Mascot Towers: Unsurprising loss on termination application – an interesting look at the impact of strata loans on owners

Mascot Towers' History – a tragic tale

Mascot Towers has had an unfortunate history. Construction was completed in 2009, however building defects were subsequently found. The owners corporation commenced proceedings against the builder, developer and building manager and these proceedings were settled. Then in April 2019, significant structural cracks were found in the transfer beams. In June 2019, Fire and Rescue NSW issued an order that all occupants be evacuated because the building was deemed to be unsafe and at risk of collapse.

The owners corporation engaged various building consultants about rectifying the towers and the estimated costs were in the millions.

In October 2019, the owners corporation resolved to enter into a $10 million multi-drawdown finance facility with Lannock Capital 2 Pty Ltd ("**Lannock**") to partly fund some of the rectification works.

In November 2020, the owners corporation resolved to enter into a second loan from Lannock for $22.5 million.

Interestingly at this meeting, the owners corporation also resolved to consider 'doing nothing' in terms of the remediation other than making the building safe so that a collective sale could be investigated.

In April 2021, the owners corporation received an offer from a developer for a collective sale in the amount of $42 million. However, around this time, the owners corporation became aware of another possibility – to seek to terminate the strata scheme.

In May 2022, the owners corporation commenced proceedings in the Supreme Court of NSW seeking to terminate the strata scheme pursuant to section 136 of the Strata Schemes Development Act 2015 ("**SSDA**").

Termination Proceedings

Section 135 of the SSDA provides power to make an order to terminate a strata scheme. Section 136 of the SSDA provides that a termination order may include directions about a multitude of things include the sale or disposition of property of the owners corporation and the discharge or liabilities of the owners corporation.

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Following the commencement of proceedings, multiple banks were joined who held mortgages over various lots in the building. Additionally, Lannock was joined to the proceedings given that it was owed millions of dollars by the owners corporation.

However, the Supreme Court has never considered a termination case in circumstances where the owners corporation submitted it was insolvent and could not pay its debts, the application was not brought by all owners and there were multiple competing creditors who all had concerns about the proceeds of the sale of the owners Corporation's assets.

There were three broad questions before the Court:

1. Whether the strata scheme should be terminated?
2. If a termination order was made, what directions ought to be made, including as to the priority of payment out of the owners corporation's pooled assets?
3. How the termination process should be administered and by whom?

The Court's determination

The Court considered the financial evidence before it, noting that the parties' experts agreed the further rectification costs would be at most $21.5 million and that lot owners could re-occupy within 6 months. The Court also noted Lannock's unchallenged evidence that the current value of the building was $59.75 million and if rectified, would be valued at about $122.3 million.

Unsurprisingly, based on the evidence before the Court that it was more commercial to fix the building rather than to terminate the owners corporation and sell the building in its current state. Therefore, the Court rejected the application to terminate.

The Court held at [71] – [72]:

> *"In all cases where a termination of a strata scheme has been ordered, it has been done cautiously, and only where every lot owner within the scheme seeks such an order. That is not the case here.*
>
> *While in 2022, a resolution was passed at a general meeting to make the termination application, not every lot owner was at the meeting, and not all those present voted in favour of the resolution. Where there is not a unanimous desire to sell all lots in a strata scheme, Part 10 of the SSDA provides a mechanism for a 75% majority of owners to nevertheless apply for a Court order approving the collective sale of the all the lots. Reluctant owners can be compelled to join in a collective sale, but only after various detailed procedures found within ss 170-190 SSDA have been satisfied, and the Land and Environment Court approves a specific sale (see s 182 SSDA). Such a process provides all lot owners with certainty about a sale price and process, with a clear and known outcome for each of them."*

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The Court concluded at [84]:

> *"Put simply, the Court was not prepared to terminate the scheme as an alternative to a failed collective sale process and where it was not necessary to demolish the building. I agree with that approach."*

Points of interest from the decision

Whilst not needing to determine this issue, the Court considered the priority of the payment of debts relating to the unsecured strata loan from Lannock.

The Court held that on termination of the owners corporation, the proceeds of sale did not go to Lannock. Rather, the registered creditors (i.e. the individual owners mortgagees) were to be paid out first and the balance of any money would be paid to the individual owners. After this point, Lannock could pursue owners individually for the outstanding debts of the owners corporation.

To this effect, the Court held at [117]:

> *"An owners corporation is able to commit itself to an unlimited sum and thereafter levy lot owners for contributions to meet its expenses until sufficient funds are raised. To that extent only, it might be said that lot owners have "unlimited liability".*

This is obviously concerning as multiple owners in Mascot Towers are already facing severe financial distress. Following termination of the owners corporation, Lannock could pursue the remaining owners potentially into bankruptcy for the debts of the owners corporation.

Thus, any owners corporation considering obtaining strata finance should take into account the fact that individual owners have unlimited liability for the debts of the owners corporation. As a result, it may be preferable to meet large expenses by way of special levy as opposed to entering into strata finance.

So where to from here?

Following the commencement of SSDA that incorporated the strata renewal process into law, this has somewhat changed the landscape for buildings that may be uncommercial to repair. This is because owners corporations can now go down the path of the strata renewal process even in circumstances where they cannot get 100% support from all owners in the building.

Whilst there has been a longstanding provision in strata legislation to terminate schemes, the case law on the issue illustrates that the Court is hesitant to invoke this power and only does so in limited circumstances. The Court is also is very careful not to prejudice the interests of anyone affected by the termination.

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The Supreme Court made it very clear in these proceedings that termination was not the appropriate path to take in the circumstances and if anything, that the OC should have undertaken a strata renewal.

The below articles may also assist:
How to Terminate a Strata Scheme (Even if Required Consent is not provided by all parties)
Navigating Strata Urban Renewal: Commercial Gain vs Home Ownership
First Owners Forced to sell under the new 75% rules

If you have questions about strata renewal or concerns about the ability to repair your strata scheme please contact us at enquiries@bannermans.com.au or on 02 9929 0226. We have considerable experience and expertise in this area and can help guide you through this process.

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