STRATA TITLES - Problems And Recent Developments

The changes to Strata Title law made by the 2015 Development and Management Acts are great in number and vary from major to trivial. It would take at least day to discuss them all.

This morning it seems best in the time available to concentrate on the two most substantial reforms, the introduction of Part 10 of the Development Act providing a process for strata renewal and of Part 11 of the Management Act relating to building defects. Necessarily the discussion must be brief and I will concentrate on the salient features of each rather than the detail. Obviously if you are acting for a party involved in a strata renewal or building defects situation you should consider the legislation itself in detail and not rely in any way on the content of this paper.

1. **Strata Renewal Part 10 2015 Development Act.**

Purpose of the legislation.

After excluding schemes the subject of a development contract or which involve a retirement village, s153 of the Act states:

"(2) *The purpose of this Part is to facilitate the collective sale or redevelopment of freehold strata schemes in accordance with the process set out in this Part".*

A "collective sale" involves the sale of the whole scheme (i.e. of all of the lots in the scheme) to a specific purchaser or by placing the lots collectively on the market.

A "redevelopment" is a redevelopment of the land the subject of the scheme by the current lot owners.

There are no prizes for guessing that the vast majority of strata renewals will be by way of a collective sale to a specific purchaser – loosely referred to as "a developer."

Summary of the steps involved.

A brief summary of the steps involved in a collective sale or redevelopment of a strata scheme is as follows:

1. A proposal for collective sale or redevelopment of the scheme is submitted to the owners corporation;
2. The strata committee of the owners corporation either decides to submit the proposal to a general meeting of the owners corporation or dismiss it. In the latter case a proportion of lot owners (being the owners

of lots with at least 25% of the aggregate unit entitlements) may requisition a general meeting to consider it but if that does not occur the proposal lapses;

3. If the matter does come before a general meeting it may decide to appoint a strata renewal committee to prepare a strata renewal plan; if it does not once again the proposal lapses;

4. If a strata renewal committee is set up it must prepare a strata renewal plan and submit it to another general meeting;

5. This second general meeting may decide not to proceed further (once again the proposal lapses) or instead it may by special resolution decide to submit the plan to lot owners to see if it is supported;

6.If support is received from the necessary number of lot owners (being the owners of 75% of lots in the scheme excluding utility lots) a further general meeting is held to decide (by a simple majority) whether to submit the plan to the court for approval. Once again failure to obtain support within a specified time (3 months) or pass the resolution results in the lapsing of the proposal;

7.The court may order the plan to be put into effect (and must do so if the provisions of the Act have been fully complied with).

Content of a strata renewal proposal.

A strata renewal proposal is the starting point for the approval of a strata renewal application under Pt 10. Usually it will be given by a third party (or its agent) who is the proposed purchaser under a collective sale of the lots but of course the purchaser may be an existing lot owner or owners.

However it could also be a proposal by one or more lot owners that the whole scheme be placed on the market for sale or in a rare case redeveloped by the lot owners themselves.

Clause 30 of the 2016 Development Regulation provides what a strata renewal proposal must include- a list of some 11 principal items with a number of sub-items.

In particular it must specify:

(f) an estimate of the total cost (including application fees and legal fees) of obtaining an order from the court to give effect to the strata renewal plan,

(g)whether the proponent will provide any monetary contributions (whether initial or continuing) towards the reasonable costs and expenses incurred by the strata renewal committee or owners corporation in relation to the following:
(i)preparing a strata renewal plan,
(ii) obtaining specialist consultant reports,
(iii)obtaining an order from the court to give effect to the plan,
(j) if the proposal is for a collective sale of the strata scheme:
(i) an indicative sale price and an explanation of how that price was determined and the distribution of that sale price on current unit entitlements, and

(ii) the proposed timetable for the collective sale, including a proposed completion date and the proposed date by which owners will be required to vacate premises forming part of the scheme,

I suggest that when the approach is for sale to a particular buyer, an owners corporation which has the benefit of good advice will decline to consider such a proposal unless it receives at least a binding undertaking from the purchaser or developer to pay all of its costs incurred in the preparation of a strata renewal plan (including in particular the cost of valuations), the obtaining of a support notice, the costs of the necessary court application and ancillary expenses whilst at all times maintaining its right to refuse to proceed at least until all of the steps up to the point of applying for a court order have been satisfactorily completed. Further, it will require a deposit or satisfactory security for the payment of those costs. (It is not unknown for developers to operate by way of a "two dollar" company providing an escape from its obligations if, for example, financing arrangements fall through.)
With this in mind, an owners corporation may wish to go further and insist that the giver of the notice enter into a binding contract to proceed with the purchase or redevelopment if the owners corporation makes a successful application to the court for approval of the proposal, once again with a deposit or appropriate security and always maintaining its right not to proceed until the application is made.

A sophisticated proposed purchaser is likely to have included as part of the proposal a form of contract for sale which would take into account some or all of the matters set out above.

Obviously, there will be room for negotiation in the period during which an owners corporation, which decides to consider the proposal seriously, proceeds to the point of the preparation of a strata renewal plan and in that regard it is significant that the legislation contemplates that the person giving the proposal may be involved in the preparation of that plan (see s164(2)(b).)

One further matter which is not covered in the legislation is whether a proposal, which takes the form of an offer to buy the parcel, can be withdrawn unilaterally. A strata committee at the outset or a strata renewal committee when appointed might well consider insisting that it receives a binding agreement from the developer that a proposal will not be withdrawn unilaterally, before a general meeting is convened to consider a strata renewal proposal or a strata renewal plan under s172.

With such a wide variety of scenarios, the requirements of the Regulations as to the contents of a strata renewal proposal will be of considerable importance in ensuring that it is comprehensive since a strata committee cannot be expected to make an appraisal of a proposal without appropriate details being provided. In that regard it must be remembered that older buildings that are ripe for redevelopment are often occupied by self-managed schemes with less than sophisticated committees.

If the strata committee considers the proposal warrants further consideration it is required to call a general meeting to consider appointing a strata renewal committee. As pointed out in the above summary if the strata committee decides that the proposal is not worth consideration or the owners corporation declines to appoint a strata renewal committee the proposal lapses (s159) and cannot be renewed for 12 months (s190.), All lot owners must receive a complete copy of the renewal proposal so that even if the strata committee regards it as not worth pursuing, it will still be possible for a group of the owners holding at least 25% of the aggregate unit entitlement to bring the matter before a general meeting under s158(2).

Schemes in existence at the commencement of the Development Act 2015.

Schedule 8 of the Act containing transitional provisions includes cl 8, which deals with the application of Pt 10 to freehold schemes in existence at the time of the commencement of the Act (30 N0vember 2016.)

The clause requires that if Pt 10 is to apply, the owners corporation must so decide by an ordinary resolution. The resolution may be passed at any time before a renewal proposal is considered at a general meeting so that it may be passed at the beginning of a general meeting convened under s158 before the renewal proposal is discussed.

In these circumstances, it is unlikely that an owners corporation would bother to pass such a resolution earlier. It is, however, most important that the matter is not overlooked as, if it is, the failure to pass the resolution may be seized upon by a dissenting owner as a ground for opposing a court application to give effect to a renewal plan, relying on s 182(1)(b).

Tenants.

Note that while tenants are entitled to be given notice of general meetings the owners corporation may and usually will determine that they not be present at meetings concerning a strata renewal proposal. If the proposal advances to the stage of preparation of a strata renewal plan it will be important that the matter of vacant possession of lots is considered and individual situations taken account of -otherwise lot owners may be faced with actions from dispossessed tenants.

Strata Renewal Committee & Plan.

Sections 160-163 of the Act deal with the setting up of a strata renewal committee and ss 164 – 169 and with its procedures, functions and operations.

There are time limits specified within which these steps must be taken (see s158.) Obviously there will be opportunities for negotiations to take place within this process which may occur often– most of which will no doubt concern price.

Assuming that the process reaches the stage of preparation of a strata renewal plan s170 sets out the content which must be included in such a plan leaving it open of course for other matters to be added as appropriate. Importantly s170(3) requires a plan for the collective sale of the scheme to provide for the

purchase of each owner's lot at not less than the "compensation value" for the lot which is determined by reference to s 55 of the *Land Acquisition (Just Terms Compensation)Act 1991* as modified by the 2016 Development Regulation cl 27. Subject to this the amount received on a collective sale is to be divided between lot owners in proportion to their respective unit entitlements s171.(1).

This means that the price for a collective sale must necessarily at least equal the aggregate of the compensation value of all of the lots in the scheme. However even that may not be sufficient if there have been changes in value over time so that the unit entitlements in the scheme no longer reflect differences in value between the lots. Note also that the definition of "compensation value" contains such elements as compensation for severance and/or disturbance and solatium .

If the result of apportioning the sale proceeds on a unit entitlement basis, one or more lot owners would receive less than the compensation value of the lot, the sale price will need to be increased to ensure that the requirement in s170(3) is met.

Nor will the problem be solved by a "top up" by the purchaser of the amount paid only to the owners of the lots in question since any such "top up" would form part of the collective sale price and therefore be required to be shared with the other owners in the scheme on a unit entitlement basis (s171(1))

A further issue in practice may arise from the interaction of s170(3) and s171(1): consider a situation where two lots in the scheme have the same unit entitlement as set out in the strata plan but one has subsequently been improved by the owner by internal renovations or is used (legally) for business purposes as say a home office so that its compensation value far exceeds that of the other lot. Despite this each of the lot owners will receive the same amount when the purchase price is divided up on a unit entitlement basis (s171(1). This outcome is likely to provoke disharmony among the lot owners and may even lead the owner of the more valuable lot to assume the position of a "dissenting owner."

Redevelopment

Obviously in the case of a proposed redevelopment there will be far more risk involved for the lot owners not the least being an unexpected fall in the market (as has occurred recently). And there have been a number of cases where property owners have sold their properties to a developer with the promise of receiving a unit or townhouse in the completed development only to find when the project fails the financier has taken possession under its mortgage and sold the property to recover its money leaving little or nothing over for the original owners. (In these cases the usual result has been an action by the owners against their solicitors for alleged failure to advise against entering the project without adequate independent security.)

No doubt, a court considering the renewal plan under Div 7 will need to be comfortable that the supporting owners are aware of the risks they may be running and that their interests are protected as far is possible having regard to the circumstances of the case.

As has already been pointed out there will be a need for a contract for sale to be entered into in the case of a collective sale and a redevelopment will also need a contract or contracts usually with a developer an owners corporation will certainly need legal advice as may individual lot owners so there is considerable scope for the involvement of solicitors when a strata renewal proposal for redevelopment is received and a strata renewal committee is appointed.

Valuation.

The requirement as to the valuations to be included in the strata renewal plan as set out in cl 33 of the 2015 Development Act Regulation:

(*c) a report of an independent valuer that includes details of the market value of the whole building and its site (at its highest and best use) and details of the compensation value of each lot*

In practice it seems that obtaining of these valuations has proved to be a problem since owners who oppose a proposal have refused entry to their lots to the valuer and there is no obvious way for a valuer to legally gain access.

A further issue relates to the valuation of the whole parcel which seems to have no purpose except perhaps to enable lot owners to compare it to the offer price in the proposal.

It is also noteworthy that the valuations to be included in the strata renewal plan must be made no later than 45 days before the date of the general meeting called to consider the plan and that similar valuations are to be placed before the court in an application for an order that the plan take effect having been made no earlier than 45 days before the application is made. This is, no doubt, to take account of a possible change in value in the period between general meeting and application to the court – very possible one might think in to-day's falling market.

The only problem with this arrangement is that I am reliably informed that presently the average time elapsing between application and hearing date in the Land and Environment Court is approximately one year!

Finalisation and approval of a Strata Renewal Plan

Note the importance of careful scrutiny of the plan by the owners corporation to ensure that it complies fully with s170. This is because under s178(3) the owners corporation must not apply to the court for an order to give effect to the plan unless it is satisfied that it complies with s170. If a failure to comply with some part of that section is discovered at that stage, it may be necessary to amend the plan and resubmit it to the owners seeking support causing at the least a significant disruption to the process of having the plan put into effect.

When a strata renewal plan has been finalised it must be presented to a general meeting of the owners corporation

It is suggested that, when the notice of that meeting is sent, it should be accompanied by a warning that the contents of the plan should be kept confidential and not disclosed to third parties. Obviously this is especially important if the proposal is for a collective sale to the market.

The owners corporation may amend the plan by an ordinary resolution or return it to the committee for amendment (s172(3)) – no doubt with an indication of what part or parts of the plan require amendment. In the latter case, the amended plan must be placed before a further general meeting.

It requires a special resolution be passed if the plan is to be given to the owners for their consideration (s172(5)). Note especially, that, this being a special resolution, votes are counted on a unit entitlement basis (s5 of the 2015

Management Act) and the motion will pass if not more than 25% of votes cast oppose the resolution (priority votes do not count (s172(6).)

However, when it comes to assessing the support of the owners for the plan, the "required level of support" as defined in s154 is that of the owner or owners of at least 75% of the lots (excluding utility lots). The two tests are thus different and for the plan to be adopted both must be passed. In other words it is possible that although the special resolution required under s172 was defeated, had it have been passed the plan would have obtained the required support.

Obtaining Support.

The passing of the special resolution does not adopt the plan – it merely sets in train the next step in the process which is to obtain the support of the owners of at least 75% of lots in the scheme (utility lots are excluded.)

The procedure for obtaining the support of the necessary percentage of lot owners is set out in ss173 – 176. If that support is obtained a further ordinary resolution of the owners corporation at a general meeting is required to bring the matter before the court to obtain an order to give effect to the plan (s178 (1))

At least three AGM's.

It will be noted that the general meeting convened under s178 (1) is the third of three general meetings of the owners corporation which must be held if a strata renewal proposal made under s156 (subsequently morphed into a strata renewal plan) is to reach the stage of being the subject of an application to the court to make it effective.

The first of those meetings is that held under s160 to set up a strata renewal committee and the second is held under s172 and requires a special resolution if the strata renewal plan is to be put to the owners to see whether it garners sufficient support to proceed. (An additional general meeting may be needed under s175 to consider amendments made to the plan by the strata renewal committee at the request of the owners corporation.)

Application to the court

The court to which the application is made is the Land & Environment Court. The form of the application and the material which is to accompany it are set out in s178 and the parties who need to be served and may object are specified in ss179(2) &180.

Sections 181 – 187 deal with the hearing of the application , the powers of the court ,the orders which may be made and ancillary matters.

Without going into detail it should be noted that provisions are included to expose any conflicts of interest which may be involved in the procedure and also to ensure that valuations are made by qualified and independent valuers. The service provisions are also wide ranging and the Regulations provide for particulars of estates or interests affecting lots or the common property to be notified to the court so that it can be satisfied that these have been appropriately taken account of in the plan.

Requirements for the court to make an order.

Section 182(1) requires the court to make an order giving effect to the plan if the provisions of ss 182(1)(a)-(g) are complied with. Many of these requirements are procedural but some are not.

For example Section 182(1)(d) repeats the requirement in s 170(3) that in a collective sale each lot owner is to receive at least the compensation value of the lot. It has already been pointed out that unless the sale price is high enough this may conflict with the requirement in ss171(1) that the sale proceeds are to be divided among the lot owners in proportion to their respective unit entitlements.

This may well become an issue in cases before the Land & Environment Court at the time of writing. Judgments on procedural matters have been given in those cases and these are discussed in detail in an Article in the August edition of the Law Society Journal at pp86-87.

In two of those cases the Judge at the request of the parties has referred the matter to conciliation. (Note that even if an agreement is obtained at a conciliation conference the matter must be referred back to the court for its approval before any order is made.)

Query whether the court would be prepared to approve the plan under s182(2) if an additional payment or payments were made by the purchaser to

"top up" the amounts received by dissenting lot owners to obtain their agreement to the plan as part of a conciliation agreement without increasing the payment to other lot owners to ensure that they continue to receive their share of the total consideration on a unit entitlement basis.

It is suggested that it would be desirable if the legislation made clear whether the court has power to do so. Note in that regard that the court has a limited power to amend a strata renewal plan in an application to have it order the plan to take effect -s182(3) but it may only do so if:

a) the variation is of a minor nature that does not affect the plan in any substantial way, and

(b) written agreement to the variation has been given by the owner of each lot in relation to which a support notice for the plan has been given.

Again part of s182(1) (d) requires the Court to be satisfied that the terms of in settlement in a in a collective sale "are just and equitable" and part of s182(1)(f) that those under a redevelopment applying to dissenting owners are "just and equitable in all of the circumstances" are not straightforward issues of fact.

In particular the question of how far the Court may have regard to the individual circumstances of dissenting owners in respect of matters other than the question of the fairness of the share of the total payment they will receive, is left open. Will the fact that that the dissenting owners of a residential lot are an elderly couple of pensioners who have occupied the lot for many years one of whom is bed-ridden and cared for by the other have any weight or does "just and equitable" refer only to financial matters?? My opinion is that the latter is the intention of the legislation but time will tell.

Sales of lots in schemes subject to a strata renewal proposal.

Finally from a conveyancing point of view there are further matters to consider if a lot in a scheme which is subject to a strata renewal proposal is up for sale.

For one thing the Sale of Land Regulations include as an adverse affectation (giving a right to rescind to a purchaser if not disclosed) if at the time of entering into the contract:

… the contract relates to land that comprises or includes a lot in a freehold strata scheme within the meaning of the *Strata Schemes Development Act 2015* :

(a) the owners corporation has passed a motion for a resolution under Part 10 of that Act that a strata renewal proposal warrants further investigation by a strata renewal committee, and

(b) the owners corporation has established (or has not yet established but continues to be required to establish) a strata renewal committee to give effect to the resolution, and

(c) minutes of the meeting recording the resolution that are required to be kept under Schedule 1 to the *Strata Schemes Management Act 2015* have not yet been prepared. (Sched 3 cl 15.)

You will note that this provision appears to assume that a pre-purchase inspection of the minutes will always be made.

In addition the 2018 standard form of contract includes cl 23.8.4 which provides to a purchaser the right to rescind if "a resolution is passed by the owners corporation before the contract date or before completion to give a strata renewal plan to the owners in the scheme for their consideration and there is not attached to this contract a strata renewal proposal or the strata renewal plan."

The obvious conclusion is that an appropriate disclosure should always be made in the contract in such a case. Fortunately the fact of the receipt of a strata renewal proposal and the strata committee's decision as to whether it warrants further consideration will have necessarily been made known to existing lot holders (S157(5)) and should therefore emerge when instructions are obtained from an intending vendor for the preparation of the contract for sale.

2.Strata Building Bond & Inspection Scheme Part 11 2015 Management Act

Part 11 of the 2015 Management Act was introduced as an antidote to the controversial exclusion of multiple storied residential buildings from the requirement of Home Building Insurance under the Home Building Act 1989 which occurred some years ago under a previous NSW government -see Reg 56 of the *Home Building Regulation (2004).*

Part 11 was originally intended to take effect on 1 July 2017 but this was postponed until 1 January this year.

The provisions of Pt 11 are supplemented by Sch 1 cl 15, Sch 3 cl 16 and cll 44 – 56 of the Regulation.

The following summary gives a general out-line only of the four main components in the scheme and when advising developers, builders or owners corporations in relation to building defects the various provisions will need to be carefully scrutinised.

The *first* component is the ascertainment of the building work to which Pt 11 applies. This is "residential building work" (as defined in the *Home Building Act 1989*) carried out on a building or part of a building which is part of a strata parcel; it also includes work carried out on such a building or part of such a building intended for mixed uses including residential purposes (s191(1).)

The building work must have been carried out for the purposes of or contemporaneously with registration of a strata plan or a strata plan of subdivision of a development lot (s191(2).)

However, it does not include building work in respect of which it *is* required to obtain home building insurance or which is not required to do so only because the contract price falls below the threshold in the Home Building legislation.

Further, Sch 3 cl16 of the Act excludes building work for which a contract was entered into before 1 January 2018, or if there was no contract for the work, was commenced before that date.

The *second* component (ss193-206) is the appointment of an independent building inspector to give an interim report identifying any defective building work and later a final report. The building inspector must be nominated by the developer and approved by the owners corporation within a specified time and, if not appointed for any reason, is to be appointed by the Secretary. Provision is made to allow the builder who carried out the building work to rectify defective work (s206).

The *third* matter is the lodgement by the developer of a bond of 2% of the contract price of the work with the Secretary at the time of the issue of an occupation certificate to cover the cost of rectification of any building defects

which are identified and not rectified by the developer or the builder (ss201-211 and cll 50 – 55 of the Regulation).

The *last* component is the provisions which give the Secretary power to control the bond and its realisation and general oversight of the whole procedure with the ability of interested persons to have certain decisions of the Secretary reviewed (s213 and cl 56 of the Regulation).The "Secretary" is defined in the Management Act as the Commissioner for Fair Trading or if there is no Commissioner the Secretary of the Department of Finance, Services and Innovation.

Note that anything done under Pt 11 does not affect any other action that may be taken in respect of the building work under any other law but naturally any court, tribunal or other body may take into account any payment made or rectification work carried out when determining any such action (ss 215(3) and (4).)

In addition to the above you should be aware that Fair Trading has proposed amendments to the legislation in the draft *Strata Schemes Management Amendment (Building Defects Scheme) Bill* 2018 the principal changes being:-

- developers must lodge a building bond *before applying* for an occupation certificate (rather than at any time before it is issued).
- The owners corporation and the developer must agree on the amount to be released from the bond to meet the cost of remedying building defects – in default the Secretary will do so.
- wider investigating powers for the Department to enable verification of contract prices and the bond amount.
- a very substantial increase in the maximum penalty for failure to lodge the bond (up to $1.1 million.)
- making it an offence for developers to provide false or misleading information to the Secretary in relation to contract price or bond amount and
- a good faith defence for building inspectors.

In addition a number of changes to the Regulations are proposed details of which can be obtained from the Department.

N.J.Moses Aug 2018.