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Preparing community title sale contracts

The impact of recent amendments¹

Preparing a community title sale contract in a way that prevents cancellation by the buyer has always been a challenge for real estate agents and lawyers. However, the task has become more difficult since 4 March 2003 when the *Body Corporate and Community Management and Other Legislation Amendment Act 2003* commenced.

In the case of contracts for sale of existing lots:

- obtaining and attaching an accurate Disclosure Statement²;
- ensuring the Information Sheet³ is properly affixed;
- ensuring the Warning Statement⁴ is properly affixed; and

¹ Section references are as at 14 March 2003. It should be noted that the Parliamentary Counsel is expected to renumber the sections when the next consolidated version of the *Body Corporate and Community Management Act 1997* (“BCCM Act”) is prepared.

² Section 163 of the BCCM Act.

³ Natural Resources Form BCCM 14 (Version 1).

⁴ Fair Trading PAMD Form 30c.

- completing the Additional Body Corporate Information panel in the Reference Schedule

is challenge enough. But all of that is relatively easy when compared to completing the Seller’s Disclosure section of the standard REIQ Contract, particularly given the recent changes.

Seller’s Disclosure

The Seller’s Disclosure section of the contract is often neglected by those who prepare sale contracts, particularly real estate agents. There has been a tendency to insert statements such as “*Enquiries will reveal*” or “*Seller is unaware*”. These types of statements are not at all useful and may put the contract at risk of cancellation or expose the seller to a claim for damages.

The Seller’s Disclosures are directly related to the warranties implied in all community title contracts by section 180 of the *Body Corporate and Community Management Act 1997* (“BCCM Act”). Those warranties cannot be excluded and are designed to protect buyers who are effectively buying into the existing problems of the community titles scheme and its building. The disclosures are the means by which the seller is protected from cancellation of the contract or a claim for damages for breach of warranty. Everyone who prepares a community title sales contract needs to have a thorough understanding of these implied warranties and their relationship to the Seller’s Disclosures.

The need to complete the Seller’s Disclosure section of the contract is not new. However, since the March 2003 amendments, this part of the standard contract has become more critical because of the changes to the wording of the warranties and an increased risk of contract cancellation and claims for damages.

Potential liability

A person preparing a Contract, whether a lawyer or a real estate agent, is acting on behalf of a seller and must protect the seller’s interest. While the standard of care required of

a lawyer will be higher than that required of a real estate agent, the agent will almost certainly be expected to fully understand the legal requirements for preparing the contract and to go about the task in a competent way, having regard to the normal standards of competency of agents. This requires the agent to pay particular attention not only to the warranties and statements in the sale contract and Disclosure Statement, but also to the implied warranties in the BCCM Act.

If the lawyer or agent fails to act competently and the seller suffers a loss as a result, they will incur a liability to the seller to compensate for that loss. The loss can be particularly significant if the seller, to the knowledge of the person preparing the contract, is buying another property and is dependant on the sale proceeds to complete the purchase.

The implied warranties

Section 180(2) of the BCCM Act implies in every contract for sale of community title lots⁵, the following warranties which must be satisfied **as at the date of the contract**:

- (1) To the seller's knowledge, there are no latent or patent defects in the common property or body corporate assets, other than the following –
 - (a) defects arising through fair wear and tear;
 - (b) defects disclosed in the contract.
- (2) The body corporate records do not disclose any defects to which the warranty in (1) applies.⁶
- (3) To the seller's knowledge, there are no actual, contingent or expected liabilities

⁵ Although the warranties implied in contracts for the sale of proposed lots by section 180(2) of the BCCM Act are probably ineffective because they apply as at the date of the contract and, as at that date, no body corporate is in existence. (See *Gelski v. Dainford Limited* (1985) NSW Title Cases ¶30-061.)

⁶ Note that this is an absolute warranty and does not depend on the state of knowledge of the seller.

of the body corporate that are not part of the body corporate's normal operating expenses⁷, other than liabilities disclosed in the contract.

- (4) The body corporate records do not disclose any defects to which the warranty in (3) applies.⁸

In addition to these warranties, section 180(3) of the BCCM Act implies a warranty by the seller that, as at the completion of the contract, to the seller's knowledge, there are no circumstances (other than circumstances disclosed in the contract) in relation to the affairs of the body corporate likely to materially prejudice the buyer.⁹

The seller's knowledge

While some comfort can be taken from the limitation of some warranties to "*the seller's knowledge*", that comfort is eroded somewhat by section 180(4) of the BCCM Act that says a seller is taken to have knowledge of a matter if the seller had actual knowledge "*or ought reasonably to have had knowledge of the matter*".¹⁰

Consequences of breach of the warranties

⁷ Normal operating expenses would probably include most, if not all administrative fund expenses. This is because the cost of "operating" the body corporate is borne by that fund. However it is most unlikely that any sinking fund expenses would be a "normal operating expense".

⁸ This also is an absolute warranty and does not depend on the state of knowledge of the seller. Therefore, if, by way of example, a building needs to be painted and this fact is recorded in the minutes of the body corporate, the cost of the painting would not be a normal operating expense and would need to be disclosed in the Seller's Disclosure section of the contract if a breach of the warranty is to be avoided.

⁹ The BCCM Act itself gives 2 examples of likely material prejudice; the appointment of an administrator and the affairs of the body corporate are in such disarray that the buyer has no reasonable prospect of finding out if the warranties have been breached.

¹⁰ Thus a seller who fails to read correspondence and copies of minutes sent to them by the body corporate may have imputed knowledge of the contents of those documents.

The buyer may, by written notice to the seller, cancel the contract if there would be a breach of any of these implied warranties were the contract to be completed at the time it is in fact cancelled. The buyer must however act within 14 days of the later of the following to happen:

- the buyer's copy of the contract is received by the buyer or a person acting for the buyer;
- another period agreed between the buyer and the seller ends.

In simplistic terms, the buyer can cancel the contract at any time within the relevant time limit. It is not necessary for the buyer to establish material prejudice or other adverse effect. The seller must then repay all moneys.

Even if the contract is not cancelled the buyer may have a claim for damages against the seller for breach of the warranties.¹¹

Protecting against breach of the warranties

The best protection for the seller against breach of the warranties is to make full disclosure about:

- latent or patent defects;
- actual contingent or expected liabilities; and
- special circumstances of the body corporate.

In other words, the Seller's Disclosure section of the Contract must be carefully and fully completed. This can only be done if the person preparing the contract either:

- interrogates the seller (who would need to be knowledgeable about the affairs of the body corporate) using a comprehensive check list; or
- carries out a comprehensive search of the body corporate records and

¹¹ Section 179(2) of the BCCM Act says that the cancellation rights are in addition to, and do not limit any other remedy available to the buyer for breach of the warranty.

discloses the relevant results in the Seller's Disclosure section.

A body corporate records search agent (appropriately insured) may be willing to provide a completed Seller's Disclosure for immediate annexure to the contract. Alternatively, a records inspection report could be annexed to the contract and a simple endorsement along the following lines could be placed in the first 3 parts of the Seller's Disclosure section of the Contract.

“All those disclosed or referred to in the attached Records Inspection Report.”

In either event, it is most important that the information for the Seller's Disclosure section of the contract is not obtained from the body corporate manager, other than through an independent inspection, because:

- the manager is not legally entitled under the BCCM Act to give the information in any other way;
- if they do so it is most unlikely that they will be covered for errors by their professional indemnity insurer;
- they will be acting in conflict with their duty to the body corporate; and
- the body corporate itself may incur a liability to the purchaser for an error.

Why are these warranties so strict?

At first sight these warranties appear to be unfair on the seller. That raises the question why the legislature has gone to such extremes to protect purchasers of community title lots.

The answer lies in the nature of a community title body corporate. From a legal perspective it is akin to an unlimited liability corporation. That is, its members (the lot owners from time to time) must contribute (if necessary, to the full extent of their personal assets) to discharge the unfunded liabilities of the body corporate. For example; if a body corporate incurs a liability for damages for personal injury for \$8 million but it is only insured for \$5 million, then the difference (\$3 million) must be paid

by the body corporate itself from funds raised from lot owners. If it does not raise those funds an administrator may be appointed to forcefully raise the funds and discharge the debt.¹² Of course, the position would be even more drastic if the body corporate's insurer had collapsed or, for some reason, refused to meet the claim.

It follows that the buyer of a lot in a community titles scheme is concerned to ensure that everything is in order with the affairs, including finances, of the body corporate. The implied warranties are intended to protect the buyer in this regard. The buyer is further protected by their lawyer who is concerned to ensure that there is nothing in the records of the body corporate that could result in a breach of any of the seller's express or implied warranties.

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¹² See new section 247A of the BCCM Act.