Submission No 15

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

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SCHOOL OF LAW
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Hon Emily Suvaal MLC
Chair, Inquiry into the ability of local governments
to fund infrastructure and services
Standing Committee on State Development

Dear Ms Suvaal,

Re: Submission to the Inquiry into the ability of local councils to fund infrastructure and services

I am a professor in the Law School at Macquarie University and on the executive of the research group, Smart Green Cities. I am the author of *Strata Title Property Rights: Private governance of multi-owned properties* (Routledge 2017), as well as multiple academic articles in the area.[1] I have been engaged by governments in Australia and overseas to advise on their laws in relation to high density development. I am a long-term Academic Fellow of the Australasian College of Strata Lawyers, the peak industry body for lawyers working in strata industry and am currently a member of the Strata and Building Consumer Roundtable, chaired by the NSW Building Commissioner, David Chandler.

I am not an expert in the finances of local councils but am making a submission because of the increasing trend of local councils shifting costs for substantial infrastructure and services to specific groups of homeowners. This is done through strata and community title. These developments all include common property that is collectively owned by all apartment/townhouse/house owners. Unlike owners of non-strata properties who can choose not to maintain their properties (which will be reflected in ultimate sale prices), owners in strata and community title developments have a statutory obligation to pay for the maintenance and repair of common property through levies. As a result, whenever infrastructure is sited on common property it becomes private property that owners will have to maintain and repair. Bodies corporate (owners corporations, community and neighbourhood associations) can also be bound by contracts, frequently negotiated by developers, to pay for infrastructure and services. In large-scale, complex developments with lifts, chillers, air conditioning, fire services, embedded networks, hydraulic, energy and

[1] See Cathy Sherry – Research Outputs — Macquarie University (mq.edu.au)

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sustainability infrastructure, the combined costs of the statutory obligation to repair common property and pay for body corporate contracts is substantial, even when shared. The people bearing these costs now and, in the future, include young people who cannot afford freestanding houses in established suburbs, as well as retirees on fixed incomes who have elected to downsize. There are deep problems with the equity of requiring these groups of homeowners to bear significant, on-going financial burdens for infrastructure and services by privatising them in strata and community title schemes.

This submission mirrors a submission that I made to the NSW Parliamentary *Inquiry into the development of the Transport Oriented Development Program* because the focus of new development will be around transport lines, and it is in these new developments that infrastructure costs are shifted to homeowners.

Connecting the supply of housing to the long-term life of housing, in particular its true costs

At the outset of this submission, I want to make very clear that I am in favour of medium to high density development. However, I am extremely concerned that to date, there has been almost exclusive focus on the initial creation of housing (supply) with little to no focus on the long-term life of that housing and the experience of individuals, families and communities living in it. It is a bit like focussing exclusively on a wedding or childbirth, with no thought to the decades of marriage or child rearing ahead. Like marriage or childbirth, the creation of housing is simply the first step in a long-term endeavour. If that first step is short sighted, with limited understanding of the challenges to come, it will create an unstable foundation that is guaranteed to cause problems for citizens and governments.

Every time a large high rise building or master planned estate is built, extremely complex legal relationships and financial responsibilities are created that will be imposed on the ultimate owners of apartments for years to come. However, few if any of the people making decisions in relation to high density developments – architects, designers, planners and local councils – fully understand the obligations they are creating. In saying that, I don't mean any disrespect to those professions. As a property lawyer with 30 years' experience and a good understanding of strata, community and stratum title, I struggle to understand the legal relationships. They are created by voluminous legal documents - contracts and registered dealings – and it is likely that the only people who understand them properly are the developer's lawyer and surveyor. By way of example, I listened to an excellent presentation at the Australasian College of Strata Lawyers conference last month by the lawyer and surveyor responsible for the development at Wentworth Point. It was mind bogglingly complicated, as evidenced by the fact that the contracts of sale for apartments were two lever arch folders thick. That is two lever arch folders of legal and financial obligations created by the subdivision and associated contracts that will bind all owners on the purchase of their homes. Even if disclosed to purchasers, it is fanciful to think that they, or even their legal advisers, would understand the terms. It is my understanding that this complex legal structure was

necessitated by Canada Bay Council's preference not to take responsibility for the roads within the development, a preference which was no doubt driven by its own level of funding.

Fundamentals of strata title that allow it to facilitate cost shifting

There are two key differences between low-density housing and medium to high density housing. The first is physical form (which we can all see) and the second is legal form. Low density housing (freestanding houses, traditional semis and terraces) is legally simple. A house is constructed and sold by the developer to a purchaser. Once the purchase price is paid, the purchaser has no legal relationship with their vendor or their neighbours (other than minimal obligations under the *Dividing Fences Act 1991* (NSW) and the common law of nuisance). Owners are regulated by planning law, but nothing else. That is not an accident; it is a result of active choices made by parliaments and judges over centuries who strove to keep property titles simple to ensure their *financial* and social viability.[2]

In contrast, medium to high density housing is legally complex. Purchasers of apartments buy an individual lot, along with a share of common property. They immediately become legally bound to tens or hundreds of neighbours. They automatically become a member of a governing body corporate (owners corporation, neighbourhood or community association) which has extensive statutory rights and obligations that they must discharge. They are legally obliged to comply with and enforce privately created by-laws. They are regulated by hundreds of sections of legislation in the *Strata Schemes Development Act 2015* and the *Strata Schemes Management Act 2015*, along with their regulations and associated case law.

The ultimate authority and responsibility in all strata schemes does not rest with 'the strata' (there is no such thing); it rests with the owners corporation - all of the owners - in other words, people who just wanted a home.

Master planned estates are even more complicated still. An apartment might be inside a high rise building, regulated by the strata Acts, inside a master planned estate, regulated by the *Community Land Development Act 2021* and the *Community Land Management Act 2021*. Apartments in Jacksons Landing or Breakfast Point are regulated this way. Individual owners are members of their own owners corporation, but the owners corporation is then a member of an overarching community association. Community title allows all of the roads, parks and infrastructure, that would otherwise be publicly owned, to be private property, controlled and paid for by individual homeowners.[3]

Increasing numbers of master planned estates are now created through stratum (as opposed to stratA) subdivision. These subdivisions are done under the Part 23, Division 3B of the *Conveyancing Act 1919* (NSW) and allow land and buildings to be subdivided into separate

[2] C Sherry, *Strata Title Property Rights: Private governance of multi-owned properties*, Routledge, 2017, pp 47-72.
[3] C Sherry, *Strata Title Property Rights: Private governance of multi-owned properties*, Routledge, 2017, pp 30-33.

lots, some of which might be strata schemes and some of which might have a single commercial owner.[4] Examples of stratum subdivisions include Barangaroo, East Circular Quay (the 'Toaster') and Woolloomooloo Wharf. Woolloomooloo Wharf has three residential strata schemes, one commercial strata scheme, one retail strata scheme, a car park strata scheme, a marina strata scheme, and a non-strata hotel.

Developers and commercial owners like stratum subdivision because it allows commercial owners to sit outside residential strata schemes and most importantly, outside of the protections/limitations in the strata and community title legislation. Rather than having common property, these developments have 'shared facilities', (e.g. a foyer, car park, promenade, park, infrastructure, solar panels, trigeneration plants etc), which are areas of the estate or building that everyone can use or access but are inside the land title of one owner. The use and payment for those facilities is determined by a strata or building 'management statement' (SMS or BMS) which is almost wholly unregulated. It simply has to be 'fair' (cl 2(1)(e1), Sch 8A, *Conveyancing Act 1919*) and must be reviewed by the owners every five years to ensure it remains 'fair' (cl 2(1)(e2), Sch 8A, *Conveyancing Act 1919*). The fact that those provisions are in subclauses (e1) and (e2) tells us that the legislation had to be amended when it was discovered (predictably) that left to their own devices, developers and original landowners would not necessarily create payment obligations that were fair to all owners. To alter a BMS/SMS, all owners of parcels of land must agree (s196G(1)(a) of the *Conveyancing Act 1919*), and inevitably, any owner who is advantaged by the current costs schedule is not going to agree to a change.

There is increasing dispute in relation to stratum subdivisions, including Woolloomooloo Wharf,[5] and the notoriously unworkable, failed Italian Forum in Leichhardt.[6] Most lawyers who work with stratum subdivision would concede that the legislation is manifestly inadequate to regulate these developments fairly, particularly for residential apartment owners, and yet it is being used repeatedly for new developments all across Sydney.

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[4] C Sherry, *Strata Title Property Rights: Private governance of multi-owned properties,* Routledge, 2017, pp 33-36.

[5] *Walker Corporation Pty Ltd v The Owners - Strata Plan No 61618* [2022] NSWSC 1246 (16 September 2022)

[6] *Italian Forum Ltd v. Owners – Strata Plan 60919 [2012]* NSWSC 89 and Ben Cubby and Natasha Chrysanthos, 'Rome's arches have stood for 2000 years. But in Sydney's Italian Forum, they're crumbling', *Sydney Morning Herald*, 29 August, 2022 < Syd https://www.smh.com.au/national/nsw/rome-s-arches-have-stood-for-2000-years-but-in-sydney-s Italian-forum-they-re-crumbling-20220826-p5bd40.htmlney's Italian Forum in state of ruin (smh.com.au) See also, *Owners Corporation Strata Plan 70672 v. The Trustees of the Roman Catholic Church for the Archdiocese of Sydney* [2011] NSWSC 973; Cathy Sherry, *Strata Title Property Rights: Private governance of multi-owned properties* (Routledge, 2017), 142-148; Cathy Sherry, 'Building management statements and strata management statements: unholy mixing of contract and property', (2013) 87(6) *Australian Law Journal* 393.

Some developments, like Wentworth Point combine strata title, community title and stratum subdivision, hence the two lever arch folder thick contracts. There are two key drivers for this extraordinary legal complexity.

1. *Local councils not wanting to pay for infrastructure*
   Community title and stratum subdivision allow infrastructure that has traditionally been publicly owned to be privatised. This includes roads, parks, hydraulic and energy infrastructure. All of that space and facilities can be common property in a community scheme or shared facilities in a stratum subdivision. Councils are eager for developers to pay for these costs, and that will often be crucial to securing development consent. For example, as noted above, it is my understanding that the community title legal structure at Wentworth Point was necessary because Canada Bay Council did not want to take responsibility for the roads in the estate. However, developers never actually bear these costs; they pass them on to homeowners. People pay for the costs of infrastructure in their initial purchase prices and through on-going levies. The key attraction of complex strata, community and stratum titles is that they allow for the imposition of on-going costs on homeowners, that are not possible in ordinary subdivisions. This is because there is an ordinary rule of property law that you cannot sell a freehold fee simple and impose obligations to pay money on it. That is why when you buy a non-strata house or terrace, your only payments will be your purchase price to the vendor and council rates. In contrast, when you buy a property in a strata or community title scheme, you will have a statutory obligation to pay for the maintenance and repair of all common property, and in a stratum subdivision, obligations to pay for shared facilities. Having become a member of the body corporate (owners corporation, neighbourhood and/or community association) you will also become liable to pay for the contractual obligations of that separate legal entity.
2. *On-going contractual obligations*
   Body corporate contracts are the second reason these developments are so desirable to councils and developers, but so complicated and burdensome for owners. Although every square centimetre of land inside these developments is private property that must be managed and paid for by the owners, lay people are not capable of managing high rise buildings and entire estates on their own. Management requires serious professional expertise. That then compels people to pay for expensive professional services to help them manage their own homes. Those services include strata managers (to deal with the complex finances of the scheme, as well as management of the community), building managers (to help with cleaning and maintenance, control people moving in and out etc), garbage removal contracts, security contracts, landscaping contracts, EV charging station contracts, and increasingly deeply exploitative embedded network (energy and water) contracts. The bigger and more complex the development, the more contracts for professional services will be needed. Some of these contracts are necessary and value for money. Some are unnecessary,

excessive, or downright extortionate. Many exist because the people designing, planning, and approving these developments do not appreciate the legal consequences of the decisions they are making. For example, an architect or planner might want to include shared open space or shared renewable energy infrastructure, quite sensibly thinking that it is an efficient and beneficial provision of services. However, they may have no understanding of the body corporate meetings, levies and professional contracts that will be needed for the on-going management and financing of those facilities by homeowners. Alternatively, some people, namely developers and service providers, understand perfectly well the costs of facilities to homeowners – they are the source of their profit.

For example, developers are now routinely having electricity and water infrastructure installed in developments by embedded network operators for free, in return for the owners corporation being made to enter into a long-term contract with the embedded network operator. Apartment owners are not only paying excessive bills for energy and water, but they are also literally being made to pay for the infrastructure twice – once in their contracts of sale (because no developer discounts the sale price of an apartment because they were given infrastructure for free) and again through the capital costs, included in the embedded network contract with the owners corporation.[7]

There have been multiple parliamentary and regulatory inquiries into embedded networks, including NSW,[8] with all concluding that they are deeply exploitative to owners and tenants. However, the practice of creating embedded networks has continued because they are profitable for developers and embedded network operators, and because consent authorities are in favour of sustainability infrastructure (understandably), as well as development applications that appear to minimise public costs in perpetuity.

I have seen contracts for embedded networks that are purportedly between owners corporations and the embedded network operator, but as they include extensive provisions on concrete slab tension and layout, metering, detailed building drawings, cables, inverters and other technical requirements, they are clearly contracts between the embedded network operator and the developer (which will be the owner of all apartments on the initial registration of a strata plan). However, agreements ultimately need to be signed by the owners corporation made up of all owners to tie the owners corporation into long term contractual agreements that guarantee the embedded

[7] C Sherry, 'Minns must stop this energy rort before development binge', *Sydney Morning Herald*, 14 November, 2023;
[8] New South Wales Legislative Assembly Committee on Law and Safety, *Embedded Networks in New South Wales*, Report 3/57, November 2022).

network operator's profit, including the operator's ability to clawback capital costs the developer did not pay for.

These contracts do not necessarily provide financial or sustainability benefits to strata schemes and their owners. For example, one embedded network operator makes arrangements with developers to install solar panels on the roof of apartment buildings, with a contractual provision stating that the operator owns all of the electricity generated and has the right to sell solar energy generated to the grid for their own profit. They have the option to sell it to the owners corporation on the embedded network operator's terms which will not include any discount that should flow from the fact the energy was generated from the apartment owners own land – their roof.

Conclusion

While the legal and financial structure of strata, community and stratum subdivisions may not seem to be central to the Inquiry's terms of reference, the level of income councils need will be affected by the extent to which councils believe infrastructure and service costs can be privatised through strata, community and stratum title. Costs can be privatised that way, but councils and state governments need to understand exactly how this occurs and the financial burdens that will be imposed on specific groups of homeowners. Government needs to turn its attention to the economic and social equity of young homeowners and retirees paying for their own privatised infrastructure.

The private sector is not necessarily more efficient and innovative than government, and in emerging industries like sustainability, private actors can be inexperienced and excessively focussed on short-term profit. All private infrastructure costs include private sector profit. In strata, community and stratum subdivision, those costs are paid by homeowners through levies, which in the current cost of living crisis owners are increasingly struggling to afford. In the United States, during the global financial crisis, many strata and community title schemes (condominiums and homeowner associations) were bankrupted when owners could no longer afford to pay for infrastructure and services. Infrastructure, including hydraulic infrastructure and open space, reverted to the public sector.

Yours sincerely,

Professor Cathy Sherry

Macquarie Law School, Centre for Environmental Law and Smart Green Cities