First Owners Forced to Sell Under the New 75% Rule

In the recent landmark decision of *Application by the Owners – Strata Plan No 61299 [2019] NSWLEC 111*, the first ever application was brought before the Court under Part 10 of the *Strata Schemes Development Act 2015* (**SSD Act**).

This case now serves as a guide for owners corporations interested in strata renewal and will provide some confidence to purchasers and financiers investigating or considering urban renewal sites.

Facts

- The Applicant is the owners corporation (**OC**) for a large 21 storey high apartment complex in Sydney, Strata Plan No 61299. The strata scheme is comprised of 159 lots, of which 120 are apartments, 36 are utility lots (being 34 basement car spaces, a storage room and a lot for signage) and a lot each for a café, hotel reception and lobby area, office and gym.

- All the lot owners are investors and, except for one apartment and car space lot, the lots are leased to Seasons Harbour Plaza Pty Ltd to run a service apartment business.

- The Applicant sought orders from the Court to give effect to its strata renewal plan for a collective sale of the strata scheme. Although not all the lot owners consented to the collective sale, none of the non-consenting owners or their mortgagees sought to appear in the proceedings.

Important Takeaways from the Judgement

Strata Renewal Steps

- The Court detailed the steps required for strata renewal, which may be summarised as follows:

    1. A strata renewal proposal is prepared and submitted to the strata committee;

    2. The strata committee must then consider the proposal within 30 days;

    3. If the strata committee is supportive of the proposal, it must hold a general meeting of all the owners regarding the proposal within 30 days and then send minutes of that meeting to all lot owners within 14 days with a complete copy of the proposal;

    4. If the general meeting of owners is supportive of the proposal, a strata renewal committee must be formed and, within 14 days, all lot owners must be informed by written notice of the strata renewal committee;

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5. The strata renewal committee prepares a strata renewal plan and has a term of 1 year, which can be extended by a special OC resolution;

6. Once prepared, another OC general meeting must be held to consider the strata renewal plan and, if specially resolved, the plan must be provided to all owners within 14 days;

7. At least 75% of the non-utility lot owners must support the strata renewal plan and, if this support is reached, the OC must give notice of this to the owners and the Registrar-General;

8. If support notices are received from 75% of the non-utility lot owners, another general meeting of the OC is to be held and, if specially resolved, the OC may apply to the Court to have the strata renewal plan made; and

9. The Court considers the strata renewal plan and, if satisfied of certain matters, may make orders giving effect to it. These orders bind the both the consenting and non-consenting owners and any purchaser of the scheme.

- Further, the SSD Act allows for a general meeting of the OC to be convened to consider a strata renewal proposal on a "qualified request" – a request by an owner or owners holding a total of 25% or more of the scheme's unit entitlements – whether or not the strata committee has considered the proposal or decided it warrants further consideration.

- During the process, non-consenting owners may object to the Court and the SSD Act provides for a conciliation process between such non-consenting owners and the OC.

- Regarding the steps taken by the Applicant, there are two important takeaways from this case:

1. A total of 12 support notices were invalid, because they had not been executed by mortgagees, but, luckily, the required 75% support was achieved regardless. This could have derailed the strata renewal plan and could easily have been prevented by, say, better instructions with the mail out to the owners.

2. The minutes of the meeting in which it was specially resolved to apply to the Court did not mention a key point required by the SSD Act – that the OC is satisfied that the strata renewal plan includes all information required by the SSD Act. The Applicant successfully argued that the Court should infer that the OC was satisfied. The need to argue this point could have been avoided if more care is taken with the minutes of meetings conducted during the process.

Leases

- The Court noted that the SSD Act allows a collective sale to occur subject to a lease and that it provides some mechanisms for the termination of leases if vacant possession is required under a strata renewal plan. However, if vacant possession is not required, as in this case, then those clauses will have no work to do.

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- The judge's comments on this aspect of the matter seems to indicate that, although the Court has power to terminate leases, leases will ordinarily be terminated according to their terms or be the subject of a negotiated surrender.

Acting in Good Faith

- The concept of 'good faith' is found throughout the law regulating collective sales:

    1. An "independent valuer" is one whose interests do not affect their *"ability to give the valuations in good faith"*;

    2. If the strata renewal committee has a vacancy or *"defect in the election of a member"*, then any acts it does remain valid as long as it is *"done in good faith"*; and

    3. The making of the Court order relies on any relationship between the lot owners and purchaser having not prevented the strata renewal plan *"being prepared in good faith"*.

- The judge was satisfied that the collective sale was conducted in good faith as:

    1. The marketing and sale was conducted by a separate real estate agency, Colliers International (**Colliers**) and so was at arms-length;

    2. Colliers undertook four rounds of expressions of interest offers to arrive at the final bidder, which resulted in a competitive process and achieved a record sale price; and

    3. The lack of replacement of a member of the strata renewal committee member who resigned did not impact steps taken by the committee after the resignation as there was transparency in the committee's discussions.

Valuations

- Two independent valuations are required for the strata renewal process – first to support the strata renewal plan and second to support the Court application. Each valuation is required to make two assessments:

    1. Market value assessment – being *"the market value of the whole of the building and its site (at its highest and best use)"*; and

    2. Compensation value assessment – being a determination of *"the values of the individual lots within the strata scheme"*.

- The Court noted that it must make an order giving effect to a collective sale strata renewal plan only if it is satisfied that:

    1. *"the proposed distribution of the proceeds of sale apportioned to each lot is not less than the compensation value of the lot"*; and

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2. the settlement terms under the strata renewal plan *"are just and equitable in all the circumstances"* and *"despite any difference between a valuation contained in the plan and any valuation that accompanied the application for an order to give effect to the plan"*.

- An important takeaway is that the market value assessment is not simply valuing the strata scheme as is but rather valuing it at its "highest and best use", which *"means the lawful, physically possible and financially feasible use that maximises the value of the land"*. In this case, the Court accepted that the "highest and best use" was sale of all the lots *"in one line to a hotel organisation that could refurbish it and reposition its offering."*

- Interestingly, for the compensation value assessment in this case, the Court accepted a per lot apportionment of the market value assessment and so an individual valuation for each lot in isolation was not required.

Re-allocation of Unit Entitlements

- In addition to being *"just and equitable"* and "*not less than the compensation value of the lot*", another section of the SSD Act requires that *"the amount paid for the sale of the lots and common property in the scheme must be apportioned among the owners of the lots in the same proportions as the unit entitlements of the owners' lots"*.

- An issue arose when the Court attempted to reconcile the valuation amounts of 5 non-residential lots, being the café, storage lot, reception, office and gym, with their respective unit entitlements. The judge noted that if these lots were paid based on their unit entitlements, then their owners would receive payments below the compensation value assessed by the valuer.

- The judge noted that the SSD Act *"should be read harmoniously and as a whole"* and that, although *"the SSD Act does not clearly specify which section is to be given priority"*, the conflict between the two sections could be resolved by using the Court's *"broad and facultative"* ancillary order powers under section 186(1) of the SSD Act to give effect to a strata renewal plan and so, ordered a *"modest"* re-allocation of unit entitlements with the result that both the conflicting sections of the SSD Act *"would be satisfied with respect to how much money each lot owner will receive."*

This historic decision is a sensible and pragmatic approach to the interpretation of the SSD Act and provides greater certainty to owners corporations who wish to embark on the strata renewal process.

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