Hynes LEGAL

Management Rights

Separating your lot from your management rights business

Banks like real estate. We all need somewhere to live. These largely underpinned the creation of the typical management rights business model of a home with an income.

Back when real estate wasn't as expensive, multipliers weren't as high and banks didn't care as much about serviceability as they do security, it all worked without much of an issue. That has changed, which has led to us receiving lots of requests from clients about separating their lot from their management rights business.

Every management rights business is different. There are no hard and fast rules, but in general terms, these are the issues that come if you want to consider doing breaking that link of your home and your income.

Let's start with the legalities.

By-laws

The by-laws usually provide a form of protection through special usage rights being given to the owner or occupier of the manager's lot. These by-laws can all be framed differently. Some define a specific lot by reference to the lot number. Some define a lot 'associated' with the holder of the management rights agreements. Some allow different lots to be nominated from time to time (sometimes not by the manager).

Whatever the position, it remains critical that if you are looking to be able to use the lot associated with the management rights business independently of the management rights business itself that any special usage rights associated with it are cleared up.

There is no point separating the lot from the business and leaving the special rights associated the lot in place. That could lead to the position where the later owner or occupier of that lot could notionally compete with the owner of the management rights business (be that you or a later purchaser). That is a very real legal due diligence issue for a buyer and their bank.

Changing the by-laws will require a special resolution at general meeting.

The lot itself

Some lots may be capable of being split into two separate lots – being an office lot and a residential lot. There is a bit in this legally in terms of dealing with the local authority and the body corporate about the subdivision. One of the issues is apportioning lot entitlements of your existing lot into your two 'new' lots.

There are also practical considerations. If your office is the third bedroom or garage of your townhouse, you aren't much chance of getting it onto a separate title. If you are in a tower (or low rise) with a distinct office component/area, it is usually more achievable.

This is an idea in the sense that if you manage to split your lot into residential and business real estate, you can retain special rights with the business part and look to be able to do something else entirely with the residential part. It also will reduce the value of the real estate component in any transaction (the 'dead money' bit that doesn't produce income).

The management rights agreements

This is a bit clearer. You need to look at what obligations the management rights agreements include about:

1. Owning a lot; and
2. Residing onsite. Remember – the *Property Occupations*

Act does not require you to reside onsite anymore as a condition of your resident letting agents licence, but that does not mean that the obligations in the management rights agreements to reside onsite have changed. If you are contractually bound to live in a lot you must.

An alternative here might also be not to have an obligation to own a lot but to have an obligation to reside onsite in a lot. That could be owned by you or one of your investors. This can be a bit scary for financiers though because they will always ask the question of what happens if there is no lot available to rent. Not living onsite would be in breach of your management rights agreements.

The end game here should be seeking the maximum flexibility you can provide without alienating the body corporate in the process.

Any changes to your management rights agreements will require an ordinary resolution at general meeting. If the changes do not relate to the term of the agreements, they will not require a secret ballot.

Now to the commercialities.

It is all well and good to go down a legal path, but there is literally no point even spending a cent if you don't understand the likely outcome. The old adage of not asking a question you don't already know the answer to applies very much to this topic.

Your committee

If your committee is hell bent on you living onsite, you need to make sure you promote the concept of 'decoupling' very delicately. There is a communications process here you need to manage. Simply getting the legal documents done and lobbing them by email to the body corporate manager on the last day of the body corporate's financial year for AGM purposes without talking to your committee is definitely not the way to go.

The immediate objections here to overcome (and our immediate answers) are usually:

'We pay you to live here'

No. I just happen to live here. I do what I need to do during the day. I am not supervising contractors or mowing lawns at night.

'What happens if there is an emergency?'

The people aware of the emergency ring the police, the ambulance or the fire department. There is nothing I can do about any of those anyway.

'What happens if we need by-laws enforced?'

You do what lawfully you must – which is deal with a notice of breach of by-laws through the body corporate manager tomorrow. If it is an owner occupier there is nothing I can do anyway. I it is a tenant for a lot mi manage, let me know and I will deal with it under the terms of the lease with the instructions of the owner. If it is an outside agent, you should let that owner know why I am best placed to deal with managing their tenants too :)

And so on!

Your bank

You need to engage with your financier (or your chosen finance broker) early in the process. From a bank's perspective, the obligation to own a lot or reside onsite probably will not matter that much. Your financier will become much more interested is if you do get it all passed and then want to sell your lot or your business as a separate asset.

Bank's lending policies all differ. How much they lend and what they secure it over all depend on their credit policies (which are usually driven by where they have had bad experiences in the past).

Banks love residential real estate as security. If you (or a subsequent buyer) don't have that to offer, the bank's lending ratio might be a bit less than for the standard management rights structure (unit and business). If you are successful in decoupling, what the bank requires you to repay on settlement of one asset or the other will depend on their policy on standalone real estate or management rights businesses. It is worth at least having a basic understanding of what that might mean if you are looking to sell the unit or business separately.

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Voting rights

Not owning a lot means you won't have the rights to vote at general meetings or submit motions for the AGM. In a sense you become what we are when we act for bodies corporate, which is a third party contractor, (although your connection with the scheme is obviously far tighter). This is where keeping that little bit of office real estate (if you can) works for you.

Do you do it all at once?

If you have a longer term time frame, it may be better to take this on in bite size pieces over consecutive annual general meetings (i.e. changing the obligation for ownership of lot first then residing onsite second). Having said that, if you think the mood is such that it will all get through first time around, then there is no need to hold back.

As always, we can help with both the legalities and the strategies and can work on fixed fees for almost all of this process as it is very structured.