# Building Management Agreements in New South Wales Strata Schemes

**By Gary Bugden***

**The strata title management rights industry in New South Wales has been in a growth phase for the past 5 years but it is now confronted by a more regulated legal environment.**

**An increase in the number of problems associated with on-site management arrangements, a series of recent cases and the changing face of strata titles legislation are all impacting on the development of the industry. This article examines the current position and looks at the prospects for the industry's future.**

"Management rights" over strata title properties are a native of Queensland, or more specifically, Queensland's Gold Coast. Their origin dates back to the 1970's when serviced apartments on the Gold Coast started to emerge as a popular form of holiday accommodation and a tax effective way for Sydney and Melbourne residents, in particular, to invest in a holiday home on Australia's sun belt.

## Historical background

The management rights "package" has traditionally comprised:

- A caretakers unit, which usually incorporates the foyer reception desk either as part of its title or as exclusively used common property[1]
- A management (or caretakers) agreement with the owners corporation
- A letting agreement with the owners corporation
- A number of special by-laws for the strata scheme.[2]

Sometimes the management agreement and letting agreement are combined in a single agreement, usually termed a "management agreement".[3] The final component of the package is a licence to permit the on-site manager to act as a real estate agent to lease or licence the individual units that owners place in a "rental pool" operated by the manager.[4] In New South Wales this licence is an on-site residential property manager's licence issued under the *Property Stock and Business Agents Act 1941* ("**Agent's Act**").

This category of licence was the key to the emergence of the management rights industry in New South Wales. A similar form of licence was first introduced in Queensland over 30 years ago, thus making it easy for "mum and dad" retirees in that State to acquire and operate management rights businesses. This, combined with the willingness of banks to finance the acquisition of these businesses on security of a mortgage over the unit and a charge over the agreements, fostered a secondary market for this type of business. Over the years the market has become so intense in Queensland that it has been necessary for the Government to tightly regulate it.

In New South Wales the industry did not develop until the 1990's, after the introduction of the on-site residential property managers licence in 1992. Prior to this the secondary market was limited to licensed real estate agents, who had little or no interest in the industry. The result was little prospect of capital appreciation of the businesses and very little growth or interest in them. In recent years property developers have been keen to market management rights packages for major projects and there has been growing primary and secondary markets for this product in a substantially deregulated environment.

### Consequences

This has resulted in some undesirable practices, particularly in relation to the sale of management rights by developers, and a range of problems being experienced by owners corporations. In turn this has generated litigation and prompted the intervention of the Parliament which enacted the *Strata Schemes Management Amendment Act 2002*, effective from 10 February 2003. This Act amended the *Strata Schemes Management Act 1996* ("**SSM Act**") which in 1997 re-enacted (in slightly different terms) the management provisions of the old *Strata Titles Act 1993* ("**Old Act**").

The cases emerging from these problems, combined with the legislative changes, have posed challenges to lawyers advising developers, managers and owners corporations about management agreements. They have also raised questions about the future of the management rights industry in New South Wales.

### The litigation

To date litigation about management rights has revolved around the need for a building manager to be a licensed strata managing agent in order to carry out various functions of the body corporate (later re-named 'owners corporation'). This initially arose from section 78(1AA) of the Old Act which prohibited a body corporate from appointing a person as a strata managing agent unless the person held a licence under the Agent's Act. However, the legal basis of the litigation was usually no more than a mechanism to remedy an underlying problem being experienced by the owners corporation (e.g. underperformance of the manager or unfair contractual arrangements).

The first problems arose in the retirement village context, involving arrangements that are not dissimilar to management rights, but in a substantially unrelated environment. In *Thomas and Ors v Regal West Pty Ltd; Regal Holdings Pty Ltd v Regal West Pty Ltd* (1990) NSW Titles Cases ¶80-010 a strata title body corporate entered into a management agreement with the village manager under which the manager agreed to do a number of things on behalf of the body corporate and for this purpose the body corporate delegated its powers and duties to the manager. This included a duty "to carry out all its obligations in relation to the common property". The manager was not a licensed strata managing agent and *Brownie J* held that there could be no delegation of body corporate powers in the absence of a valid appointment as strata managing agent. Because the manager was not licensed, section 78(1AA) of the Old Act was not complied with and the agreement was void for illegality.

This was followed by the decision of the New South Wales Court of Appeal in *Gillett v Halwood Corporation Ltd & Ors* (2000) NSW Titles Cases ¶80-055. In that case a body corporate became a party to a retirement village management agreement by authority of a resolution of its council (later re-named 'executive committee'). The manager under the agreement was not a licensed strata managing agent. The judge in first instance held that the council had the power to enter into the

agreement because by-law 2 of the fixed by-laws in the Old Act authorised the council to "employ … agents and servants … in connection with the exercise and performance of the powers, authorities, duties and functions of the body corporate". This power was seen as separate and distinct from the power of the body corporate by ordinary resolution of a general meeting to appoint and delegate to a strata managing agent under section 78(1) of the Old Act.

On appeal, the Court considered the relevant provisions of the Old Act and canvassed the distinction between an "employee" engaged by the council of the body corporate under by-law 2 and a contractor who was appointed and delegated by the body corporate in general meeting. It held that the body corporate did not become a party to the agreement because the affixing of its seal was beyond the power of the council, the agreement needing the authority of an ordinary resolution pursuant to section 78(1). Further, the actions of the manager in performing its functions under the agreement were not lawful because it was not a licensed strata managing agent as required by section 78(1AA) of the Old Act.

*Regal West* and *Gillett* were barely noticed by the fledgling industry. It was not until the decision of Hamilton J in *The Owners – Strata Plan No 51487 v Broadsand Pty Ltd* [2002] NSWSC 770 that alarm bells began to sound. In that case, the body corporate at an inaugural general meeting held on 4 December 1995 during the initial period of the strata scheme:

- appointed and made a delegation of powers, authorities, duties and functions to a strata managing agent for a period expiring on the date of the first annual general meeting of the owners corporation;
- resolved to execute a management agreement with Victoria Tower Management Pty Ltd ("**Victoria Tower**") as manager, but without any limitation in either the resolution or the agreement of the time during which the agreement was to operate; and
- approved a special by-law 28 (which is not relevant to the current discussion).

Victoria Tower subsequently entered into the agreement and at the time it did not hold a strata managing agents licence under the Agent's Act. Following an intermediate assignment from Victoria Tower, the body corporate on 6 May 1998, despite initially resisting on the basis that there were questions about the validity of the agreement, resolved at an extraordinary general meeting to approve its further assignment and entry into certain deeds for this purpose. The deeds were executed on 13 May 1998 and Broadsand Pty Ltd became the manager.

The Court held that:

- The agreement effected the appointment of Victoria Tower as a managing agent within the meaning of section 78(1AA) of the Old Act
- A clause declaring that the manager was not appointed as a strata managing agent under section 78(1) could not prevail over the substance of the agreement
- Because Victoria Tower was unlicensed the appointment contravened section 78(1AA) and the agreement was void for illegality
- The agreement was also void for contravention of the restriction in section 66(1)(a) of the Old Act that prohibited the appointment of a managing agent during the initial period for a period extending beyond expiry of that period
- Estoppel was not established by the defendant, but in any event the case was in a class where an estoppel cannot be availed of in the face of a statute.

This decision relied heavily on the distinction drawn in *Gillette's case* between a manager who was "employed" by the council of the body corporate under by-law 2 of the old fixed by-laws and a manager who was "appointed and delegated" as an independent contractor by a general meeting of the body corporate. The rationale was that a contractor would not in the ordinary course be subject to the immediate control and supervision of the body corporate and therefore it is consistent that the legislation requires them to be licensed. An employee, on the other hand, would be under the direct control of the council and therefore licensing was not necessary.[5]

Because all management agreements tend to be similar, *Broadsand* raised the real prospect that many New South Wales agreements, which had been acquired for substantial sums of money, were actually void. The next issue was whether this was restricted to agreements entered into under the Old Act or whether the problem also extended to agreements entered into under the SSM Act. The answer came in *Regis Towers Real Estate Pty Ltd v The Owners – Strata Plan No 56443* [2002] NSWSC 1153.

In that case the owners corporation and the manager entered into a "first agreement" based on the authority of a resolution of the executive committee. Subsequently, amendments to this first agreement were authorised by an annual general meeting and a "second agreement", incorporating the amendments, was then executed. The manager was a licensed real estate agent but did not hold a strata managing agents licence. The owners corporation claimed the 'agreement' appointed the manager as a strata managing agent because it delegated one or more functions of the owners corporation. As such it could not be authorised by the executive committee. In any event, it claimed that the agreement was void for illegality under section 20(3) of the Agent's Act because of the absence of a strata managing agents licence.[6] *Gillett* and *Broadsand* were cited as authority.

*Macready AJ* analysed the difference between the provisions of the Old Act and the SSM Act. He contrasted section 78(1AA) of the Old Act that prohibited the appointment of a person as a managing agent unless they were licensed strata managing agents under the Agent's Act with section 13 of the SSM Act. Section 13(1) authorised an owners corporation to employ persons to assist it to exercise its functions. Section 13(2) required it to ensure that any person employed has the qualifications (if any) required by the SSM Act and section 13(3) prohibited the delegation of its functions unless the delegation was specifically authorised by the Act. Division 1 of Part 4 of the SSM Act dealt with the appointment and delegation of managing agents and only allowed licence holders to be appointed.

His Honour took the view that the power to "employ" under section 13 of the SSM Act is different to the corresponding power under the old by-law 2, a view that was supported by clear expressions of intent by the Minister when the Bill for the SSM Act was debated in the Parliament. He distinguished *Broadsand* and having regard to the whole of the provisions of the first agreement held:

- there was no delegation of a function or functions of the owners corporation; and
- therefore, there was no breach of the prohibition in section 13(3) of the SSM Act against delegations not specifically authorised by the Act.

He reached the same conclusion in relation to the second agreement.

The likelihood is that *Regal West* has cleared up the issue for caretaker agreements entered into under the SSM Act. But in the meantime, in the face of ongoing problems being experienced by

owners corporations with managers appointed by developers, the legislature has not been standing still.

### Recent amendments

The *Strata Schemes Management Amendment Act 2002* amended the SSM Act in a number of respects:

- A caretaker has been formally recognised as one who may assist an owners corporation in carrying out its management functions[7]
- A new Part 4A has been inserted in Chapter 2 to regulate the appointment of caretakers[8]
- The key management areas of an owners corporation have been clarified so that the role of a caretaker is now clear[9]
- Caretaking agreements have been expressly included in the information available to purchasers and other persons seeking information from an owners corporation[10]
- The appointment of a caretaker or other person to assist in the management or control of use of the common property during the initial period has been restricted in the same way that it was for strata managing agents[11]
- A Tribunal is given jurisdiction to make a range of orders in relation to caretaking agreements (e.g. terminating or varying the agreement)[12]
- The ability of developers and caretakers to influence the decisions of the owners corporation has been further restricted by changes to the priority voting and proxy provisions[13]
- Transitional provisions have been inserted to preserve the terms (i.e. duration) of existing caretaker agreements[14] and to extend the new proxy provisions to existing proxies[15]

These amendments present a whole new range of issues for developers and their lawyers who in the future seek to establish management rights in strata schemes. However, they clearly put to rest any suggestion that in future arrangements a caretaker will need to be a licensed strata managing agent in order to effectively perform their role.[16] They also make it clear that an owners corporation now has the power to appoint a caretaker and remove the need for empowering by-laws.[17]

### Future prospects

As regards the future of the industry in New South Wales, in the view of this author the position can be summarised as follows:

- Management rights established under the Old Act (i.e. before 1 July 1997) will most likely be at risk of invalidation on the basis of the decision in *Broadsand*. Documents associated with those rights will need to be carefully analysed and in many cases may need to be re-documented with the co-operation of the owners corporations.
- Management rights established between 1 July 1997 and 10 February 2003 may be at risk, depending upon the functions of the owners corporation that the manager is required to perform. These too should be analysed to determine whether they are likely to benefit from the decision in *Regis Towers*. If there is any doubt, they should be re-documented.
- Management rights established post 10 February 2003 should not be a problem, assuming they follow the intent of the amendments to the SSM Act that took effect in 2003.
- All caretaker agreements entered into before 10 February 2003 will be subject to review and termination by the Consumer, Trader and Tenancy Tribunal in the same way as

"caretaker agreements" (within the new defined meaning) entered into after 10 February 2003, except that their term will not be subject to review.

These 2003 amendments will be inconvenient for developers but will not necessarily resolve the problems experienced in the past by lot purchasers and owners corporations. This is because of the way in which the amendments attempted to address those problems.[18] Therefore, further amendments can be anticipated and it is in these amendments that the real risk lies for the industry. In the meantime, the management rights industry in New South Wales is in a position to further develop and prosper provided it is based on equitable and carefully drafted agreements that are fully disclosed to purchasers and caretakers perform satisfactorily.

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[1] The right of exclusive use is granted in a by-law pursuant to section 52 of the *Strata Schemes Management Act 1996*.
[2] Of the two most common by-laws, one is an empowering by-law that seeks to extend the powers of the owners corporation to enter into the management and letting agreements (thus trying to avoid ultra vires agreements of the type dealt with in *Humphries & Anor v The Proprietors "Surfers Palms North" GTP 1955* (1994) 179 CLR 597; (1994) NSW Titles Cases ¶80-027). The other is a by-law purporting to confer letting business exclusivity on the owner of the caretaker's lot.
[3] They were originally kept separate in Queensland because the licensing provisions in that State required the manager to have body corporate approval as a pre-condition for a resident manager's licence. If the management agreement was terminated by the body corporate, or invalidated, the manager still had the letting agreement containing the necessary consent. In recent times interdependency clauses have defeated this objective and effectively removed the benefit of separate agreements.
[4] The rental pool is usually voluntary and in most cases **does not** involve the pooling of income and payment of expenses from the pool.
[5] See comments of Hamilton J in paragraph 17 of his judgment.
[6] Section 20(3) of the Agents Act was a general prohibition against carrying on the business of a strata managing agent without an appropriate license under that Act.
[7] See section 9(c) of the SSM Act (i.e. in its amended form).
[8] This includes a restriction on appointments for terms exceeding 10 years.
[9] Section 61(1).
[10] Sections 108(3)(i) and 109(4).
[11] It must not extend beyond the holding of the first annual general meeting - section 113(1)(c).
[12] Section 183A.
[13] Schedule 2 Part 2, clauses 7, 10 and 11.
[14] However, the wording of the transitional provision (Sch 4 Pt 4 cl 12) effectively catches all caretaker agreements entered into before 10 February 2003 and brings them within the review provisions of the new section 183A. The only concession is that the agreements cannot be reviewed as regard their term.
[15] Schedule 4, clauses 12 and 13.
[16] The focus will be on ensuring that the caretaker's duties conform with the role envisaged for the caretaker in the new definition of "caretaker" in section 40A of the SSM Act; that their appointment conforms with Part 4A and that they are not actually delegated the functions of the owners corporation.
[17] However, it should be kept in mind that the decision of the High Court in *Surfers Palms North* was more concerned about the power of a body corporate to engage and remunerate a letting agent rather than the engagement of a caretaker. Therefore, when drafting combined agreements it is still important to ensure that the caretaker is "authorised" to conduct the letting operation and not "required" to conduct it.
[18] Full disclosure of management rights arrangements to purchasers is still not required. There is scope to circumvent the amendments by ensuring that the manager is not a "caretaker" (because one of the qualifications for a person to be a caretaker is for the person to have exclusive possession of a lot or common property). Also, developers can still procure entry into agreements at the first annual general meeting by capturing voting rights from purchasers.

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