When the developers come knocking: considerations when selling a strata block

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Snapshot

- The most controversial of recent strata reforms are the strata renewal provisions contained in Part 10 of the *Strata Schemes Development Act 2015,* which allow for the collective sale or redevelopment of an entire strata scheme to a developer if 75 per cent of lot owners agree.
- Owners corporations, developers and their lawyers will need to consider a number of matters when participating in a strata renewal process.
- Lawyers will have a significant role and need to ensure the costs and other risks to their client are carefully explained and understood across the 'end-to-end' scope of the transaction.

The most controversial of recent strata reforms are the strata renewal provisions contained in Part 10 of the *Strata Schemes Development Act 2015*. Part 10 has now established a fourth category of strata termination. It will allow for a collective sale or redevelopment of an entire strata scheme to a developer if 75 per cent of lot owners agree. This has been made law against the lobbying of some advocates because those in dissent of the collective sale or redevelopment will have to sell their units against their wishes. The Part 10 provisions are prescriptive and process-driven, and there are many traps that an owners corporation ('**OC**') can get caught in if they do not receive detailed advice.

This article will focus on some of the matters that OCs, developers and their lawyers will need to consider in participating in a strata renewal process. Freehold strata schemes can be terminated in one of three ways under the *Strata Schemes Development Act 2015* ('**the Act**').

(i) If there is the unanimous approval of each owner in the scheme, and there do not appear to be other significant competing interests, then an application to the Registrar-General can be made at relatively low cost.

(ii) Where the unanimous approval of individual owners cannot be obtained, then it is possible to make an application to the Supreme Court of NSW for an order terminating the strata scheme.

(iii) On 30 November 2016, a third method of termination was introduced in NSW allowing for a collective sale or redevelopment of a freehold strata scheme. The new provisions were inserted into Part 10 of the Act and with the aim of freeing up prime sites from underutilised and aged buildings under the policy of 'urban renewal'.

Benefits for owners wanting to sell

The first benefit for owners participating in the strata renewal provisions is the guarantee of minimum compensation and the terms of settlement under the strata renewal plan being 'just and equitable in all the circumstances'. Compensation must be no less than market value plus an additional sum calculated using (modified) principles borrowed from the *Land Acquisition (Just Terms Compensation) Act 1991* (NSW). It is clear from the second reading speech of The Hon. Niall Blair on 21 October 2015 that the legislature intended for owners to obtain the financial benefit of Part 10 of the Act as '[t]he actual amount the lot owners will receive should be expected to be much higher than the compensation benchmark', because '[t]he collective sale will reap more than the sum of market values of the individual lots because the value of the whole scheme as a package is much higher than the individual lots being on sold to individual buyers'.

The second benefit is the element of certainty afforded to the majority owners where the necessary level of support is obtained (75 per cent of owners in the strata scheme). The Land and Environment Court ('**L&E Court**') is responsible for granting the order and must grant an order to give effect to a strata renewal plan where the Court is satisfied of all matters contained in s 182(1). Once the order is made, the sale is binding on the lot owners and their successors in title. Section 184(2) states that '[t]he owner of each lot in the strata scheme must sell the owner's lot in accordance with the strata renewal plan and the [court] order.'

Costs

Giving the L&E Court the ultimate power to approve or reject an order has been said to be one of the strongest 'safeguards' in the strata renewal provisions. Aside from the costs of the proceedings, lawyers acting for an OC should inform their client that they are liable for the reasonable legal costs of the proceedings of dissenting owners and that the OC cannot impose a levy to fund these costs (s 188). Some of the other costs in the strata renewal process involve:

- legal costs prior to commencement of proceedings;
- costs of an independent valuation (to determine 'highest and best use') on at least two occasions;
- due diligence costs;
- costs of meetings;
- funding the strata renewal committee to prepare the strata renewal plan, including the specialists who will provide input to the plan; and
- costs of the returning officer.

An OC is a unique client and the law recognises this in the *Strata Schemes Management Act 2015,* s 103 (formerly s 80D).

Lot owners that are also laypersons may undermine the true costs involved in obtaining specialist advice that are necessary components of the strata renewal plan, placing a higher duty on the advisor to explain and make clear these costs from the beginning. Budgets for funding the strata renewal committee should be forecast within the same timeframe that the strata renewal committee is established and the committee must not exceed expenditures unless they are approved by the OC by resolution (s 164(2)(a)).

There is scope for the developer to contribute to the OC's costs of developing a strata renewal plan which will be comprehensive, although the developer is not compelled to do so. This is contemplated in s 156(2), which requires that the developer's strata renewal proposal disclose minimum information, including information as to whether the 'proponent' will provide any monetary contributions towards the strata renewal committee's reasonable costs and expenses (see item (g) in cl 30 of the *Strata Schemes Development Regulation* 2016). If so, it will be in the interests of both parties that a separate agreement between the proponent and the OC is entered into, so that both parties are clear about their obligations and the maximum amounts the proponent would be willing to pay to contribute to the strata renewal plan in compliance with Part 10.

> **The strata renewal process will work best where there is collaboration between owners, but lawyers who regularly act for owners corporations know the bumpy ride that may lay ahead... [E]ncouraging owners to negotiate fairly may assist them to reach a consensus about the fate of the strata scheme**

There is an assumption in Part 10 that a developer will have capital available to fund the costs of the acquisition. Keeping costs down will be a challenge for the developer, especially if the strata renewal plan lapses and there is a limitation imposed on further attempts (s 190). It is likely that prior to issuing the strata renewal proposal to the relevant strata scheme, the developer has already invested money into feasibility reports and undertaken the necessary due diligence. These are costly exercises and there is no concession in the legislation for the developer in offsetting these costs. Highly experienced developers have mastered the business of being liberal with their ideas and conservative with their costings. This will be tested for an acquisition involving a strata renewal proposal. The legislature expects the developer to carry the financial burden of these risks, and some developers will not be able to afford a site acquisition using the strata renewal provisions at all.

Avoiding conflicts

Solicitors owe their clients a proactive duty to avoid conflicts. Where acting for an OC, the lawyer should be clear who they are acting for. Individual lot owners should always be advised to obtain their own independent legal and/or financial advice.

Lawyers who are retained as legal advisors to an OC for a strata renewal plan should avoid also being retained as a 'returning officer'. A returning officer must be appointed by a resolution of the OC and be independent of the OC. Equity has long held that a fiduciary relationship arises where one party reposes trust and confidence in another, and is expected to act in the interests of that party to the exclusion of another. Given the pivotal roles of the returning officer to administer the support notices in the strata renewal process, the dual roles may imply a parallel fiduciary duty to the OC, alongside the fiduciary duty owed by a lawyer to their client. Indeed, the Minister's second reading speech suggests that a 'returning officer' could be a 'mediator, independent managing agent or any other person the owners trust for this role'. Lawyers engaged solely as a returning officer should make sure the appropriate procedures are established internally to properly fulfil the role under s 174(7). It is also prudent to make enquiries as to whether the returning officer carries the appropriate indemnity insurance.

Keeping a timetable and procedural requirements

The strata renewal process will require those involved to manage their time effectively so they can keep momentum as they follow the processes set out in Part 10. Lawyers acting for an OC may want to prepare a timetable of tasks comprising a list of key dates and the person responsible for those tasks. This will provide a useful working document for the strata renewal committee in keeping traction and monitoring progress.

It is also worth mentioning that Schedule 7 of the Act applies additional requirements with respect to notices of meetings relating to the strata renewal process. This applies in addition to the detailed requirements contained in Schedules 1 and 2 of the *Strata Schemes Management Act 2015*, which respectively apply to meetings to the extent of an inconsistency (s 155 (2)). A departure from these provisions may jeopardise the validity of those meetings, costing time and adding uncertainty to owners.

Encouraging fairness

Emotions may run high in residential schemes and in such cases, it will be inevitable for the lawyer to become involved in times of strong disagreement or impasse. Lawyers should take the time to understand concerns. Owners who dissent or object to the strata renewal plan are not required to lodge an objection with the returning officer; only the support notices that have not been withdrawn are counted. The strata renewal process will work best where there is collaboration between owners, but lawyers who act regularly for owners corporations know the bumpy ride that may lay ahead. Lawyers are invaluable and respected advisors to an OC and encouraging owners to negotiate fairly may assist them to reach a consensus about the fate of the strata scheme during their engagement. **LSJ**