
- storage units
- farms and vineyards.

Key demographics

It is estimated that:

- there are approximately 65,000 bodies corporate in Victoria and 480,000 lots
- the number of bodies corporate is increasing by approximately 2,000 each year
- approximately 66,000 lots have been created in bodies corporate in the last 5 years
- the capital improved value of lots affected by the operations of bodies corporate in Victoria is at least \$40 billion
- there are approximately 1,000 people employed full-time in the management of bodies corporate (250 professional body corporate managers and 750 support staff).

The vast majority of these bodies corporate are small (less than 20 lots) – around 96 percent – although they represent only 55 percent of lots. There are fewer large bodies corporate, although because of their large size they represent a significant proportion of the lots. In the case of the really large bodies corporate (greater than 100 lots), although there are only 650 of them, they represent a quarter of all lots in Victoria (see table below).

Table: Estimated distribution of bodies corporate in Victoria

size of body corporate	Number of lots		Number of Bodies corporate		
	Number of lots	% of total	corporate	% of total	
less than 5 lots	140,400	29%	46,800	71%	
5 to 20 lots	125,440	26%	15,600	24%	
20 to 50 lots	60,450	13%	1,950	3%	
50 to 100 lots	37,700	8%	650	1%	
100 lots plus	119,600	25%	650	1%	
Total	483,590	100%	65,650	100%	

Conduct of the review

Consultation undertaken

To achieve these objectives set out in the Terms of Reference, the review has consulted extensively with the members of the community, key industry groups and relevant Government agencies. For example, consultations have been undertaken with:

- the City of Melbourne
- the Coalition of Residents Association and community forums within the City of Melbourne (East Melbourne, South Yarra area, North/West area, Southbank area), St. Kilda, Prahran and Essendon
- the body corporate management industry (Real Estate Institute of Victoria and the Institute of Body Corporate Managers)
- the Law Institute of Victoria and St Kilda Legal Service
- Docklands residents and VicUrban.

To facilitate consultation with the community, an Issues Paper was made available in October 2003 and a Future Directions Paper was released in March 2004. A conference on body corporate issues was also held in March 2004.

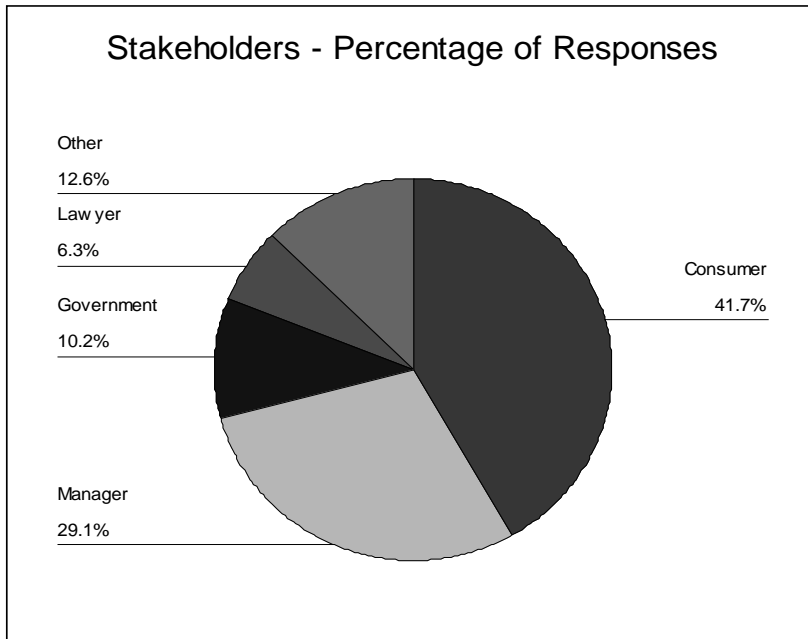
Over 200 submissions in total have been received on the body corporate review (approximately 130 submissions on the Issues Paper and 80 submissions on the Future Directions Paper).

Suggestions for reform contained in the submissions

A broad range of stakeholders have contributed to the review and have provided significant written submissions to both the Issues Paper and the Future Directions Paper.

Submissions were received from consumers (both owner-occupiers and investor owners), body corporate managers, lawyers, developers, government agencies, local councils, insurance companies, banks and professional and community groups from all over Victoria, interstate and overseas. Many individual consumer submitters requested that their submission remain confidential.

Figure 1: Breakdown of submissions received on the Issues Paper by 30 January 2004.



In general the submissions from the community have called for:

- improved communications between members to ensure fair, open decision making by the body corporate and minimise disputes
- more body corporate information, education and advice service
- incentives to promote compliance with the regulations and laws governing bodies corporate
- better access to body corporate dispute resolution to resolve disputes relating to breaches of rules and other day to day operations of the body corporate
- sufficient powers and flexibility to enable bodies corporate and body corporate committees to operate effectively
- clearer duties, rights and responsibilities of members and the body corporate
- improved financial management and protection of body corporate funds
- long term maintenance planning of buildings and common property
- promotion of higher professional standards in the body corporate management industry
- better disclosure requirements when buying into bodies corporate.

Submissions from individual lot owners were most concerned with information about rights and responsibilities of members and committees. Particularly, consumers identified difficulties for self-managed bodies corporate in understanding and dealing with the complex body corporate regulatory framework. Many consumers said they were unable to afford legal advice and that many problems were long standing or recurring problems with the body corporate, committee or manager. Consumers said that managers and committees should be made more accountable. There were also concerns about gaining access to body corporate records and contact details of other members. Consumers called for provisions to deal with conflicts of interest and called for government to consider the impact of any new legislation on self-managed bodies corporate.

Although there is no specific consumer body representing body corporate lot owners, there were submissions from the Consumer Law Centre, St Kilda Legal Service and the Council of the Aging (Victoria) and members of the Coalition of Residents Associations. In general, issues raised by these groups included the need for better body corporate information and dispute resolution services to address the hardship created by unexpected or unplanned expenses for maintenance. For example, a submission from the management committee of one body corporate said:

"Any new government Body Corporate Regulator needs to look at all facets of the Body Corporate, not just dispute resolution. It needs to be a cohesive inter-disciplinary body with all services and information available"

Body corporate managers supported self-regulation of managers and a low cost expert ombudsman scheme to resolve body corporate disputes. They also had concerns that new legislation may be costly or difficult to implement, or force up fees and lead more bodies corporate to decide to be self-managed. Individual body corporate managers called for licensing of managers, changes to the definition of "special resolution" and the establishment of a compensation scheme to protect body corporate funds.

The Estate Agents Council and the Real Estate Institute of Victoria raised concerns about the lack of supervision over funds held in trust by body corporate managers. It was suggested that protection of body corporate funds could be provided by requiring licensing of managers and the establishment of a compensation scheme.

There were a range of submissions from the Law Institute of Victoria and from individual lawyers suggesting a range of proposals. These included a call for an annual levy on each body corporate to establish a compensation scheme, the establishment of a state-wide network of accredited expert body corporate mediation officers, and the appointment of an adjudicator employed by government to resolve matters that could not be resolved by mediation or conciliation. There was some support for licensing managers, the establishment of maintenance funds paid into a

trust account, and amendments to s32 of the *Sale of Land Act 1962* to improve disclosure to potential purchasers.

Development industry organisations such as the Housing Industry Association, Urban Development Institute of Australia, Australian Property Institute and the Property Council of Australia raised issues relating to multiple bodies corporate and proposed consideration of community titles legislation. Many of this group raised issues indicating that the regulatory framework was not effective or efficient in relation to upgrades to buildings and compliance with essential services provisions under the Building Regulations. Particularly, this group proposed changes to the definition of "unanimous resolution". Some of the development industry organisations supported funding an information and dispute resolution service from body corporate trust account interest and others supported registration of all bodies corporate. There were some concerns in the development industry that Victoria may adopt the detailed and prescriptive legislation in other states.

Those local councils that made submissions sought measures to clarify boundaries of the lot on the plan of subdivision, strategies to deal with conflict and competing interests, more flexible body corporate rules to deal with parking, and energy and water saving strategies. There was also support for both using interest on trust accounts and requiring the payment of a fee by all bodies corporate to fund information and dispute resolution service.

The body corporate environment

The review has noted that there has been an evolution of the role of the body corporate, and related rights and obligations for body corporate members.

The roles of the body corporate

Body corporate structures are used in residential developments, commercial developments, industrial and agricultural developments, and perform a range of roles.

The legal role of the body corporate

The body corporate has been created under the *Subdivision Act 1988* as a convenient mechanism to enable people to share the ownership of property and make decisions related to the management and administration of land and buildings.

The *Subdivision Act 1988* and Subdivision (Body Corporate) Regulations 2001 constitute a regulatory framework which:

- enables people to share the ownership of real estate (property law)
- protects purchasers through disclosures in the Body Corporate Certificate (consumer protection law) and
- enables the management and operations of the body corporate (corporate governance law).

Importantly, a body corporate is a legal entity made by statute and has only the functions and powers set out in the *Subdivision Act 1988* and the Subdivision (Body Corporate) Regulations 2001. Consequently, if the functions and powers have not been provided by the Act and Regulations then the body corporate does not have the legal power to act.

With bodies corporate now encompassing high rise tower blocks and large developments, a range of issues are arising which are difficult to categorise within the spectrum between private property rights and community property rights. Consequently, the regulatory framework needs to be improved to balance lot owners' rights with sensible and practical restrictions in the public interest.

The economic role of body corporate

Bodies corporate play an important economic role as they reduce transaction costs for owners of the common property. The creation of the body corporate and the delegation of the powers of the body corporate, does involve the introduction of some potential conflict of interest issues.

Co-ownership of property inevitably requires the owners to conduct the business together. The nature of this business and how it is conducted effects the transaction costs imposed on those owners. For example, where decision making involves a unanimous decision, high transaction costs are imposed in ensuring that each and every lot owner actively participates in a positive way).

Legislation creating a body corporate reduces transaction costs to lot owners by providing systems and processes to facilitate decision making. The effectiveness of the regulatory structure will impact on those transaction costs.

Decision making works best when individuals have full information available on the options, rights and responsibilities they have. In relation to the role, rights and responsibilities of bodies corporate, the review has found the cost of acquiring complete (or nearly complete) information can be prohibitive. For example, legalisation is difficult to understand without legal advice, and there is limited easy access to information on common issues. Consequently, bodies corporate make decisions with limited and imperfect information which impedes the effective and efficient operations of bodies corporate.

Conflict of interest issues

By streamlining decision making for lot owners some potential conflict of interest issues are introduced. Where decisions are made on behalf of the body corporate, for example by the body corporate manager or the body corporate committee, the manager or committee is operating as the delegate of the body corporate. The incentives faced by the delegate (the manager) mean that their interests will not always align with those of the body corporate. The review has considered ways of addressing the issue.

Contribution to the economy

Bodies corporate are often non-profit private housing organisations that provide a vehicle to ensure the sharing of the costs of insurance and maintenance of common property and services. The body corporate essentially acts as the owner of the common property.

Available data suggests that bodies corporate provide services to between 10 percent¹ to 25 percent² of all residential housing in Victoria. In 2002, it was estimated that the minimum total value of residential housing affected by bodies corporate to be \$40 billion which represents approximately 7 percent of the total value of all property in Victoria.³

¹ Spatial Information Valuer-General Victoria

² Australian Bureau of Statistics ("ABS")

³ Spatial Information Valuer-General Victoria

Consequently bodies corporate play an important role in maintaining property and sustaining residential property values in Victoria.

Governance

The body corporate acts on behalf of the individual lot owners. However, many issues raised in the review reflect a lack of clarity in processes and poor supervision and control by the lot owners. As a general principle, organisations, including bodies corporate, operate more effectively and efficiently if they are properly directed, controlled and are held to account.⁴ It is therefore important that the regulatory framework supports lot owner participation and where appropriate promotes self-governance. Improved financial management, building management and governance of bodies corporate will maintain consumer confidence in the large proportion of residential property managed by bodies corporate in Victoria.

The social role of the body corporate

An active and effective body corporate can create significant social benefits and strengthen relationships between people who own, live, invest and work in lots governed by a body corporate.

The review has noted there are often tensions between:

- owners and body corporate managers
- owner-occupiers (or resident owners) and investment owners (who may live in other countries)
- owners and occupiers (or tenants).

However, bodies corporate also play a role in resolving these tensions.

Communication

The review has found that communication is the foundation for the effective working relationships which underpin the effective operation of bodies corporate and individuals' enjoyment of a residence, property ownership or property investment. Poor communication exacerbates lack of knowledge of roles and responsibilities and can increase the level of disputes.

The review has also found there are emerging tensions for consumers and the body corporate industry. In many cases, social body corporate issues relate to compliance with the (standard or additional) body corporate rules.

⁴ The OECD principles of Corporate Governance as set out in Standard Australia AS 8000-2003. Para 1.5.1 Corporate Governance page 8

The submissions to the review and consultation with the community have demonstrated that there is a direct connection between active participation by lot owners in the body corporate and more harmonious body corporate communities.

Submissions indicated that there were significant opportunities to minimise disputes and improve social harmony by specialist body corporate information and advice and amending the regulatory framework. Specifically the submissions said that the major causes of disputes are:

- lack of information about the operations of bodies corporate
- lack of information about the role of the body corporate and the individual lot owner's rights and responsibilities before purchase
- lack of recourse for breaches of the Act and regulations
- lack of incentives to deter breaches of the Act and regulations
- poor communication and a lack of an ability to contact other members to call a meeting to discuss and resolve issues
- poor understanding, or differences in understanding between parties, of roles and responsibilities of bodies corporate and body corporate managers
- conflict between minorities and majorities in body corporate communities
- differences in personalities and views about the rights and responsibilities of individual lot owners.

Problems for bodies corporate

In most property subdivisions (whether they be town houses, units, apartments, a combination of retail/commercial and residential, car parks and so forth) there usually exists common property that can be non-exclusionary and exclusionary.

Non-exclusionary common property typically provides access to individual property owners within the property subdivision. Typical common property includes pathways, driveways, car parks, foyers and stairs.

Most residential subdivisions with more than two lots will share the ownership in other forms of common property such as mail-boxes, garbage carousels and lawns & gardens. Depending on the design of the subdivision, other forms of common property could also include intercom systems, cooling towers, hot-water and air-conditioning systems, and lifts (elevators).

Common property is generally defined as a resource not subject to private ownership and available to all, such as a public park or the oceans. This broad definition cannot be applied entirely to body corporate common property as the individual property owners of the subdivision each have a share (private ownership) in the common property. Unlike a public park and the oceans, some of the common property categories such as hot water and air conditioning systems are not available to everyone and have a degree of exclusivity to the individual property owners; whereas common property that provides access is generally available to everyone and non-exclusive.

There are three main groups which interact with common property in a subdivision: lot owners (owner-occupiers), lot owners (investors) and tenants. These three distinct groups have different needs and expectations in relation to their maintenance (economic) and usage (social behaviour) of the common property.

By and large, lot owners that are owner-occupiers own and live or work in their individual property within a subdivision and have the greatest incentive to ensure maintenance of the economic features and adherence to the social norms of the common property. Any negative economic feature of the common property (such as a lack of maintenance in respect to lawns and gardens) will impact on the outward appearance of the building and affect the capital value of individual lot owners. However, there can be exceptions such as multiple access points to a building such as pathways or stairs. An owner-occupier may not necessarily have an economic or social incentive to ensure that a damaged pathway or stair in another part of the common property is repaired (unless the damage is likely to cause injury) as the owner-occupier does not need this infrastructure to access their property and furthermore, the damaged infrastructure is unlikely to significantly affect the capital value of the individual property. Given this, owner-occupiers are likely to have an economic and social incentive to maintain the common property as it mostly directly impacts on the capital value and amenity of their individual property lot within a subdivision.

However, this can change dramatically in a larger subdivision with many lot owners. There is an inverse relationship with respect to a vested interest in the maintenance of capital value/amenity as the scale of a subdivision grows larger, both in terms of physical size and number of lots. By way of illustration, an owner-occupier in a twenty-storey apartment building with multiple hot water systems serving different parts of the building would not be directly affected if one of the systems breaks down that serves occupants in another part of the building. Similarly, a lot owner-occupier located twelve storeys below an owner or tenant that has noisy parties late at night is not going to be affected by the noise compared with the neighbouring occupants to the party-reveller.

Owner-investors have similar attributes to owner-occupiers in respect to the economic maintenance of the common property as it directly affects the capital value of their individual property. However, the break-down of common property equipment (services) and untoward social behaviour does not directly affect the owner-investor as he or she does not live/work in the subdivision. While legislation exists to ensure landlords maintain and repair essential equipment such as hot-water systems, most negative social behaviour is not legislated and would be difficult to enforce.

Tenants have no private ownership in the individual property and common property and as a group lack the least incentive to maintain the economic and social aspects of the common property. However, the real estate agency market has access to a national tenant database and any adverse impact on the common property caused by a tenant would affect the ability of a tenant to gain a lease in a similar standard of residential housing. Hence, tenants are constrained to some degree, in the economic, and to a lesser extent, the social norms, of the common property.

The conflicting interests of the three groups affect the level of equity and efficiency in the management of common property and services within a subdivision. In general, there is greater potential for inequitable and inefficient management of common property for larger subdivisions.

Given the differing interests that exist amongst lot owners, conflicts arise in bodies corporate, either between individual lots owners or between lot owners and the body corporate itself. These conflicts can be driven by differing personalities, different approaches to issues or different underlying economic interests.

The body corporate exists to attempt to mediate dispute or conflicts between lot owners. The body corporate regulatory system attempts to provide a framework that minimise disputes. For example, insurance provisions can be a cause for disputation between lot owners. The regulations require the body corporate to have appropriate insurance, but disputes may arise between members as to the nature of the appropriate insurance.

There are two other key groups: property developers and professional managers acting on behalf of lot owners who also have an impact on the equitable and efficient management of common property within a subdivision.

Property developers, separate to the completion of a building and sale of individual property lots, determine the lot entitlements (voting rights for the subdivision) and lot liabilities (financial contributions for the subdivision) that may maintain their control over the management of the common property to the detriment of the lot owners. This could also include entering into long-term service contracts with subsidiary or related companies that are not necessarily cost competitive and

efficient from the lot owners' perspective. The impact of these long term contracts may not be reflected in the price if arrangements are not transparent and well understood. In off-the-plan developments, lots may be sold before the plan of subdivision is submitted, and thus these arrangements may not be disclosed at the time of sale, as they do not exist at the time of sale.

Lot owners within a subdivision generally delegate by contracting the day to day management of the common property to professional managers. However, lot owners also pool their financial contributions to meet the maintenance costs of the common property and hand-over these pooled funds to the professional manager to organise the maintenance and spend their funds accordingly.

As the body corporate manager acts as the delegate of the body corporate and often manages the funds of the body corporate there is a risk to the body corporate of loss. For this reason the current regulatory regime provides that body corporate managers must have professional indemnity insurance. However, there is no process for ensuring managers have this insurance and the risk remains that body corporate managers will not keep insurance up to date.

The size of the subdivision will determine the complexity of the tasks to be undertaken, the skills of a professional manager requires, and the ability of lot owners to supervise the body corporate and the body corporate to supervise the body corporate manager. A small sized subdivision with twelve lots may entail basic maintenance such as gardening, cleaning, plumbing with a \$12,000 turnover for the subdivision; tasks which are easy to undertake and supervise. Whereas the tasks for a high-rise tower may involve the tendering and performance management of significant service contracts for items such as elevators, air conditioning, hot water systems, and electronic surveillance systems; tasks which involve several million dollars of turnover for the subdivision. The risk to lot owners of financial mismanagement are greater (large developments have higher average costs) and the risk of possible misappropriation of pooled funds are far greater for these subdivisions given the complexity of the arrangements.

Key areas for reform

The review has identified a range of areas where improvements could be made to the regulatory structure. Detailed analysis of the issues, including consideration of stakeholder viewpoints, alternative approaches and costs and benefits has been undertaken. The following sections provide an overview of the issues and provide recommendations on the issues.

A new regulatory scheme governing bodies corporate

The *Subdivision Act 1988* and Subdivision (Body Corporate) Regulations 2001 aim to regulate the management of common property and the constitution and operation of bodies corporate. The current regulatory framework reflects limited government involvement in body corporate operations with a reliance on self-governance by the body corporate community.

The review has found that it is necessary that a new legislative framework be developed that is sufficiently flexible to evolve with the changing paradigm. The new regulatory scheme must set out sufficient powers to enable the efficient and effective operations of self-managed bodies corporate and professionally managed bodies corporate.

It is proposed that the regulatory scheme for bodies corporate implement the following objectives:

- providing sufficient powers and functions to support the operation of bodies corporate
- improving communication in order to minimise disputes, building a sense of community and making bodies corporate more liveable
- facilitating self-management and owner participation
- balancing the rights of individuals with the responsibilities of the body corporate to act in the best interests of the body corporate
- promoting an obligation of fairness and good faith on every duty, power, function or contract entered into under the legislation
- providing sufficiently flexible administrative arrangements to promote improved management, maintenance and protection of common assets and buildings with a long term focus

- promoting transparency in financial management in order to protect body corporate assets and minimise the risk of loss to consumers
- providing bodies corporate with the flexibility they need in their operations and dealings to accommodate changing circumstances within the body corporate community
- promoting improved professional management services
- ensuring that consumers have access to information and are informed decision makers
- providing an appropriate level of consumer protection for owners and intending buyers of lots in a body corporate
- providing an efficient and effective dispute resolution process and
- promoting fair, reasonable and consistent application of the Act, Regulations and Rules.

Many of the provisions under the Subdivision Act in relation the duties, functions and powers of the body corporate and the dispute resolution provisions are unclear. In the decision in *Walker and Sopov v Registrar of Titles [2001] VSC 354*, Mr Justice Eames stated:

'It must be said that the interpretation of this important legislation [Subdivision Act] is made exceptionally difficult by virtue of the confusion and lack of clarity of the terms in which it has been drafted.'

The submissions also said that the current regulations were too vague about lot owner's rights and responsibilities and they therefore often feel marginalised and powerless. The submissions stated that expert information on rights and responsibilities under the Act and Regulations was too costly, because of its technicality (much body corporate information is complex technical-legal information). Some submissions said that it was common to receive inconsistent expert advice which added to disputes.

In 2001, the Subdivision (Body Corporate) Regulations were reviewed and remade. At its meeting on 20 August 2001 the Regulation review Subcommittee of the Scrutiny of Acts and Regulations Committee examined the regulations and made the following comments:

"Given the serious nature of the matters dealt with by the Regulations, Subcommittee members are of the view that empowering bodies corporate to perform a range of functions should more appropriately have been dealt with by an Act of Parliament"

rather than in Regulations and that the ten year review provided an opportunity of doing this. Subcommittee members also note that, as an alternative to these Regulations, consideration was given to creating new legislation dealing specifically with bodies corporate. This alternative would have involved a stricter enforcement regime, great public information and awareness, more investigation of complaints; dispute resolution together with stronger financial management and standards of performance amongst professionals dealing with the body corporate community.”⁵

The present review has found that there are compelling reasons for the development of a new legislative scheme for the operations of bodies corporate to ensure that people are better informed of their rights and obligations living and working in bodies corporate.

Proposal 1: Enhanced legislation

It is proposed that new legislation be developed to provide for more modern regulation of the operations and management of bodies corporate.

Clarifying aspects of the legislation

The review received feedback on the ability of the body corporate to undertake legal proceedings. For example, the St Kilda Legal Service reported:

“Recently a client sought legal advice from St Kilda Legal Service after having taken legal action against a body corporate manager in the Civil Claims List of the Victorian Civil and Administrative Tribunal (VCAT), on behalf of the body corporate in relation to a matter affecting all members. However, in this instance VCAT awarded the costs against the complainant, which raised the issue of whom should bear the costs and the cost awards of civil litigation where an individual member is acting on behalf of other body corporate members.

St Kilda Legal Service therefore supports amending the legislation to clarify the powers for a body corporate to take legal action on behalf of its members, including the appropriate resolution required of the members.”

By clarifying when bodies corporate are able to undertake legal proceeding on behalf of its members more certainty should be provided to members of bodies corporate.

Proposal 2: Clarify the ability to take legal proceedings

It is proposed that the new legislation clarify when the body corporate is able to take legal proceedings on behalf of the members and the processes and circumstances for this.

⁵ Annual review 2001 of the Scrutiny of Acts and Regulations Committee, page 45.

Throughout the consultations problems were identified with the scope of the legislation and roles and responsibilities under the legislation. It was identified that there was a divergence between the scope of the body corporate regulations as identified in the regulations, and the practical responsibility of the body corporate as it operates across Victoria.

The limited set of activities covered by the current regulations does not encompass all activity. A submission from Mirvac Victoria Pty Ltd advised the review that some bodies corporate are managing areas leased or licensed by the body corporate, maintaining and controlling open space, providing membership to fitness clubs and providing power, telecommunication and other services. Mirvac Victoria Pty Ltd asked the review to clarify the scope of the powers of the body corporate so that bodies corporate can better understand their functions and that their exercise of powers is limited to those functions.

The review has found that the current regulatory regime does not take into account issues surrounding multi-storey towers developed as part of the recent inner city real estate development.

Proposal 3: Clarify role and responsibilities

It is proposed that the new legislation clarify that the body corporate is responsible for the management, repair and maintenance of easements, and shared infrastructure services whether or not they are on common property or lots to ensure that buildings are safe and properly maintained.

It is proposed that there be a prohibition against adverse possession of common property for lot owners. This is due to the special relationship between lot owners and the owners corporation under which it is the lot owners who protect the owners corporation's interest.

Proposal 4: Adverse possession

It is proposed that the legislation clarify that a lot owner cannot claim adverse possession of the common property.

Promoting understanding on the role of bodies corporate

It is proposed to clarify the responsibilities of the body corporate and send a clear message to the community that effective and efficient bodies corporate require active participation by their members. The review has found that there is a lack of understanding about the role of the body corporate and the role of the lot owners in the administration and management of the common property and land affected by the body corporate.

It is proposed that the current body corporate created under the *Subdivision Act 1988* will be known as an “owners corporation”. This provides greater clarity regarding the role of the body corporate and is consistent with terminology used in other states. It is not proposed that bodies corporate be required to change their name, but rather only when materials such as stationary, signs are being updated.

Proposal 5: Owners corporation

It is proposed that it is clarified that a body corporate created under the *Subdivision Act 1988* is a collection of the owners of the lots and that it be called an "owners corporation" in the new regulatory framework.

Simplification for small bodies corporate

The submissions advised that compliance with the current regulatory scheme is a burden on subdivisions where there are two lots. The review notes that two lot subdivisions can effectively operate as tenants in common. However, lot owners of two lot subdivisions may still wish to make application to the dispute resolution mechanism should there be a dispute.

Proposal 6: Two lot subdivisions

It is proposed that the new legislation enable two lot subdivisions to be exempted from certain requirements under the legislation.

Knowledge and information

The review found that a significant issue has been the lack of knowledge by lot owners of the current provisions of the legislation and regulations and the complexities and inconsistencies of the operations of bodies corporate complying with a whole range of other legislation. This lack of knowledge was evident at every level, including professional body corporate managers or people with legal training.

The submissions to the review provided examples where officers (secretary, members of committee or a paid professional manager) were often faced with many complex financial, social and legal issues. Consequently, officers sometimes made mistakes and failed to comply with the procedures for conducting meetings, adopting budgets, collecting fees, recording minutes and enforcing parking. In addition, bodies corporate need to comply with other legislation that is based on separate rather than common ownership models. The lack of knowledge in the community relating to body corporate responsibilities and dispute resolution provisions has been further hindered because of the lack of clarity of the provisions under the Subdivision Act. Appleby Real Estate reported in their submission:

“The majority of new owners I meet have almost no knowledge of the role of a body corporate in relation to boundaries, use and misuse of common property, standard and additional rules and insurance obligations.”

There was general agreement in the submissions that specialist information and advice would reduce disputes and enhance the effectiveness of any expanded regulatory regime for bodies corporate. The review recommends the development of an integrated information, education and advice service (telephone and web based) to provide holistic support to consumers and the body corporate industry.

In addition, the review has found that there is a low level of knowledge and compliance with the current regulatory framework by managers. As bodies corporate operate in a complex economic, legal and social framework, there is a need to educate the managers of the requirements of the legislation. The proposal to provide specialist information, education and advice will have significant long-term public benefits in increased consumer confidence in higher density living, improved standards of body corporate management, and reduced disputes and reliance on dispute resolution mechanisms. While the current legislation provides for some record keeping, many submissions provided evidence that more detailed description of the reporting requirements was needed.

Proposal 7: Information and advice

It is proposed that appropriate information and advice be provided by CAV. The specialist information and advice would consist of telephone advice, printed and web based information in the form of information sheets and guidelines.

The review has found that information relating to lot owners’ contact details, financial statements, management statements, maintenance plans and body corporate rules must be readily accessible to ensure consumers are informed and that the body corporate is accountable. Many body corporate members reported having difficulties accessing information. For example one body corporate member stated:

“I have request the addresses of the other non-resident owners from the current BC manager, in so that I can inform them that they are largely forking out payments for ‘extraordinary expenses’ needlessly, however it seems they cannot be provided?”

This highlights the need for explicit requirements in the legislation for the provision of information by the body corporate to its members. It is proposed that this information be collated in a form that can be easily inspected by body corporate members.

Proposal 8: Improving record keeping and disclosure

It is proposed that the new legislation clarifies the records that are required to be kept and made available and provide for a 'body corporate register' of essential matters.

While there are legislative requirements for the provision of information as part of the purchase process, submissions to the review have shown these provisions to be limited in their usefulness to prospective purchasers. The Council of the Aging Victoria stated:

"[We recommend] that any person contemplating moving into a unit with a body corporate be comprehensively informed of what this entails. That full details are provided regarding who is managing the body corporate, the number of owner-occupied to investment properties, a copy of the latest financial report, information on meetings, annual general meetings, whether there is a sinking fund, etc"

Clements and Co lawyers stated in their submission:

"It is perhaps time to revisit the information to be included in the Form 3 Certificate and to expand that information by, for example, requiring to be attached any additional rules of the body corporate, a financial statement for the last year and the minutes of the last annual general meeting."

"However, the parties involved in neighbourhood type disputes should be encouraged to mediate prior to taking any legal action or if legal action is taken, then a mediation should be ordered at an early stage of the proceeding. Other disputes involving real legal issues would be better resolved by a hearing in a specialist body corporate tribunal or court."

The Law institute of Victoria argued:

"If section 32 of the Sale of Land Act was amended to require vendor's statements to include a Form 3 body corporate certificate or disclosure of the equivalent information, this would ensure that appropriate details would be provided to all prospective purchasers."

It is proposed that greater information be provided to prospective purchasers through the body corporate certificate.

Proposal 9: Improving disclosure

It is proposed that the disclosure of information be improved for prospective purchasers of units in bodies corporate.

Proposal 10: Improved body corporate certificate

It is proposed that the body corporate certificate contain brief details of key matters, such as: fees paid, special levies struck and paid, insurance, maintenance plan, proposed works, contingent liabilities, leases and licences, any legal proceedings.

It is proposed that the body corporate certificate be made available within 14 days of receipt of the application, be attached to the section 32 statement made under the *Sale of Land Act 1962*.

Access to justice

The *Subdivision Act 1988* provides that disputes between members of a body corporate are civil disputes and the parties can apply to the Magistrates' Court for an Order. The current regulatory framework does not provide for dispute resolution additional to that generally available for other neighbourhood disputes. In his booklet *Subdivisions and Bodies Corporate* (Law Press, 1995), Simon Libbis states (at page 56):

“The procedures available under s.38 are very rarely used. This is not because of a lack of disputes but more an unwillingness to take them to Court. There is, therefore, no guidance available on how the Courts will exercise the powers given to them under this section. This uncertainty may increase the reluctance to litigate. If this results in disputes being resolved without resorting to the Courts it is a desirable result. It is likely in many cases that such uncertainty is a hindrance to justice being obtained and, if this is so, more accessible dispute resolution procedures should be introduced.”

The current regulatory framework reflects limited government involvement in body corporate operations and self-governance by the body corporate community. However, the review found that there was a large number of issues raised in the submissions and a growing number of enquiries and letters to CAV relating to lack of accountability for use of body corporate funds, breaches of rules and incidents where a majority lot owner or the manager holding a number of proxies was able to act against the interests of the minority lot owners. However, the current data on applications to the Magistrates' Court or VCAT does not reflect the anticipated number of disputes relating to these issues. Information obtained from the Magistrates' Court reveals that 95 percent of 500 disputes in Victorian bodies corporate relate to unpaid fees.

The submissions highlighted the significant financial costs (which acted as deterrence) for an individual obtaining expert legal advice. The submissions stated that high costs are a disincentive to lodging a claim in the Magistrates' Court. For example, the submission from the Council on the Aging National Seniors stated:

“The cost of settling disputes and interpretation of documents through normal court procedures is too costly and lengthy for the resources and time left for the average resident.....”

The submissions highlighted the difficulties of members resolving disputes with the body corporate or the manager (or both). For example, the submission from the City of Melbourne stated:

“Council is aware of instances where some members of bodies corporate have been denied access to body corporate records and accounts. At present access to such records requires the member to seek an order from the Magistrates’ Court and incur the attendant expense, delay and frustration occasioned by this process. Council considers there is a need for a more accessible, timely and less costly means of dispute resolution to be available to members of bodies corporate. The existing referral to the Magistrates’ Court for an Order, for matters including non-compliance with the regulations, is for the most part inappropriate.”

The review has found that there are significant barriers to accessing justice for members of bodies corporate. The submissions were of the view that the commitment to take legal action was a deterrent to enforcing the Regulations or rules by taking matters to Court because the outcomes of legal action are uncertain, legal costs are usually disproportionate to the nature of the dispute, attendance at hearings by members are impractical where there are many members and obtaining orders through the Courts or a Tribunal takes too long for day to day operations of bodies corporate.

The review has noted that some disputes between owners of lots, occupiers of lots (including tenants) and the body corporate are neighbourhood disputes that are more appropriately resolved by an internal communication and grievance procedure and some disputes between the individual lot owners and the managers are more appropriately disputes between the body corporate and the manager under the *Fair Trading Act 1999*.

The review notes that there are significant barriers to providing alternative dispute resolution and accessing the justice system when there are multiple parties (possibly living overseas or interstate) and that there are opportunities to provide a fairer, more accessible and effective justice system.

As stressed in the Attorney-General's Justice Statement⁶, there are also opportunities to develop policies to provide non-litigious solutions early to disputes and enable consumers to move seamlessly between stages of the dispute resolution spectrum.

⁶ "New directions for the Victorian justice system 2004-2014", The Attorney-General's Justice Statement May 2004. The core values in the Attorney-General's Justice Statement include:

Fairness – the processes of justice should be fair, incorporating principles of natural justice and proportionate sanctions and remedies.

As discussed above, lack of clarity leads to the increase in transaction costs in resolving issues for lot holders. The impact of this high transaction cost manifests itself in three ways:

- bodies corporate often make mistakes in their operation and procedures
- issues in dispute are difficult and costly to resolve through the court system
- the myriad of smaller issues (such as incorrect fees, or improper procedures) offer no simple process for resolution and remain unresolved for long periods of time.

However, several submissions asked the review not to over-regulate or load the regulatory framework with micromanagement minutia that made self-managing bodies corporate difficult or increased the cost of professional management services.

The review has found a need to develop an integrated approach in providing dispute resolution services that deals with different types of disputes and best meet the needs of consumers and the community. For example disputes between owner-occupiers and occupiers may be best resolved by the body corporate, while disputes between lot owners, the body corporate and the body corporate manager may be best resolved by conciliation or by direction or adjudication.

The review recommends that the body corporate regulatory framework actively address several of the key initiatives outlined in the Attorney-General's Justice Statement which include that:

- legislation should be more accessible to users
- advisory services should be strengthened
- disputes should be resolved at the lowest appropriate level
- matters in dispute should, as far as possible, be able to seamlessly move between different stages in the dispute resolution process.

It is recommended that the legislation sets out an integrated three tiered dispute resolution model to enable a body corporate dispute to be resolved at the lowest possible level and to seamlessly move between the different stages in the dispute resolution process.

It is proposed that CAV have jurisdiction to conciliate and provide direction on matters related to the new legislation. To maximise consumer protection, it is recommended that the legislation sets out clear criteria for determining whether matters are related to the operations of bodies corporate and are appropriate for

Accessibility – the justice system should provide appropriate access to all people regardless of their means, and a range of processes which are appropriate to the issue to be resolved.

Effectiveness – the justice system should be responsive, and able to efficiently deliver the outcomes expected of it by the community.”

conciliation, direction, or investigation or other action under the *Fair Trading Act 1999* or referred to VCAT.

Proposal 11: Appropriate dispute resolution mechanism

It is proposed that the legislation sets out a multi-tiered dispute resolution process as follows:

first tier: dispute avoidance. This should including information and advice on internal communication and grievance procedures, as well as internal dispute resolution for bodies corporate, with a default process set out in model rules

second tier: access to a low cost dispute resolution process. It is proposed that CAV provide conciliation for body corporate disputes and, as necessary, referral to VCAT

third tier: the Victorian Civil and Administrative Tribunal (VCAT). It is proposed that VCAT consider more complex technical and legal issues relating to the operations of bodies corporate.

Protection of body corporate funds

The Issues Paper and Future Directions Paper encouraged public comment on current practices and risks to body corporate funds. The submissions identified the following risks to body corporate funds:

- no standards of financial record keeping and reporting by people operating body corporate accounts
- no enforceable requirements as to where body corporate funds are kept. For example, possible investment with high returns and possible risk of loss of funds
- persons in control of body corporate funds applying those funds for their own personal use
- persons in control of body corporate funds retaining interest off the accounts and not accounting to the body corporate for the amount of interest received or used
- managers using the funds of one body corporate to finance another building or body corporate
- inability of bodies corporate to meet repairs and maintenance of expensive items such as air conditioning and lifts.

There are several issues of concern for body corporate members. First, members have unlimited liability to the body corporate and members and potential purchasers must be attentive to body corporate finances and any unusual body corporate liabilities to minimise the risk to their personal assets.

Second, the submissions were concerned that the introduction of a requirement to establish maintenance funds would increase the amount of money held by the body corporate and potentially, a greater risk of loss of body corporate funds. The number of issues raised was a clear indication that the current provisions are no longer adequate to protect body corporate funds and personal assets of members. In particular, the submissions called for a requirement that body corporate funds be held in trust accounts and be subject to scrutiny by law.

Protection of body corporate funds

The review has found that bodies corporate are responsible for managing and protecting a significant pool of property and financial assets on behalf of lot owners and there are significant risks to the financial assets of the body corporate including:

- the inability of the body corporate to budget for long term maintenance and replace expensive infrastructure
- the mismanagement and misappropriation of body corporate funds
- the inability of a body corporate to supervise body corporate funds or have funds returned on the change of professional body corporate manager where the manager operates a common bank account and funds from one body corporate are mingled with other body corporate funds.

It is important that the legislation clearly spells out the obligations imposed on bodies corporate. Melbourne Inner City Management, a body corporate management firm specialising in high-rise developments, stated in its submission:

“The operation of a bank account in line with current business practice, coupled with keeping proper books and preparing proper financial statements for all income and expenditure and assets and liabilities is open to interpretation. The current regulations are very vague and provide little accountability and transparency thereby offering little protection or safeguards to members to protect their funds.”

Appleby Real Estate argued in their submission that:

“The clarity and scope of financial statements varies widely from excellent to cryptic.

Sufficient and accurate information should be provided by bodies corporate to their members to ensure that members can monitor money managed on their behalf by bodies corporate.

Proposal 12: Protection of body corporate funds through better book keeping
It is proposed that legislation introduce:

- a requirement for the body corporate to record all transactions of income and expenditure and assets
- a provision requiring the preparation of annual budgets to be sent out with the notice of the annual general meeting.

Proposal 13: Protection of body corporate funds through better accounts and audits

It is proposed that legislation:

- introduce a requirement that the body corporate operate a bank account in the name of the body corporate
- clarify that body corporate funds be held on trust
- enable standards of accounting for prescribed classes of bodies corporate to be set out in model rules
- enable audits of accounts and require audits of accounts for prescribed classes of bodies corporate.

Proposal 14: Protection of body corporate funds through better funds management

It is proposed that legislation:

- enable the establishment of a separate maintenance fund and budgeting to raise sufficient monies to provide for the maintenance plan
- require the establishment and management of a maintenance fund for prescribed classes of bodies corporate
- enable internal expenditure approval procedures to be set out in the model rules
- provide a relatively simple and straightforward process for fee/debt recovery.

Asset Management

Submissions raised concerns that limitations on the operations of a body corporate created under the *Subdivision Act 1988* and Subdivision (Body Corporate) Regulations 2001 restrict the appropriate management and maintenance of the buildings on the plan of subdivision. These concerns centred on the inability of the body corporate to:

- improve or renovate or upgrade common property

- prepare long term maintenance plans to ensure appropriate maintenance or replacement of obsolete essential infrastructure or services whether common property or not
- ensure compliance with health and safety requirements under relevant legislation.

It is recommended that the regulatory framework be amended to enable bodies corporate to develop a maintenance plan and establish a maintenance fund. This will reduce disputation between newer and older owners about upkeep and respective liabilities.

Proposal 15: Improved asset management

It is proposed that the powers of the body corporate be expanded to enable:

- improvements and upgrades to common property by special resolution
- maintenance and repairs to easements and services in lots
- preparation of maintenance plans on the estimated cost of repair/ replacement for major items and the expected life of those items

It is further proposed that prescribed classes of body corporate be required to prepare maintenance plans.

Insurance

Feedback received during the review indicated that it was not always obvious which parts of the buildings and other infrastructure were common property for the purposes of insurance. In addition some bodies corporate found it difficult to take out additional insurance, or found themselves underinsured due to infrequent valuation.

Proposal 16: Clarification of insurance provisions

It is proposed that the regulatory framework be amended to provide greater protection for consumers by:

- clarifying what is required to be insured
- enabling bodies corporate to take out additional insurance by an ordinary resolution
- requiring prescribed bodies corporate to have sufficient replacement and reinstatement insurance cover for the building.

It was clear from the consultation process that the requirements that apply to small bodies corporate will need to be different to the requirements that may apply to larger bodies corporate. It is proposed that the mechanism to handle this is the creation of certain classes of bodies corporate that may have higher obligations imposed on them through regulations.

Proposal 17: Prescribed classes of body corporate

It is proposed that the legislation create a flexible mechanism for providing for specific regulation of certain bodies corporate. The legislation should allow for the prescribing of additional requirements for certain classes of bodies corporate, for example for large bodies corporate.

Rules

The current regulatory scheme provides for the body corporate to make rules.

The review has found that the current standard rules are no longer appropriate for all bodies corporate and bodies corporate are not clear what they can or can't include in additional rules. The review has found that rules are best developed for the specific body corporate. Consequently, it is recommended that schedules of model rules will enable bodies corporate to tailor make their own rules. In addition, it is recommended that model rules will apply as default rules if the body corporate does not make its own rules.

Proposal 18: Improving rules

It is proposed that the legislation should improve the operation of body corporate rules by:

- expanding the power for the body corporate to make rules
- ensuring that bodies corporate lodge consolidated rules when lodging rules
- stating that body corporate rules will be unenforceable if they unfairly discriminate against the owner of a lot or occupier or are inconsistent, limit a right or avoid any obligation under the Act or regulations or other law.
- producing updated model rules.

Proposal 19: Enforcement of body corporate rules

It is proposed that the power for the body corporate to enforce rules should be set out in the legislation. The enforcement of rules will require notice of rules, notice of the breach and enforcement through VCAT.

Governance issues

In general, the submissions suggested that governance problems within bodies corporate result from poor communication and lack of control by members. Another theme which emerged in the submissions was that the body corporate regulatory framework was inadequate because it restricted the ability of the body corporate to consider other possible types of management functions such as physical asset management or safety and risk management. In particular, submissions suggested that the regulatory framework is no longer adequate to facilitate or promote:

- full and open communication between members
- understanding of rights and obligations under the Act and Regulations
- transparency in financial transactions
- mechanisms to measure and monitor management services provided by committees and professional body corporate managers
- standards of conduct and mechanisms to deal with conflicts of interest
- powers to enable and promote long-term asset management to maintain the value of the building
- powers to prepare for emergency situations such as fire and terrorist attacks and undertake emergency evacuations
- incentives to encourage compliance with body corporate legislation, regulations and rules.

A submission from a lot owner living in Hong Kong illustrates some of the difficulties and costs relating to asset management and governance:

"Complaints to the body corporate manager continued. It was noted by residents that the person concerned was not often available to speak to, did not return phone calls, did not return emails (although I emailed numerous times, I never once received a reply, did not deliver a timely and reliable services, was negligent in respect of services and did not adequately and satisfactorily follow up on issues regarding building works.....

I, therefore came down from Hong Kong and contacted the other owners. Most felt the same as I did, so I collected the required number of signatures required to call a special general meeting, the purpose being to dismiss the BC manager. At this meeting, the BC manager was dismissed and a new BC manager appointed.....

After the special general meeting, the original BC manager was notified of the decision and requested to hand over all the papers etc concerning our Body corporate. He, however, ignoring the legal requirements, did not hand over the accounts and other information until well past the time by law. This was despite numerous phone calls from the owners of flats, faxes and requests by the newly appointed BC to do so, When we did get the accounts etc. the information was incomplete and, what is more, we found ourselves with an underinsured building and the building insurance only paid up to a short while ahead. A levy was needed to cover this. Further we were left with a deficiency of around \$12,000. Owners faced a special levy to cover this amount."

The review has found that the preferred option to improve standards of governance and provide greater consumer protection is to introduce general principles of conduct into the legislation.

The submissions identified an increasing risk of conflicts of interest in decisions made on behalf of the body corporate. Conflicts of interest may arise, for example, where the developer enters into long-term agreements on behalf of the body corporate or there is a majority lot owner or a manager holding a number of proxies making decisions on behalf of the body corporate. The concept of acting in good faith has already been introduced under section 29(5) of the *Subdivision Act 1988*. However, the review notes that there are opportunities to develop the concept of acting honestly and in good faith is central to the effective and efficient operations of the body corporate and a means to attaining the objectives of the legislation.

Proposal 20: Conduct principles

It is proposed that general principles of conduct be introduced into the legislation. This should cover the body corporate, the committee, the body corporate manager and the holder of a proxy. It should also include a duty on the developer to act in good faith and exercise a degree of care and diligence and to make reasonable efforts to pursue any remedies under the building contract regarding the common property.

Many submissions were received regarding the nature of unanimous and special resolutions. After examining the various options the review has proposed a model which should balance the needs of bodies corporate to have flexible decision making and the need to protect lot owners.

Proposal 21: Facilitating decision making

It is proposed that an interim resolution mechanism be introduced for special resolutions. The interim resolution process should be as follows:

- a special resolution may be made by postal or electronic ballot
- if a 75 percent majority in favour is not received, but 50 percent are in favour and not more than 25 percent against, then the decision is an interim decision

- the interim decision process then applies which requires sending of minutes and notice of the interim decision within 14 days of the meeting
- an interim decision becomes a decision of the body corporate if no petition is received within 29 days.

It is proposed that there be no change to the definition of a unanimous resolution.

Many submissions also provided feedback on the granting of perpetual or irrevocable proxies for bodies corporate. These are inconsistent with fair and appropriate management of bodies corporate and the review found that the law with respect to these proxies should be clarified. The Body Corporate Management Committee of Pier 9 in Patterson Lakes reported in their submission:

“There is a growing practice amongst developers to award themselves the proxy votes belonging to the first owner of lots in a development. Whilst this may be necessary for a short term only, Pier 9 is an example of proxy votes being awarded to a subsidiary company of the development company for an indefinite period of time.

In addition some developers are also naming themselves as the Body Corporate Manager or a subsidiary company of the developer.

These two contract work together to deny the Body Corporate Lot owners the right to vote on their own behalf, as a result the manager (regardless of how incompetent or negligent) cannot be voted out of office, as he holds the majority votes. Catch 22!”

Proposal 22: Avoiding the legislation

It is proposed that the legislation explicitly state that any clause in a contract will be unenforceable if the clause is inconsistent with or limits a right or avoids an obligation under the Act. It is proposed that there be a prohibition on requirements to give away proxies.

During the review stakeholders identified issues with the allocation of lot liabilities and entitlements which often lead to perceived inequities.

One way to address this issue is to ensure that purchasers of properties are informed on the distribution of lot liabilities when they purchase a property, and that they are informed on the basis for the allocation of lot liabilities.

Proposal 23: Fairer allocation of lot entitlements and lot liability

It is proposed that the basis of the initial allocation of lot liabilities and lot entitlements are to be explained in the plan of subdivision.

The lack of clarity regarding the role and powers of the body corporate committee has been identified as an impediment to the effective and efficient operations of

bodies corporate. One member of a body corporate in regional Victoria stated in his submission:

“A serious fault of our BC was that the lone Secretary did not have any powers delegated to him. Apart from the weaknesses of the lone position for breadth of understanding and support and for continuity...the lack of defined powers worsened things.”

It is recommended that the legislation should clearly set out the responsibilities and powers of the committee, subject to the directions of the body corporate at a general meeting. It should also clarify the appointment process for body corporate managers.

Proposal 24: Clarifying the constitution and powers of committees

It is proposed that the constitution, duties, functions, powers and responsibilities of committees be set out in the Act and enable the committee to be delegated powers and duties of the body corporate to facilitate effective management.

The smooth operation of the body corporate and the body corporate committee are important to ensure that these bodies can discharge their responsibilities appropriately. The review has found that improvements to the methods of communication and the meeting procedures of bodies corporate should assist in their operation.

Proposal 25: Meeting procedures

It is proposed that the legislation clarify that bodies corporate must:

- keep full and accurate minutes
- not act on an interim decision for 29 days from the date of the interim decision
- send minutes to members within 14 days of the AGM.

Body corporate managers

There have been a number of calls for licensing of professional body corporate managers in the submissions, on the basis that this would improve the quality of body corporate management. However licensing can be a costly approach, and will not always address the issues of quality body corporate management.

The review has found that the range of recommendations provided above should address many of the issues regarding body corporate managers. A simple register is proposed. A register would provide:

- current contact details of professional body corporate managers (currently required to be recorded on each plan of subdivision)

- current details of professional indemnity insurance (currently required on the initial form appointing a professional body corporate manager)
- an effective and efficient gateway to update professional body corporate managers throughout Victoria on legislative requirements and emerging issues.

By providing a means to ensure managers have professional indemnity insurance, bodies corporate can be protected (by having an avenue for redress) against professional misconduct by body corporate managers.

Proposal 26: Registration of body corporate managers

It is proposed that all body corporate managers be registered. It is proposed that the Business Licensing Authority administer the registration of body corporate managers and create a public record of:

- current contact details of professional body corporate managers (currently required to be recorded on each plan of subdivision)
- current details of professional indemnity insurance (currently required on the initial form appointing a professional body corporate manager).

Many individual submissions raised issues with the management of body corporate managers. Ace Body Corporate Management in their submission commented on the process for approval and removal of body corporate managers:

“The process for dismissing a manager needs to be clearly spelt out in both the Act and Regulations. It should be stated that a body corporate manager must hand over all monies and records of the committee, new manager or body corporate owner within one month of being dismissed by the body corporate.”

The most appropriate way to manage the range of body corporate managers is to ensure that bodies corporate have effectively manage body corporate managers that they employ. To facilitate this, the legislation should clearly set out the process for appointment and removal of the body corporate manager.

Proposal 27: Clarifying the appointment and removal of a body corporate manager

It is proposed that legislation provide more detail on the process to appoint and remove a manager.

Other issues

The review puts forward a range of recommendations to address the deficiencies in the current regulation of bodies corporate. The proposal will have implications for

government and for members of the public and the business community. These issues will continue to be worked through with stakeholders.

Proposal 28: Funding

It is proposed that funding of the specialist body corporate information, advice and dispute resolution should be provided by a combination of manager's registration fees, application fees, penalties and funds from the Victorian Property Fund. It is proposed that manager's registration fees, application fees and penalties be paid into the Victorian Property Fund.

Proposal 29: Further consultation

It is proposed that an exposure draft of any proposed legislation be made available to provide further opportunities for community and key stakeholder consultation.