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FIRST STRATA COLLECTIVE SALE APPROVED BY THE COURT

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Background and General Comments

Application by the Owners – Strata Plan No. 61299 [2019] NSWLEC 111, handed down on 8 August 2019 is the first decision on the operation of Part 10 of the *Strata Schemes Development Act 2015* (SSDA) for strata scheme renewals, since its introduction in 2016.

The case concerned the making of an application by an owners corporation to the NSW Land and Environment Court to approve a strata renewal plan for a collective sale to a purchaser by all the owners of lots in a mixed use strata scheme, under Part 10 of the SSDA.

Interestingly at the time Part 10 of the SSDA was introduced it was envisaged that many older strata schemes would avail themselves of this process, but this decision and other cases yet to be decided in the court lists suggest that it is the larger and more complex strata schemes, including a number of mixed use strata schemes, that are going down the Court approved strata renewal route.

This may be due to the time, cost and resources required to go through the Court approved process, including strict compliance with set timeframes and service of proper notices on owners, lessees and mortgagees, obtaining support notices to the proposal and determining who are dissenting owners, and producing evidence to the Court to establish that the Part 10 procedure has been followed to the letter.

Part 10 might also potentially be useful with the collective sale or redevelopment of more recently built schemes that are riddled with defects, and we await to see whether strata schemes who face these issues consider strata renewal under Part 10 a relevant option.

While not the only manner to achieve a strata renewal, introduction of the collective sale or redevelopment provisions under Part 10 of the SSDA enables Court approval of a majority-initiated proposal, having regard to what is fair and equitable in all the circumstances. The Court approved process, where a 75% majority of lot owners by unit entitlement agree to take action towards achieving a collective sale or redevelopment of a strata scheme is useful, given many older strata buildings are showing signs of age, and in circumstances where there are a majority of lot owners who want to sell or redevelop their strata scheme with a minority of lot owners who resist doing so, and where continual repair of existing structures, and the raising of substantial special levies to carry out certain works is not worth pursuing.

Collective sales or redevelopment of a strata scheme can be undertaken without taking the Court approved process, in the form of a combined private sale or redevelopment where all the lot owners in a strata scheme are in agreement to being collectively involved in selling their individual lots under a single arrangement negotiated with a purchaser or developer. While this might take some negotiation, it might be in the long run be cheaper and quicker than going through Court-approved strata renewal process, assuming all lot owners can in fact reach an agreement. This is worth considering particular in the context where market conditions may change in the time it takes to go down the Court approved process.

The decision in *Application by the Owners – Strata Plan No. 61299* [2019] NSWLEC 111 sets out the procedures that need to be satisfied to obtain the Court’s approval to a strata renewal, and while these procedures are ultimately aimed at protecting the interests of all lot owners in a strata scheme, they must be taken with particular care in practice in order to satisfy all of the technical requirements under Part 10 of the SSDA.

The decision highlights the need for strata committees, managing agents and their advisors to be very thorough with keeping records, serving notices, holding meetings, and complying with the strict timeframes involved in the court approval process. In fact the Court, as evinced in its decision, reviewed the evidence in forensic detail to ensure the Part 10 was complied with, with what appears to be very little margin (if any) for error.

Part 10 involves a Court assessing a strata renewal plan, considering the submissions by any dissenting lot owners and arriving at a decision having regard to a fair and equitable outcome for all concerned.

In this case, the collective sale did not have unanimous support by all the lot owners in the strata scheme, however none of the non-consenting owners or their mortgagees sought to appear before the Court and object to the proceedings as dissenting owners. Further decisions are therefore required in order to shed light on this aspect on the operation of Part 10, and on other issues that were not in contention in this case.

Nonetheless, the case illustrates the procedural steps that need to be undertaken to initiate and achieve a strata renewal plan through the Court approved process under Part 10 of the SSDA.

The case also sheds light on the manner in which notices are to be served and touches on the issues raised by the two forms of valuation used in determining compensation, namely valuation on an individual lot basis, and on a whole of building and site basis.

With regards to the service of notices, the decision found in this particular case that all the lot owners (many of whom were investors who did not reside in Australia) were served as required by the SSDA.

It was also found that the absence of another party was not an impediment to orders being sought as per the application made by the owners corporation.

This case concerned an owners corporation of a large 25 level 159 lot mixed use strata scheme at 252-258 Sussex Street Sydney consisting of serviced apartments, a retail lot, and 36 utility lots predominantly used as car spaces. The building was operated by Seasons Harbour Plaza Sydney as a serviced apartment building for all but one of the apartment and utility/car space lots.

The decision set out all the relevant strata renewal provisions in the legislation that were of relevance to the case and to the making of the application and the orders to approve the strata renewal plan.



Procedural steps for strata renewal process as outlined in the Decision

The decision also helpfully summarised the Part 10 court approved strata renewal process in the following steps:

- Step 1: A strata renewal proposal is prepared and submitted to the strata committee (SSDA s156; SSSDR cl 30);
- Step 2: The strata committee must consider the proposal within 30 days (SSDA s157);
- Step 3: If supportive of the strata renewal proposal the strata committee must hold a general meeting within 30 days (SSDA s158) and must comply with the requirement to give 14 days' notice of such meeting. The minutes of that strata committee meeting must be sent to all lot owners within 14 days after that strata committee meeting at which support was given to the proposal together with a complete copy of the proposal and detailed reasons for the strata committee's decision to support the proposal (SSDA s157(4),(5));
- Step 4: If the proposal is supported at the general meeting, a strata renewal committee ("SRC") must be formed (SSDA s160). Written notice of this decision must be given to all lot owners within 14 days of the establishment of the SRC (SSDA s162, SSSDR cl 31);
- Step 5: The SRC lasts for one year, subject to extension by special resolution of the OC (SSDA s.166) The SRC is tasked with preparing a strata renewal plan (SSDA s164(1)). There are prescriptive requirements for preparation of the strata renewal plan which must contain the information set out in section 170 of the SSDA. This step also involves the preparation of valuations on two bases, namely a valuation based on the value of each lot in the strata scheme (the "compensation value" of each lot), as well as a valuation based on the market value of the whole building and its site (SSDA s172(2) and Sch 7 cls 3; SDR cl 33), at a date not more than 45 days before the owners corporation general meeting to consider the strata renewal plan.
- Step 6: The strata renewal plan must be prepared in good faith (SSDA s182(1)(a)) and must be considered by the owners corporation in general meeting, notice of which meeting must be given in accordance with s172(2) and Sch 7 cls 3 of the SSDA. The owners corporation can by special resolution decide to give the strata renewal plan to the lot owners for their consideration (SSDA s172(5)), which must be done within 14 days of the decision being made by the owners corporation (SSDA s173).
- Step 7: At least 75% of non-utility lot owners (this particular strata scheme was a large strata scheme consisting of 159 apartment lot sand 36 utility lots) must support the strata renewal plan (SSDA s.154 see definition of "required level of support"). If this is achieved, notice must be given to the Registrar General and all non-utility lot owners of the Owners Corporation's Secretary's receipt of the required level of support within 14 days of such receipt. Interestingly, though not mentioned in

the decision, this would presumably be done by receipt of support notices to be signed by each lot owner, and would require the Secretary to keep accurate and up to date records and to determine the percentage of support as the support notices come in, so as to ensure strict compliance with the 14 day time limit.

Step 8: If support notices (SSDA s174(1)) are received from at least 75% of the non-utility lot owners the Owners Corporation may then resolve in general meeting to apply to the Land and Environment Court (Court) to have the strata renewal plan made (SSDA s.178(1)). Section 179 of the SSDA (and SSSDR cl 35) set out the documents that must be comprised in an application to the Court for such an order. The SSDA prescribes who must be served with a copy of the application to the Court, including all owners (SSDA ss 178(4), 179(2)). This would have been a considerable task in this case, given that many owners were investors located overseas.

Step 9: The Court considers the strata renewal plan and may make orders giving effect to the plan if it is satisfied of certain matters which ultimately leads to the termination of the strata scheme (SSDA ss182-183; SSSDR cls 36-37). Orders once made bind the lot owners, any purchaser of a lot in the scheme and the dissenting lot owners (SSDA 187).

Step 10: While not relevant to the case in question as there were no respondents, the decision noted that:

- Any dissenting owners and those on whom notice of the application must be served under the strata renewal regime may object to the Court to the making of the strata renewal plan (SSDA s.180); and
- The SSDA provides for a conciliation process between an owners corporation and dissenting owners which is a variation on the conciliation process under the *Land and Environment Court Act 1979* (SSDA 181, Court Practice Note - Strata Schemes Development Proceedings)
- The decision then went through the matters the Court must be satisfied with so that it can make an order giving effect to a strata renewal plan, namely:
 - the relationship between the owners and the purchaser or a developer to ensure that there was nothing there preventing the plan being prepared in good faith;
 - that all the procedural steps (Steps 1 to 8 outlined above) were taken in preparing the plan and in obtaining the required level of support in accordance with the strata legislation;
 - that all notices under sections 179 and 181 of the SSDA were properly served;
 - where the plan is for a collective sale, the proposed distribution of proceeds apportioned to each lot is not less than the compensation value of the lot; and
 - that the terms of settlement under the plan are just and equitable in all the circumstances.

Valuation issues arising from the Part 10 strata renewal process, particularly for mixed use schemes

Of note in this case, was the issue of valuation and the potential for inconsistencies and disparity between the two valuations utilised and referred to in sections 171(1) and s182(d) of the SSFD when determining the compensation value of a lot that will be subject to an order approving a strata renewal plan.

Section 171(a) of the SSFD provides that if a strata renewal plan is for a collective sale of the strata scheme the amount to be paid for the sale of the lots and common property in the scheme must apportioned amongst the lot owners proportionate to the unit entitlements of the owners' lots.

However section 182(1)(d) of the SSFD provides that the proposed distributions for a collective sale of the strata scheme that is apportioned to each lot is not less than the compensation value (determined in accordance with the *Land Acquisition (Just Terms) Compensation Act* methodology) of the lot and the terms of the settlement under the plan are just and equitable in the circumstances.

Again, the Part 10 provisions were drafted in contemplation that the strata schemes that would be availing themselves of the Court approved strata renewal process would be older style residential strata schemes, and not mixed use strata schemes as in this case.

There were 5 utility lots in this strata scheme that were used as a café, storage lot, reception, office, and gymnasium. The valuations for those 5 utility lots were, due to the uses to which those lots could be put, significantly higher per square metre than the valuations per square metre that applied to the serviced apartment lots, and the other utility lots which were used as car spaces.

This raised an interesting conundrum in determining how the valuation provisions of Part 10 provisions applied in in that:

- either the highest value of a lot in the strata scheme needed to be used to set the value for all other lots, but that would then result in a higher than compensation value for some lots and not other lots; or
- the requirement for the payment of compensation based on unit entitlements was subordinate to the achievement of a compensation value in the case where there is a conflict as between the two valuation methodologies.

This was to some extent neatly resolved in the case by the Court using its broad ancillary powers under section 186 of the Act to order that the unit entitlements for all the lots in the strata scheme be amended, on the basis that Part 10 of the Act was introduced primarily to facilitate strata renewal. To require the highest value of a lot in the scheme as the benchmark for setting the values of the other lots was found in the circumstances to be a commercially unviable option.



The Court further stated that despite the potential for discrepancies, the Act should be read harmoniously and as a whole notwithstanding the potential for conflict between the two valuation methodologies referred to in Part 10 of the SSDA, particularly in circumstances where there are different uses within a strata scheme. This decision however did rely on the presumption that the valuation submitted to the Court evinced that the unit entitlements of the lots in the strata scheme did not reflect the difference in values arising from the use of the different lots, particularly as between the serviced apartment lots and the 5 utility lots in the strata scheme.

The Court ultimately considered that a reallocation of unit entitlements was a modest change and it was considered that this would not prevent the Court from determining a fair and equitable outcome for all concerned. Interestingly while there were no active objectors to proceedings, the Court nonetheless determined that it was appropriate to make the ancillary orders to give effect to a variation of the unit entitlements of the strata scheme, so as to adjust the values in favour of the 5 utility lots without in the Court's judgement, greatly disturbing the values of the serviced apartment lots. We await to see if future decisions will also follow this approach or take a differing approach depending on what is fair and equitable in the particular circumstances.

Current leases continue notwithstanding orders for collective sale

Another interesting issue that arose in this case was the status of a number of current leases and tenancies in the strata scheme, namely the leases of the various serviced apartments under the management agreement with the serviced apartment operator, the café lease and the lease of an apartment and car space in the scheme as a residence.

Not all of these leases had early termination clauses, and the strata renewal plan contained no proposal to acquire these leases.

The Court accepted the Applicant's submission that unlike the provisions of the *Land Acquisition (Just Terms) Compensation Act 1991* under which all interests in land are automatically extinguished when the land is acquired by an acquiring authority, the Part 10 provisions were mainly directed to the collective sale of freehold interests in land. While the Court can make orders for vacant possession of a lot, this is optional and leases of a lot in a strata scheme are only terminated where a strata renewal plan provides for a date for vacant possession (presumably having regard to the terms of a lease or other arrangements reached with lessees or tenants of lots in a strata scheme). Otherwise continuing leases will remain undisturbed by a collective sale. Therefore if the redevelopment or collective sale of a strata scheme requires vacant possession in order for the deal to be viable, all subsisting interests in each lot and the common property need to be determined and dealt with or otherwise addressed in a strata renewal plan. It may well be that in any future case for a Part 10 approval of a redevelopment proposal the Courts will look to whether or not its powers to extinguish a lease will need to be utilised.



Other assets of the owners corporation

In this case orders were made that on termination of the strata scheme, the assets of the former owners corporation vested in the lot owners (and not the purchaser purchasing all the lots in the strata scheme) in shares proportional to the former schedule of unit entitlements (and not the schedule of unit entitlements that was the subject of the order made by the Court under s186 to fairly allocate the compensation payable for lot from the overall sales price) and the balance of any monies of the owners corporation was to be distributed back to the lot owners. This was according to the case, consistent with a condition of the terms of sale set out in a Deed of agreement entered into between a purchaser and the strata renewal committee, as otherwise a person acquiring all the lots in a strata scheme would be entitled, as the current owner of all the lots in a strata scheme, to the assets (and liabilities) of the owners corporation. It was not made clear in the judgment when the timing for the termination of the strata scheme was to occur, as the orders were made for each lot owner to sell their lot to the purchaser under the strata renewal plan.

Functions of strata renewal committee

The case referred to a Deed of Agreement entered by the strata renewal committee with a purchaser for the englobo sale of lots in the strata scheme. It was not fully outlined in the case whether the strata renewal committee had been given power to enter into such an agreement on behalf of the owners corporation and it is unclear in what capacity a strata renewal committee can enter into such an agreement so as to bind all the lot owners in the strata scheme. Section 164 of the SSSA sets out the functions and operation of the strata renewal committee who are primarily tasked with preparing a strata renewal plan. There is a step in the process where, in exercising its functions, it may at any time ask the secretary of the owners corporation to convene a general meeting to approve “any other matter relating to the operation of the committee or the exercise of its function.”

Also, a strata renewal committee is dissolved on the day an owners corporation decides to apply to the Court for an order to give effect to the strata renewal plan prepared by the strata renewal committee. So it is unclear how an Agreement can continue to exist and bind an owners corporation and the lot owners when the body who entered into the agreement no longer exists. Presumably the strata renewal plan for the collective sale was given effect as between the owners corporation and each of the owners of lots and mortgagees on the basis that they are bound by the decision of the Court (as was the purchaser) under section 187 of the SSSA, but this issue was not specifically considered or alluded to in the orders made by the Court.

Older strata schemes and transitional provisions

Another interesting issue was whether the owners corporation for the particular strata scheme in this case, which was created under the former strata development legislation, resolved in general meeting of the owners corporation that part 10 of the SSSA applied to the strata scheme, at or before the general meeting at which it considered the strata renewal proposal. This is required under the transitional provisions in



Schedule 8 to the SSDA. Once such a resolution is made by an owners corporation it cannot be revoked, there is no turning back.

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