

**Response to the
Recommendations of the Legislative Assembly's
Economics and Industry Standing Committee Report
on the Western Australian Strata Management Industry**

1. Introduction

In the Legislative Assembly on Thursday 26 June 2003, Mr Tony McRae MLA, the Chairperson of the Economics and Industry Standing Committee (the Committee), tabled the Committee's final report on its *Inquiry into the Western Australian Strata Management Industry*.

The Committee's terms of reference were as follows:

The Committee will examine, report and make recommendations relating to the strata management industry in Western Australia with regard to:

- *the potential risks posed to consumers by the current absence of regulation of the strata management industry;*
- *the need for and most appropriate method of regulation (if deemed necessary) of the strata management industry; and*
- *any other matters deemed relevant by the Committee.*

The Hon John Kobelke MLA, Minister for Consumer and Employment Protection, made the initial referral of the matter to the Committee due to concerns about large amounts of money being held by strata management companies and the absence of regulation for strata managers. The Department of Consumer and Employment Protection, the Real Estate and Business Agents Supervisory Board, the Strata Titles Referee, the Law Society of Western Australia and the Strata Titles Institute of Western Australia (STIWA) had in various ways raised the regulation of the strata management industry as an area of concern. The request for a Parliamentary Inquiry was supported by the Hon Alannah MacTiernan MLA, Minister for Planning and Infrastructure, who at that time had Ministerial responsibility for the *Strata Titles Act 1985* (the Act). This responsibility has since passed to the Hon Nick Griffiths MLC, Minister for Land Information.

This paper provides the Government's response to the Committee's recommendations.

2. Review Process

The Committee began the inquiry with a call for submissions on 28 and 29 September 2002 through advertisements in the *West Australian*, *Sunday Times* and all Community Group and Independent newspapers. In addition, the Committee sent letters to 128 interested persons and organisations, including strata management companies, industry groups and owner interest groups. The Committee received twenty-five submissions from a range of stakeholders, including industry representatives, regulatory agencies and strata title property owners.

While awaiting submissions, and prior to conducting formal hearings, the Committee held a public forum at the Legislative Assembly's Committee Office in November 2002. The public forum included representatives from industry associations, Government agencies and other interested groups and persons.

After receiving submissions, the Committee held a total of eight public hearings. These included a series of public forums in Perth, Kalgoorlie and Busselton, involving industry representatives and other interested parties.

The Committee collated relevant data about strata title schemes and numbers of strata title managers, researched the current administration of relevant strata titles issues in Western Australia and reviewed information about regulatory approaches in other Australian States and Territories.

The Government wishes to commend the Committee for its detailed and thorough approach to its terms of reference. The research and consultation processes undertaken by the Committee were particularly extensive and reflect a commitment to detail and accuracy.

The Government also notes the important assistance provided to the Committee by the Strata Titles Institute of WA (STIWA) and members of the strata management industry. The Law Society of Western Australia, Real Estate Institute of Western Australia (REIWA), Property Council of Australia, WA Retailers Association and other groups and individuals also provided the Committee with pertinent advice about industry practices and offered their views on the implications of various regulatory alternatives. Government agencies that provided information to the Committee included the Department of Land Administration (now the Department of Land Information), the Department of Planning and Infrastructure, the Department of Justice (including the Strata Titles Referee), the Department of Consumer and Employment Protection and the Small Business Development Corporation.

3. Defining the Strata Management Industry

3.1 Size and Nature of Strata Schemes

The Committee noted that strata schemes may vary considerably in nature. For instance, residential strata schemes may range from two lot single tier schemes to multi tier schemes of 200 lots or more. The Committee obtained data illustrating the variation in the size and nature of strata and survey-strata plans. Examples of some of the largest strata and survey-strata schemes, which include schemes from 163 lots to 209 lots, were included in the Report.

The Committee found that more than 89 per cent of strata schemes are residential properties. The remaining 11 per cent of strata schemes includes factories, farms, vineyards, industrial land, industrial complexes, shopping centres, hotels and other businesses. Retirement villages, holiday apartments and caravan parks can also be strata schemes. Strata schemes can be mixed residential and commercial schemes, for instance with commercial enterprises on the ground floors and residential apartments above. In addition, a residential strata scheme may have units which are largely owned by a business, making the distinction between residential and commercial difficult to separate.

3.2 Role of the Strata Manager

One of the most challenging tasks for the Committee was to attempt to define the role of a strata manager. The Committee found that the duties of a strata manager may vary considerably in nature due to the wide variety of strata schemes in Western Australia and the diverse needs of strata companies.

In explaining the legislative context for the strata management industry, the Committee noted:

The strata company (formerly a body corporate) comes into existence automatically under section 32 of the Strata Titles Act 1985 upon the registration of a strata plan lodged at the time of land title issue. All owners of lots within a strata plan are automatically members of the strata company (page 12).

The Committee also indicated:

The council of the strata company is constituted by and performs its functions in the manner provided by the by-laws of the strata scheme. It is generally comprised of a number of elected lot proprietors. The election of strata council members takes place at an annual general meeting as determined under Schedule 1 By-law 4 of the Act. The administrative and other functions of a strata scheme are usually performed by the strata council on behalf of the strata company.

The duties and responsibilities of the strata company include:

- *collecting levies, managing repairs, insurance and strata company transactions;*
- *preparing the strata company's accounts and keeping records of meetings;*
- *enforcing the by-laws of the strata company; and*
- *maintaining a register of lot owners.*

While strata companies may elect to undertake these tasks directly, it is not uncommon, particularly for larger or more complex properties, for a strata manager to be engaged to undertake these duties (pages 12-13).

In explaining the role and size of the industry, the Committee noted:

The strata management industry is generally accepted to mean the industry that provides external consultancy services to assist in the management of strata schemes. There are around 1 500 strata title managers in Australia, and more than 120 strata managers in Western Australia. Many strata managers are not licensed real estate agents and are therefore unregulated.

Strata property management is a diverse and potentially complex task. In some schemes, management may be relatively straightforward, while in others it may require highly developed competencies in financial reporting, investments, marketing, town planning and development issues (pages 16-17).

The seventy-five page Report provides a detailed picture of the strata management industry and the backdrop to the legislative framework established under the Act; the numbers and value of strata title properties in Western Australia; and an overview of legislation in other States and Territories in Australia.

The task of defining this complex industry was an extremely difficult one and the Government commends the Committee for its important work in this area. The Government notes that the clarification of this industry area is one of the key aspects of review and analysis that must be undertaken before decisions can be made about appropriate regulation for the strata management industry.

4. Potential Risks

4.1 Level of Public Concern

Another core aspect of the Committee's work was the examination of the potential financial and other risks to strata title proprietors arising from the strata management industry.

It is significant to note that the Committee found no evidence of crisis in the strata management industry (page xi). No major thefts or frauds, or signs of widespread and entrenched malpractice were discovered. The relatively small number of submissions received, numbering twenty-five, also did not indicate a high level of public concern in this area.

4.2 Funds Held by Strata Managers

The Committee noted the need for targeted reform in light of the potential risks which it identified in the strata management industry. One of the Committee's key concerns was the amount of money held by strata managers on behalf of strata title property owners and the potential for financial loss if this money was mismanaged or stolen. Other concerns related to general mismanagement.

The Committee obtained a range of information about the value of strata title properties from the Valuer General's Office of the Department of Land Information. Some of the key figures are as follows:

Total capital value of all strata properties at February 2003 is estimated at \$29.7 billion based on gross rental values, although (using costings based on average sales) this figure could be as high as \$36.2 billion (page 11).

The Committee noted that there is no central record of information about the amount of money held by strata companies, which makes these estimates difficult to verify. The Committee suggests, however, that:

...it is possible to estimate that there is potentially more than \$90 million held by strata councils (conservatively assuming an average of \$500 held per unit in strata fees) (page 15).

The Committee concluded that the number of strata title properties is increasing, and that the size and complexity of strata title schemes are also on the rise, leading to growth in the funds associated with strata schemes and therefore a growth in risk for strata title property owners. The Committee noted in this regard:

Figures provided by the Valuer General's Office indicate that over a period of five months between October 2002 and February 2003, the number of properties registered increased by over 8 per cent, and the number of units by 9 per cent. These numbers show that large schemes contributed more to growth of the number of units, and highlight that new developments of strata title schemes are increasing in size and complexity.

The increase in the number of strata properties and units over this five month period suggests growth of almost 20 per cent annually (page 12).

4.3 Measures to Address Potential Risks

The Committee addresses these concerns through a number of recommendations intended to improve the financial management of strata companies, including recommendations regarding a uniform financial reporting standard, a Code of Conduct for strata managers, a management plan and a compulsory annual audit. The Committee also proposed the introduction of some form of fidelity protection for strata company funds.

During the review process, the Committee identified serious concerns relating to the obligations of strata companies. The Committee found that strata title property owners do not understand their current obligations under the Act and this can be a source of disputes and problems.

The Committee also found that many strata companies were not planning sufficiently for the future and would not have appropriate capital reserves for long-term maintenance matters. The failure to set money aside for large maintenance projects can lead to a strata company having to suddenly raise large amounts of money. Problems occur if the owners are not willing to pay or simply cannot raise the necessary funds. The Committee proposed measures including a mandatory reserve fund, 10 year management plan and notifiable information for purchasers to address these concerns.

5. Response to Recommendations

The Committee arrived at twenty-one recommendations to address concerns about the strata management industry and the operation of strata companies. The recommendations are wide-ranging.

5.1 Consultation

In reviewing the Committee's recommendations, the Government has consulted a range of key stakeholders, including the:

- Strata Titles Referee;
- Law Society of WA;
- STIWA;
- REIWA;
- Consumers Association of WA;
- Property Council of Australia;
- Small Business Development Corporation (SBDC); and
- a small sample group of strata title property owners.

Responses from these stakeholders were positive overall. Most of the industry groups endorsed the proposals while making a number of suggestions for amendment. The Property Council, REIWA and STIWA all were impressed by the Committee's assimilation of information about the strata management industry and the detail provided in the Report.

In general terms, the sample group of strata title property owners considered some degree of regulation was appropriate but expressed strong concerns about the additional costs they would have to meet.

5.2 General Impact of Recommendations

The Government notes that further analysis and consultation is appropriate given the financial and administrative impacts of the recommendations.

Due to the costs involved to strata title property owners, it is anticipated that the proposals for professional strata management, mandatory reserve funds and mandatory annual audits will be the most controversial recommendations. For the estimated 100 000 owners of single tier strata schemes that are six lots or more in size, and the owners of multi-tier strata schemes that are two lots or more in size, the recommendations would have significant financial and administrative impacts.

The Committee's framework of recommendations would also have a significant impact for the estimated 121 strata managers currently in the industry and people that will seek future employment in that industry. The costing for implementing the recommendations must also be considered in order that the Government may make a balanced decision regarding the most appropriate regulatory approach.

5.3 Specific Issues

A number of issues for further consideration and possible amendment have been raised about many of the recommendations. These issues are summarised below.

5.3.1 Classification System

Recommendation 1

The *Strata Titles Act 1985* be amended to incorporate a classification system that represents strata schemes in the following manner:

- Category 1 (C1): single storey schemes of up to five lots;
- Category 2 (C2): schemes of six to 20 lots and all multi-storey schemes from two to 20 lots; and
- Category 3 (C3): all schemes of more than 20 lots.

Recommendation 2

A general meeting of a strata company may resolve to apply to the Strata Titles Referee for re-classification to the next lowest category.

General Issues:

- The classification system establishes the level of regulation with which different strata title property owners must comply and for this reason it is likely to be extremely controversial.
- The recommendation that the Strata Titles Referee be involved in the re-classification of strata schemes would have a significant impact on the business of the Strata Titles Referee/State Administrative Tribunal.

Proposed Changes to the Classification System:

- REIWA proposed the addition of a non-residential use category.
- REIWA suggested all two lot schemes should have a special category of exemption in line with the exemptions from management provisions for two lot schemes under the Act.
- STIWA noted that the classification system should incorporate the definition of “single-tier” already in the Act and perhaps also adopt the further distinctions in the Act between 2 lot schemes, 3 to 5 lot schemes and larger schemes.
- STIWA agreed with the approach in the recommendations but noted that an alternative would be to adopt the Queensland approach of establishing model rules for different types of schemes.
- The Strata Titles Referee advised that special consideration should be given to appropriate regulation of survey-strata plans, which are widely used in small suburban developments but are also used in large scale rural, agricultural, viticultural, silvicultural and other developments.

Proposed Changes to Appeals to the Strata Titles Referee:

- The Strata Titles Referee proposed that a decision to apply to the Strata Titles Referee should require more than a simple majority vote by the strata company and that a resolution without dissent or a special resolution would be more appropriate.
- The role of the Strata Titles Referee, and any new responsibilities placed on this office, will be affected by the State Administrative Tribunal Bill which will subsume the responsibilities of the Strata Titles Referee into the State Administrative Tribunal.
- STIWA, the Law Society of WA and REIWA proposed that a general meeting of a strata company should be able to resolve to apply to the Strata Titles Referee for re-classification to any category.

5.3.2 Licensing Recommendations

Recommendation 12

The *Strata Titles Act 1985* includes a definition of a strata manager, and provides for the establishment of key minimum competencies of a strata manager.

Recommendation 13

Strata companies in Category 2 and Category 3 schemes be required to appoint a licensed strata manager.

Recommendation 14

The proposed licensing body, in conjunction with other regulatory agencies and industry peak organisations, develop a system of training and accreditation for strata managers.

Recommendation 16

A two tier system of licensing for strata managers, reflecting the levels of complexity associated with Category 2 and Category 3 strata title companies, be developed for the industry.

General Issues:

- Professional strata management of schemes has never been compulsory in WA. The requirement to engage a licensed strata manager would be a significant new cost for thousands of strata companies that currently manage properties themselves.
- The costs of compulsory education and licensing fees for strata managers will be passed on to consumers, which would be expected to lead to some increases in strata management fees.
- The Act is structured so that the strata company (i.e. the strata title proprietors) are responsible for complying with the Act. By licensing strata management companies, a significant part of the responsibility for managing the conduct of strata managers will be transferred from strata title property owners to the Government.
- Some strata companies will not be able to attract a licensed strata manager because of disputes and finance problems and will therefore not be able to comply with the licensing requirement.

- Although increased financial protection is the intended outcome of licensing, it is estimated that 73 per cent¹ of strata companies would not be required to use a licensed strata manager under the categorisation system.
- The Law Society of WA suggested an exemption for owners who own all of the lots, or strata companies that wish to manage their own property.
- It would be difficult to devise legislative requirements to impose on strata companies or strata managers which would accommodate the management needs of the many diverse strata schemes.

Strata Management Industry Response:

- Broadly STIWA supported some form of licensing or regulation but there was no consensus amongst STIWA members about what form this should take.
- REIWA supported some form of licensing.

Costings for a Licensing System:

- A licensing system will be costly for Government to administer as the licensing fees for 121 strata managers would not be sufficient to fund the establishment of a licensing regime (121 x \$538 cost of a triennial real estate agent's licence = \$65 090 for 3 years). A licensing regime would need to include at a minimum a licensing database, administration, compliance and prosecutions functions. Some cost savings could occur if a licensing system was incorporated under an existing licensing system.
- STIWA estimates that no more than a few people a year would register for training after the initial number of existing strata managers had sought and obtained licences. The long-term viability of educational qualifications for licensing purposes could therefore be affected by the relatively small size of the industry.

Level of Public Risk:

- The Committee indicates that it "*...may be estimated that there is \$25 million held by 121 strata managers assuming the average of managed funds is \$200 000 per company*" (page 34). If the estimated \$25 million is considered in terms of the amount held per lot owner, this would be an average of \$334 per unit². Based on information provided by 11 STIWA members, STIWA advised that the annual levies per lot owner generally ranged from \$600 to \$2 000. These figures demonstrate a need for the amount of funds held by strata companies to be more closely examined before the Government decides to license strata companies on the basis of public risk.

¹ 31 803 strata schemes in Category 1, out of a total of 43 664 strata schemes, would be exempt from the proposed new requirements to use a licensed strata manager, conduct annual audits, hold a compulsory reserve fund, develop a ten year management plan and so on. The number of strata schemes in Category 1 was arrived at by calculating the 36 668 two to five lot schemes minus the estimated 4 865 which are multi-tiered and therefore fall in Category 2.

² This calculation is based on the total number of 11 lot and more strata schemes (74 775) given that larger schemes often choose to engage a professional strata manager.

- Another issue that impacts the level of public risk is that many strata companies do not have a large administrative fund or a reserve fund. Risk of theft or fraud is increased when funds are left unchecked for long periods of time. However, much of the money collected by strata managers is not held for long periods of time but is instead paid for insurance (generally a large portion of the levies), as strata management fees and repairs and maintenance.
- The insurer CHU issues the majority of strata insurance policies in WA. All of CHU's strata insurance policies contain fidelity cover, which covers the misappropriation of a strata company's funds by anyone, including professional strata managers and strata company members. CHU advises that most insurance companies offering strata insurance in Western Australia also include fidelity cover as part of their strata insurance policies.
- Improved accountability measures within the strata company, such as ensuring proof of payment of insurance premiums and clear financial information, may address the key public risk concerns.

Impact on Small Business:

- The impact on small businesses of a licensing regime for strata managers has not been analysed.
- The SBDC expressed concerns about the extra costs to small business.

5.3.3 Provision of Information to Strata Property Owners

Recommendation 3

The Strata Titles Referee be formally involved in the development and provision of information to strata property owners on their rights and responsibilities under the *Strata Titles Act 1985*.

Issues:

- The Department of Justice currently has responsibility for the dispute resolution provisions in the Act and produces some information material in this area.
- The role of the Strata Titles Referee will be affected by the State Administrative Tribunal Bill, which will subsume the responsibilities of the Strata Titles Referee into the State Administrative Tribunal.
- The Strata Titles Referee/State Administrative Tribunal is a tribunal and therefore the development of publications on issues outside the dispute resolution provisions of the Act would be inappropriate and more suited to the Department of Land Information or another Government Department with appropriate expertise.
- STIWA supported the development and wide distribution of plain English guides to the Act, with additional resourcing provided to DLI for this purpose, and a simplification of the information provided on strata plans.

5.3.4 Provision of Information to Strata Property Purchasers

Recommendation 4

Section 65 of the *Strata Titles Act 1985* be amended to expand provisions relating to notifiable information. Information relating to owners' rights and responsibilities, current financial records (including operating accounts and reserve funds), the management plan and management contracts must be fully disclosed to potential purchasers in the offer for sale.

General Issues:

- It is noted that section 65 is a typographical error and is intended to be a reference to section 69 of the Act.
- The provision would impose significant new administrative demands and costs on strata companies, settlement agents and solicitors to make the information available when some strata companies have difficulties meeting the existing requirements.
- Any amendments in this area will need to be considered in light of the warranties by the vendor contained in the General Conditions of Sale referred to in the standard Offer and Acceptance contract for residential sales and commercial sales contracts.
- Any proposals for implementation would need to be considered carefully in light of the potential impact on the property sale process. For instance, if some or all of the essential notifiable information is not available, a purchaser would have the right to delay the property sale process or settlement until the matter was resolved.

Comments from Stakeholders:

- REIWA suggested that the recommendation would be unworkable in practical terms.
- The Property Council of Australia supported the recommendation but noted that a different procedure for off-the-plan developments would need to be considered as no management contract would be in place at the time of sale.
- The Law Society of WA proposed an additional amendment to section 69B to enable information requirements to be included in the regulations of the Act so that the original proprietor would also be required to provide this information.
- STIWA proposed that the education of purchasers would be a more appropriate solution than introducing additional formal disclosure requirements.

5.3.5 Plain Language Provisions for the Strata Titles Act

Recommendation 5

Future revision of the *Strata Titles Act 1985* adopts the use of plain English language.

Issues:

- The Law Society of WA supported the recommendation but noted that plain language drafting can lead to lengthy legislation and that the Act is already long. (An A4 printout of the Act is 170 pages in length.)
- The Law Society of WA suggested the separation of the Act into three parts: Creation, Termination and Management Provision.
- REIWA supported plain language provisions and further suggested that explanatory sections be inserted into the Act in line with legislation in some other States and Territories.
- DLI is currently reviewing parts of the Act which provides an opportunity to the consider plain language approach to drafting.

5.3.6 Funds to be held in a Financial Institution

Recommendation 6

The *Strata Titles Act 1985* be amended to require that strata company funds for Category 2 and Category 3 schemes be held in an account at a financial institution.

Issues:

- Although it is thought that most Category 2 and Category 3 strata companies already hold their administrative funds in an account with a financial institution, the potential impacts of this requirement are not known at this point.
- The Committee acknowledged that there are options for specifying certain expectations about financial matters either in the Act (page 54) or the management contract (Recommendation 18).
- Any recommendation in this area must be made in the context of the other recommendations impacting financial accountability matters, particularly recommendations 9 and 10.

5.3.7 Compulsory Reserve Fund

Recommendation 7

The *Strata Titles Act 1985* be amended to require that each Category 2 and Category 3 strata company establish a reserve fund based on long term projections of future expenditure liabilities.

Issues:

- The recommendation is extremely controversial as it would have a significant financial impact on strata title proprietors in Category 2 and Category 3 as many strata companies do not hold reserve funds at this point in time.
- One of the reasons why reserve funds are not established is that strata title proprietors are often unwilling to make financial commitments for the long term when they may sell in the short term and not realise the benefits.
- A strata scheme with an appropriate reserve fund and administrative fund is a better property investment but many purchasers are not aware of this fact.
- Recommendation 4 concerning notifiable information would ensure purchasers are made aware of the reserve fund status of a property.
- Guidelines for determining expenditure liabilities would need to be developed to ensure the reserve funds are based on realistic projections.
- When members of strata companies cannot agree on the intended purposes of the fund and the appropriate amounts, a form of dispute resolution may be required.
- Additional ideas for regulation on financial management for strata companies include: limiting investment options to protect reserve funds; requiring any investment of reserve funds to be made only at the direction of the strata company; and including a compulsory item to discuss long term maintenance and reserve fund issues on the agenda of strata company meetings.
- The proposal for a mandatory reserve fund may have legal implications for the liability of a strata company if it does not fulfil its requirements.
- The Strata Titles Referee has strongly recommended the need for compulsory reserve funds.
- STIWA endorsed the recommendation but noted that it is important to improve “the workability” of the means by which the money can be raised, accounted for and then applied to expenditure.

5.3.8 Ten Year Management Plan

Recommendation 8

Strata management companies for Category 2 and Category 3 schemes be required to prepare a ten year management plan, reviewed every five years.

Issues:

- Some strata title proprietors noted that strata companies cannot always reach agreement on levies for future costs and expressed concern that the proposal for a management plan would not be workable for this reason.
- Some strata title proprietors considered that ten years would be too far to plan ahead because the costs would change significantly over this time.
- The Strata Titles Referee, REIWA and STIWA supported the recommendation but suggested that the recommendation should refer to strata companies rather than strata management companies.
- To be effective, a management plan would need to include a condition report on the fabric of the common property in the scheme so that the strata company can make a realistic budget estimate.
- The Law Society of WA supported the recommendation but proposed that a “model management plan” providing guidelines on the content of a management plan would assist strata companies to comply.
- An alternative approach could include targeted education for strata title proprietors and strata managers on long term planning, together with a compulsory agenda item on this issue.
- As noted above, further ideas for regulation on financial accountability issues include: limiting investment options to protect reserve funds; requiring that any investment of reserve funds is made only at the direction of the strata company; and including a compulsory agenda item to discuss long term maintenance and reserve fund issues.

5.3.9 Uniform Financial Reporting

Recommendation 9

The *Strata Titles Act 1985* be amended to require strata companies to adopt uniform financial reporting methods.

Issues:

- The diversity in the types of strata schemes would make a requirement prescribed by law difficult in this area.
- The requirement would be a significant new obligation and cost for strata companies.
- The Law Society of WA noted that financial reporting standards should be different depending on the complexity of the strata management.
- STIWA supported the recommendation but noted that the prescription of the standard will be very difficult as strata managers are not qualified accountants, and high level accounting requirements will impose greater costs and administrative burdens on strata companies.

5.3.10 Annual Audit

Recommendation 10

The *Strata Titles Act 1985* be amended to require statutory funds of Category 2 and Category 3 schemes to be audited annually.

General Issues:

- If sufficient financial information is provided to a strata company, including a bank reconciliation or bank statement, then a strata company may not consider that an annual audit is necessary.
- The terms of an audit would need to be identified to ensure that appropriate information is provided by the auditor.
- Audit information may not assist a strata company in understanding its financial position if the proprietors are inexperienced in understanding audits.

Impact on Strata Title Proprietors

- Unless their strata companies obtain re-classification to Category 1, tens of thousands of strata title proprietors would have to contribute to paying for an annual audit even in cases where the strata company has a relatively small amount of money or they feel the financial accountability of the strata manager has been highly satisfactory.
- At least 48 172 strata title proprietors of 1 107 strata schemes would have to undertake an annual audit as they would not have the option of re-classification to Category 1.
- The cost of an audit can vary considerably depending on factors such as the number of transactions, the state of the financial accounts and the qualifications of the auditor. It would be appropriate to examine further the financial risk posed to strata title proprietors and the costs and benefits of an annual audit.

Proposals for Greater Flexibility:

- STIWA did not support the recommendation but noted that each strata company should be able to make its own decision about whether it wishes to engage an external auditor.
- The Strata Titles Referee suggested allowing a Category 2 scheme to “opt out” of the audit obligation, with the audit obligation being able to be revived at any time at the request of any one lot proprietor.
- The Act could be amended to provide a strata company with the ability to require an audit of accounts which are managed on its behalf by a strata manager.
- The requirement for an annual audit could be included in the strata company’s by-laws, which could be amended by a strata company as required.
- If the requirement for an annual audit is implemented, then the appropriate level of qualification of a compulsory auditor would need to be considered. It may be appropriate that the level of qualification should differ depending on the type of strata scheme.

5.3.11 Unconscionable Conduct Protections

Recommendation 11

Any revision of the *Strata Titles Act 1985* include consideration of the use of unconscionable conduct principles contained in the *Trade Practices Act 1974* (Commonwealth).

Issues:

- The Law Society of WA and STIWA did not support this clause, noting that unconscionable conduct provisions already exist in the *Trade Practices Act 1974* and it could set conflicting standards in this area.
- The unconscionable conduct provisions in Section 51AB of the *Trade Practice Act 1974* apply to contractual arrangements. However, there is no such arrangement between the members of a strata company.

5.3.12 Fidelity Protection

Recommendation 15

The Government works with industry to develop appropriate regulation for fidelity protection across the strata management industry.

General Issues:

- Two forms of fidelity protection could be considered: the establishment of a fidelity guarantee fund or compulsory fidelity insurance.
- State sponsored fidelity guarantee funds can represent a considerable potential liability for the State Government and are often costly to implement. Levies would need to be raised from some source for this purpose.
- Legislative requirements for compulsory insurance must be considered extremely carefully because changes in the local and international insurance market can lead to significant price increases and can sometimes impact on the availability of insurance.
- In a compulsory insurance scheme, the terms of policy details would be extremely important in clarifying the extent of protection.
- In some cases, the size of the funds held by a strata company would not merit fidelity insurance yet strata title proprietors would still be required to meet this cost if insurance was compulsory.

Existing Fidelity Insurance Cover:

- As the Committee notes, "...*Insurance industry advice indicates that good general practice policies available in Western Australia do provide fidelity cover*" (page 60).
- As noted above, the insurer CHU issues the majority of strata insurance policies in WA. All of CHU's strata insurance policies contain fidelity cover, which covers the misappropriation of a strata company's funds by anyone, including professional strata managers and strata company members. CHU advises that most insurance companies offering strata insurance in Western Australia also include fidelity cover as part of their strata insurance policies.

- The apparently widespread nature of fidelity cover in strata insurance suggests that further analysis about existing fidelity cover for strata schemes would be appropriate before any plans for a legislative requirement in this area is introduced.
- Insurance brokers will often assist a client to identify which insurance product would be most suitable for them, including whether fidelity insurance is necessary.

5.3.13 Code of Conduct

Recommendation 17

The Government works with industry to establish a Code of Conduct for strata company managers.

Issues:

- STIWA supported the establishment of a Code of Conduct.
- The New South Wales equivalent of STIWA has developed a Code of Conduct which is administered by industry and may have the potential to be adapted to Western Australia.
- At a national level, the national education competencies are currently being finalised and will provide nationally agreed education standards for strata managers to Certificate III, Certificate IV and Diploma level.
- Further analysis is needed to decide if a mandatory Code of Conduct enforced by legislation, or an industry Code of Conduct administered by an industry group, would be most appropriate.
- The introduction of a Code of Conduct that is enforced by Government would raise issues such as the cost to Government, the cost to business, potential costs passed on to consumers, regional impact and small business impact. These issues would need to be considered in detail.

5.3.14 Prescribed Conditions to be included in Management Contract

Recommendation 18

The *Strata Titles Act 1985* makes provision for a management contract between a strata company and licensed strata manager to include an industry Code of Conduct as an enforceable instrument.

Issues:

- The inclusion of prescribed conditions in all management contracts between a strata company and a strata manager can provide protection for strata title property owners by enabling them to take civil action if the conditions are not met.
- Codes of Conduct administered by industry associations often include general statements about ethics and other matters which would not be appropriate for inclusion in a management contract.
- Given the sometimes diverse roles of strata managers, it would be a challenge to develop a Code of Conduct which is approved by the industry and is appropriate for inclusion in a management contract.

- STIWA agreed with the provision but questioned whether the Code of Conduct would need to be incorporated into the management agreement.
- The Law Society of WA supported the recommendation, noting that the management contract could require an obligation to comply with the Code of Conduct rather than including the full Code of Conduct.

5.3.15 Expansion of the Role of the Strata Titles Referee

Recommendation 19

The office of the Strata Titles Referee be given the responsibility to prepare, in conjunction with industry organisations, information for all stakeholders in the industry.

Recommendation 20

The office of the Strata Titles Referee adopt a system of Alternative Dispute Resolution for the strata management industry.

Recommendation 21

The office of the Strata Titles Referee be given enforcement powers for orders made under the *Strata Titles Act 1985*.

Issues:

- The Strata Titles Referee has a quasi-judicial role and, as such, should not be the key coordinating body for the publications indicated in Recommendation 19.
- For reasons of separation of powers, the Strata Titles Referee should not provide education and advice to industry members and then adjudicate on decisions.
- The compulsory conference and mediation provisions of the State Administrative Tribunal Bill would provide a means of bringing the parties together before a decision is made and assist in meeting Recommendation 20.
- The State Administrative Tribunal Bill will provide a more streamlined enforcement process.

6. Conclusion

The Report and recommendations provided by the Committee give a detailed review of a complex and diverse industry. The Report is a groundbreaking document in that it provides a detailed picture of the complex nature of the strata management industry in Western Australia. The Committee undertook an extensive consultation and research process which was evidently appreciated by the industry associations and other stakeholders. However, as with all Parliamentary Committees, the Committee had to work within significant resource and time constraints.

There are approximately 100 000 strata title proprietors and 121 strata managers that would be affected by the proposed regulation. The regulation would have significant financial and administrative impacts on these groups. It would also have impacts on small business in Western Australia, particularly strata management businesses, and regional businesses.

DLI advises that strata title proprietors are a large and diverse group which is difficult to access. A strata company is formed under the Act and is a body corporate with perpetual succession and a common seal. A strata company is a group of strata property owners whose membership changes over time as various proprietors buy, sell or change their degree of involvement in the strata company. For this reason, a strata company would have difficulty in meeting the proposed new requirements, as well as the existing requirements, if there is a lack of interest, knowledge or involvement from proprietors in the activities of the strata company. Eighty-nine per cent of schemes are residential but, as highlighted above, there is also a great diversity of non-residential schemes as well as mixed use (residential/commercial) schemes.

As past experiences in amending the Act have indicated, strata title proprietors are protective of their current rights and obligations in relation to their properties. The proposed legislative amendments would introduce considerable new protection measures for strata title proprietors but would also increase their costs, administrative work and responsibilities. Several of the most controversial issues for strata title proprietors are likely to be the recommendations concerning the obligation to use licensed strata managers, to conduct annual audits and to hold a compulsory reserve fund.

The Act is drafted in such a way that a strata company is responsible for ensuring that it has met its obligations under the Act. The strata company has the obligation to manage its contract with the strata manager because it has a legal obligation to ensure that the requirements of the Act are met. However, as the Committee noted, these groups can have little understanding of their obligations under the Act. The Government therefore considers that any additional requirements placed on strata companies should be analysed carefully before being implemented to ensure that the requirements are not too onerous and there are no unintended consequences. It is also important that education for strata companies is considered as an element of any improvements to the regulatory regime.

In reviewing the financial risks arising from the strata management industry, the Committee found no evidence of market failure.

A key area of review considered by the Committee was the amount of funds at risk. The Committee indicates that it *"...may be estimated that there is \$25 million held by 121 strata managers assuming the average of managed funds is \$200 000 per company"* (page 34). If the estimated \$25 million is considered in terms of the amount held per lot owner, this would be an average of \$334 per person³. Based on information provided by 11 STIWA members, STIWA has advised that the annual levies per lot owner generally ranged from \$600 to \$2 000. These relatively low figures demonstrate a need for the level of risk to be more closely examined before the Government decides to license strata companies on the basis of public risk. The cost of regulatory intervention versus the benefits of regulatory intervention needs further assessment. These figures do not indicate the necessity of a high degree of regulatory intervention, such as the introduction of a licensing regime.

³ This calculation is based on the total number of 11 lot and more strata schemes (74 775) given that larger schemes often choose to engage a professional strata manager.

Another issue that impacts the level of public risk from professional strata managers is that the levies collected by strata managers are often paid out regularly. Risk of theft or fraud by a strata manager is increased when the strata company does not monitor its accounts and a strata manager has access to these funds. However, much of the money collected by strata managers is not held for long periods of time but is instead paid to insurance (generally a large portion of the levies), strata management fees and money for forthcoming repairs and maintenance. A reserve fund would be a greater theft risk because it would be likely to hold larger amounts of funds for long term maintenance and repairs. However, as the Strata Titles Referee has indicated, many strata companies are not choosing to hold a reserve fund.

In addition, advice has been received that the majority of strata insurance in Western Australia includes automatic fidelity cover. Therefore insurance cover is available for many strata companies in the event that a professional strata manager absconds with the strata company's funds.

The Committee highlighted the need for increased enforcement powers for the Strata Titles Referee and provision for dispute resolution. The State Administrative Tribunal Bill will incorporate the functions of the Strata Titles Referee within the State Administrative Tribunal, leading to improved enforcement powers and compulsory conference and mediation provisions.

In terms of an appropriate sequence for further analysis and review, a central issue affecting the level of consumer risk is the amount of money held in reserve funds. The proposal for strata companies to be required to hold appropriate reserve funds was advanced by the Strata Titles Referee and has been included in the Committee's recommendations. The DOJ and DLI are currently liaising on this issue. Any resolutions to make reserve funds mandatory would impact the level of consumer risk as mandatory reserve funds would substantially increase the amounts of money at risk. For this reason, the Government considers that a further examination of the financial risks, and the Committee's recommendations on licensing and financial accountability, should be considered in light of the outcome of the DLI and DOJ review of mandatory reserve funds.

Given the wide-ranging and innovative recommendations of the Committee, the Government considers that it is appropriate to undertake further industry and public consultation about the Report before deciding whether to implement the Committee's recommendations and, if so, the most appropriate way of doing so.