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REPLACING ITEMS OF COMMON PROPERTY JUST GOT MUCH HARDER

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REPLACING ITEMS OF COMMON PROPERTY JUST GOT MUCH HARDER

The NSW Supreme Court has recently handed down a decision that will have a considerable impact on the practice of strata managers across the State. The Court's decision answers the following often asked questions:

- What type of resolution does an owners corporation need to pass in order to replace an item of common property?
- Is the replacement of an item of common property a repair that can be authorised by an ordinary resolution?
- Or does a decision to replace an item of common property need to be made by special resolution because the replacement of the item will improve or enhance the common property?

Introduction

The case of *Glenquarry Park Investments Pty Ltd -v- Hegyesi [2019] NSWSC 425* involved a dispute between the owners of an apartment building on the waterfront in Point Piper in Sydney's Eastern Suburbs. The building was constructed in the 1930's and was converted to a strata title building in 1981. The building contains 4 levels and a basement. Each level is serviced by a lift. There are items of common property in the building which are old and worn and require repair or replacement. There is a dispute among the owners as to the nature and scope of the work that should be done to repair or replace items of common property. The owners of 3 lots who hold 52% of the unit entitlement (**majority owners**) want to refurbish parts of the building at a cost of several million dollars. The owners of 2 of the lots (**minority owners**) consider the proposal for refurbishment of the majority owners to be too extensive and expensive.

The Refurbishment Proposal

In 2006 and 2007 an architect engaged by the owners corporation prepared concept plans for the refurbishment of parts of the building at an approximate cost of $3.9 million. The plans for the refurbishment included a proposal for a new lift and lift shaft, refurbished lobbies and a new penthouse to replace a parking area on the top floor of the building. In 2009 the architect of the owners corporation lodged a Development Application with the Local Council for consent to pursue the refurbishment proposal. In 2010 the Development Application was approved by the council. In May 2015 the owners corporation passed a resolution for the architect to act on the development consent granted by the council and at that time the architect produced drawings and a scope of work for the refurbishment in accordance with the development consent at an estimated cost of $2.2 million.

The Dispute Erupts

In August 2016 the owners corporation held an Extraordinary General Meeting. The majority owners proposed resolutions covering 18 items of work. Each resolution was first proposed as a special resolution and if it did not pass as a special resolution a further resolution was in most cases proposed as an ordinary resolution. Each resolution concerning the refurbishment proposal failed as a special resolution but passed as an ordinary resolution. A further ordinary resolution was passed to raise a special levy in the sum of $2.1 million to fund the refurbishment. After the meeting, one of the minority owners, Ms Hegyesi, applied to a Strata Schemes Adjudicator for orders to (among other things) prevent the owners corporation embarking on the refurbishment without passing a special resolution. Ms Hegyesi's application was dismissed by the Adjudicator and she appealed to NCAT. In August 2017 NCAT allowed the appeal and made orders restraining the owners corporation from carrying out various work associated with the refurbishment of the building unless it passed a special resolution to authorise that work. NCAT also made orders to require the owners corporation to carry out certain repairs to items of common property and appointed a compulsory strata manager.

The Supreme Court Appeal

The majority owners appealed against NCAT's decision to the Supreme Court. The key issue for the Court to determine was the type of resolution the owners corporation needed to pass to enable items of common property to be replaced either separately or as part of the refurbishment of the building. This required the Court to consider:

- (on the one hand) the duty of an owners corporation to maintain and repair and, where necessary, renew or replace items of common property by *ordinary resolution* under section 106 of the *Strata Schemes Management Act 2015* (**Strata Act**); and
- (on the other hand) the power of an owners corporation to alter or add to common property including replacing items of common property for the purpose of improving or enhancing the common property by *special resolution* under section 108 of the Strata Act.

The Lift

At the August 2016 Extraordinary General Meeting, the owners corporation had passed an ordinary resolution to replace the lift shaft and the lift. The motion to approve this work by special resolution was defeated because the minority owners voted against it. The Court had to decide whether the replacement of the lift and lift shaft would involve the replacement of an item of common property in the course of the owners corporation's duty to maintain and repair the common property under section 106 of the Strata Act or an improvement or enhancement of the common property done under section 108 of the Strata Act.

In September 2014 the owners corporation obtained a report from a lift consultant concerning the lift. The report revealed that the lift was 80 years old, did not meet current building code requirements and often stopped out of alignment with one or more floors of the building. The report also noted that wear and tear would eventually catch up with the lift and at some point in time replacement parts would be impossible to obtain meaning the lift could become inoperative for an extended period. But the report indicated that provided a lift maintenance contractor could continue to source spare parts and carry out maintenance to the lift on a regular basis, the lift could continue to operate for many more years.

The Competing Arguments

The majority owners argued that once an item of common property was in need of maintenance or repair work, or replacement work, the owners corporation had an obligation to undertake the necessary work and it should be up to the owners corporation to choose how to do so. In other words, the majority owners said that the owners corporation should get to decide, by ordinary resolution, whether it would repair or replace an item of common property that was old and worn.

The Court expressed some sympathy for the argument of the majority owners and noted that there was force in the argument that there should be a degree of latitude extended to an owners corporation in deciding what should be replaced and when that replacement should occur. Indeed the Court observed that the replacement of an old and obsolete item may be cheaper and more effective in the long run than continuing to try to patch it up.

However, the Court also said that the purpose of the requirement for an owners corporation to approve, by special resolution, improvements or enhancements undertaken to the common property was to protect minority owners in a building from having the costs of enhancement imposed on them by the majority. The Court observed that the minority may prefer to continue to “eke out” the existing items of common property even if in the long run that may prove more inefficient and expensive because, for example, they may have less money to spend or their priorities may be different. For that reason, the Court considered that the legislative purpose of that requirement could be subverted if unnecessary costs could be imposed on the minority at the discretion of the majority where, for example, an item of common property could be inexpensively repaired but the majority elect to replace that item at considerable cost.

The Court considered that the lift in the building illustrated this tension between the rights of the minority and majority owners very well. This was because the lift consultant’s report demonstrated that it would be possible to continue to patch up the lift but that may not be the most cost effective way to proceed but that the replacement of the lift was originally conceived as part of the overall plan for the refurbishment of the building which was clearly an enhancement of the common property.

Could the Lift be Replaced by Ordinary Resolution?

Ultimately, the Court concluded that an owners corporation is only required to replace an item of common property where it is reasonably necessary to do so. This means that the duty of an owners corporation to replace an item of common property only applies where the item is no longer operating effectively or at all, or has fallen into disrepair, and can no longer be kept in a state of good and serviceable repair. The Court concluded that the replacement of the lift was not reasonably necessary because the lift consultant's report showed that it would be possible to continue to maintain the lift and that it could be expected to operate for many years into the future. Put simply, there was no evidence to demonstrate that a new lift or lift shaft was required. In other words, the lift was operating in accordance with its design requirements, could be kept operating into the future and had not reached the point where it could no longer be kept in a state of good and serviceable repair. For that reason, the Court concluded that the functionality of the lift could be maintained without replacing it and therefore the proposal to include a new lift would be an improvement or enhancement of the common property and not the maintenance or reinstatement of the functionality of the lift. Consequently, the Court upheld NCAT's conclusion that the replacement of the lift and lift shaft needed to be authorised by a special resolution of the owners corporation.

Cement Render and Painting

The building contains double skin masonry façade walls. The brick ties in those walls had corroded and the bricks and mortar of the walls had deteriorated. In 2014 a building consultant engaged by the owners corporation had indicated that one of the options available to repair the masonry walls was to cover the entire façade of the building with cement render and paint it. At the August 2016 General Meeting, the owners corporation passed an ordinary resolution to cement render and paint the façade of the building. The Court was required to determine whether that work could be approved by ordinary resolution. The Court concluded that the existing functionality of the external walls of the building could be restored by repairs to the damaged bricks and mortar as a result of which rendering those walls would be an enhancement of the common property as that would go beyond restoring the walls to their previous functional state. For that reason, the Court agreed with NCAT that the owners corporation could not render and paint the façade unless it had passed a special resolution authorising it to do so.

Orders to Repair the Common Property

At the request of Ms Hegyesi, NCAT had made orders to require the owners corporation to carry out certain repairs to various parts of the common property. Those orders were not expressed with any degree of precision. For example, NCAT had ordered the owners corporation to "repair the seawall"

and “repair or replace the brick ties and loose bricks”. The majority owners appealed to the Supreme Court against those orders. The majority owners said that the orders were not specific enough and left the compulsory strata managing agent of the owners corporation having to guess at what the owners corporation was required to do in order to comply with the orders. The Court agreed.

The Court observed that the orders did not specify the works the owners corporation would be required to do. This meant that the orders left it unclear as to what the owners corporation was being ordered to do and simply commanded the owners corporation to achieve a specified result by a specified date. The Court agreed with the majority owners that the owners corporation was left to guess what it was required to do by NCAT’s orders. The Court concluded that NCAT did not ask itself what works needed to be done in order for the owners corporation to achieve minimal compliance with its duty to repair the common property and frame its orders accordingly. Further, the Court concluded that it was unacceptable that the recipient of an order should be in any doubt as to what is required in order to comply with the order. For that reason, the Court set aside the repair orders made by NCAT.

An Interesting Point

In the course of its judgement, the Court considered the powers of NCAT to make orders, at the request of lot owners, for owners corporations to carry out repairs to the common property. The Court observed that NCAT has the power to make an order to resolve a dispute or complaint about, relevantly, a failure of an owners corporation to exercise a function conferred or imposed on it by or under the Strata Act such as its duty to repair common property. That power is now conferred on NCAT by section 232(1) of the Strata Act. However, the Court observed that what is now section 232(2) says that for the purpose of that section, an owners corporation is only taken to have failed to exercise a function if it decides not to exercise the function where an application is made to it to exercise the function and it fails for 2 months after the making of that application to exercise the function. The Court suggested that this meant that a lot owner would need to put to the owners corporation in a formal and concrete way a proposal for it to repair the common property and have that proposal rejected or not accepted after 2 months before the owner could apply to NCAT for an order to force the owners corporation to carry out repairs to the common property. That is a step that is often skipped by lot owners who apply to NCAT for orders to compel owners corporations to repair common property and it represents an interesting development of the law on that issue.

The Wash Up

There are two key points to take away from the case.

First, an owners corporation will only be able to authorise the replacement of an item of common property by ordinary resolution where it is reasonably necessary to replace that item because the item can no longer be kept in a state of good and serviceable repair. In other words, an owners corporation cannot replace an item of common property by ordinary resolution if the existing functionality of that item can be maintained without replacing it.

Second, when NCAT orders an owners corporation to repair common property, the order must be specific and identify exactly what work the owners corporation is required to do rather than contain a vague "wish list" of items which are in need of repair.

Conclusion

Ultimately, the effect of the decision in the case is that it will be more difficult for an owners corporation to replace items of common property that are old and worn but can still be maintained or repaired and do not have to be replaced in order to maintain their existing functionality as the replacement of those items must be authorised by a special resolution.

This has broad implications for many owners corporations across New South Wales particularly the numerous owners corporations of older buildings that are considering large capital works projects that involve replacement of various items of common property such as old windows and balcony doors at significant cost.

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About JS Mueller & Co

JS Mueller & Co has been servicing the strata industry across metropolitan and regional NSW for 40 years. We are a specialist firm of strata lawyers with in depth and unmatched experience in, and comprehensive knowledge of strata law and levy collection.

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