DISCUSSION PAPER – RESPONSE

OFF THE PLAN CONTRACTS FOR RESIDENTIAL PROPERTY

SUMMARY

Dentons acts for a substantial number of developers in NSW.

For the reasons stated below in our responses to LRS's questions, as a general statement, it is submitted:

1. that rather than a wholesale adoption of the initiatives under consideration more will be achieved by:

    a. adopting a modest mandatory disclosure regime;

    b. procuring the development of a standard contract for off the plan sales;

    c. any sanctions for non-disclosure to be limited to intentionally wrongful conduct.

2. many of the initiatives do not address issues which particularly concern or harm the interests of off the plan buyers;

3. the wholesale adoption of the initiatives under Minister's consideration, principally the permission of pre-completion claims for compensation, could significantly negatively impact the development industry at a time when the market has cooled significantly. It should be understood that settlement funds are already to be negatively impacted in and from 2018 by:

    a. the early deduction of the GST component of completion funds to the ATO; and

    b. developer bonds.

A New Standard Form Contract for Off-The Plan Transactions

It is submitted that the Minister should consider an approach to the relevant Law Society & Real Estate Institute of NSW conveyancing committee seeking to arrange for a modified format contract for off-the-plan sales.

With the advent of electronic contracts it seems to us that the head page of the contract should have a clear statement of the following:

- DA or no DA (it being taken that the land is properly zoned unless otherwise disclosed).
- Sunset Date plus limit of available extensions.
- Price, deposit, balance of price.
- Reference to a Floor Plan or alternatively a statement as to the number of bedrooms.
- Deposit to be held by agent or solicitor stakeholder or released.
- Land tax to be adjusted or not.
- Nominated council, water and land tax numbers for adjustment.

In short, all key information should find its way to the front page. Whether transactions are conducted by paper or electronically, this addresses the very significant differences between features of an

off-the-plan sale and the 2017 version of the current standard form contract endorsed by the Law Society & Real Estate Institute of NSW .

If, as would seem appropriate, a level of mandatory disclosure is to be imposed, this seems to be an excellent opportunity to bring in a universally adopted form to integrate the disclosures with existing disclosures in the right contractual matrix.

Question 1 - Is a separate mandatory disclosure regime needed for off-the-plan contracts?

Dentons response - Yes. This is because the current mandatory disclosure regime for existing built form does not go to some of the disclosures which are made (in any event) by experienced practitioners engaged in the off the plan conveyancing.

Question 2 - Is there a benefit in mandating a prescribed disclosure statement for all off-the-plan contracts?

Dentons response - Yes but not for non-residential off-the-plan contracts.

Many of the standard warnings in the current Law Society/REINSW contract are irrelevant to off-the-plan buyers and could be dispensed with, ie smoke alarms, swimming pool warnings, etc. However, equally warnings to purchasers as to the dangers of a release of the deposit would be appropriate in an improved form of contract.

As for a proposed completion date, a disclosure of such a date is highly dependent upon when development consent, project finance and building contract is achieved.

The nub of this issue relates to whether the Minister seeks to enforce a claims regime for the developer getting its disclosures wrong without intent to do so.

It is never in the interest of a developer to delay a project. It is an overreach to punish the developer for guessing wrong as to its completion date, the final finishes, landscaping or other elements of the development which cannot be accurately predicted. So, while disclosure and inclusion of the suggested information will assist clarity in the contractual phase the prospect of pre-completion claims for compensation in respect of honest errors or misjudgements are not recommended.

In relation to the suggestion that details of a Sunset Date be included, we are not aware of any contract which does not deal with Sunset Date issues with adequate clarity. The only improvement which Dentons would urge is the inclusion of the date and available extensions on the head page so that all relevant information is caught in one place and is visible from the outset to buyers and their advisers.

Question 4 - Would buyers have more certainty if the following documents were included as part of the mandatory disclosure?

- **Proposed plan showing the proposed lot – Dentons response -** the Law Society/REINSW standard form presently accounts for a proposed plan showing the proposed lot to be an attachment to the contract – we are not aware of any circumstance where such a plan is not included in contracts and we are not aware of there being any issue to be addressed here.

- **Proposed by-laws – Dentons response -** generally speaking by-laws are attached to off-the-plan residential sale contracts or the model provisions prescribed by the LRS are deemed incorporated – again, a developer gains very little by exploiting a contractual right to change the by-laws – the developer has very little ongoing interest in the property after completion. Our experience is that most developers do wish the by-laws to be 'more or less' indicative of the final form. However, during the sales program it may become obvious that due to the demography and locale of the development, modifications will need to be made to the by-laws to render them attractive or suited to the buyers. Generally speaking rights to modify the by-laws are controlled by a 'material prejudice' measure before rights to rescind

can be exercised in circumstances where substantial adverse changes are made to the by-laws – we see no problem with by-laws disclosure being mandated but again on the basis that divergence from the by-laws and the finished product not be a strict liability but rather, the developer must, if challenged, be able to demonstrate that it included the draft by-laws in good faith based on circumstances at the time of the contract.

- **Proposed schedule of unit entitlement** – **Dentons response -** our experience is that this is not the 'evil' that the Minister's foreword indicates. Until unit entitlements can be actually 'known' we see little gained by a developer guessing at them especially if sanctions are to be imposed for a wrong guess. The comfort the development purchaser community takes is that the schedule of unit entitlement will be ultimately determined by a licensed valuer who will have regard to the value of the unit vis-à-vis the gross value of the units when determining the entitlement. We see little to be gained here by a change.

- **Estimate of proposed levy contributions – Dentons response –** we make a similar comment here. The developer is not an operator or manager of buildings. Future costs are inherently difficult to predict. Decisions taken by strata managers and the owners themselves will ultimately determine the extent to which costs can be controlled. Again, we see little to be gained by mandating this type of information particularly when the development period will span at least 2, if not 4 or 5 years depending on the circumstances and the information will ultimately be a best guess by an entity not particularly qualified to make that guess. On the other side, buyers are usually quite unconcerned as to the quantum of contributions which ultimately they will control once they are owners.

Question 5 – Are any of documents unable to be provided or would impose significant cost on developers if required at the time contracts are prepared?

For the reasons stated in response to Question 4, the 'benefit' of having figures stated in a disclosure statement are minimal when compared with the significant cost of retaining consultants to advise on what is ultimately a best guess.

It is important to appreciate that when compared to other mandatory disclosure legislation such as the Retail Leases Act, the requirement for disclosure in the retail context is made against hard current numbers and a measurable history of recent experience in the relevant centre – an intrusion into this area would be ill advised and of almost no benefit.

Question 6 – Variation of the disclosure statement

The significant foreword to this series of questions wrestles with the extent to which the developer may or must make changes during the development phase against the sanctions for making those changes.

Conveyancing practice has generally allowed purchasers to withdraw from the contract in circumstances where they are justifiably unhappy because they have been materially prejudiced by a change. How the change is characterised for the purposes of the contract is universally recognised to be a difficult thing to assess. Expressions such as 'substantial detriment', 'material detriment', etc appear in most contracts. The key issues to understand here are:

- The right to rescind is generally available but rights to claim compensation are usually contractually declined – this is done because the subjectivity associated with rights to claim compensation are generally unworkable and pose a real threat to an efficient settlements phase at a critical time for the financial success or failure of the project.

- The Law Society/REINSW printed form of conditions 6, 7 and 8 work relatively well for existing land and buildings. However, off-the-plan sales practice recognises the inherent uncertainties associated with changes which cannot be easily predicted. Again, the nature of an off-the-plan purchase is that it is a calculated bet by both parties that the initial image and

design is acceptable to statutory planners, capable of being built in the form presented at the display area and actually built that way.

Development cannot be an exact science and should not be regulated as though it were. This could only tend to depress activity at the wrong time in the cycle vis the negative impact of the imposition of vendor duty in 2005.

Question 6 – Should developers be required to notify purchasers where a change is made to

- **the proposed plan? - Dentons response –** it is not understood what is meant by 'change' – is it meant that the built form is changed or simply a plan is changed? Most developments are marketed when the development is either at a conceptual stage or approved by statutory planners but certainly way ahead of construction drawings.

  The entire development is constantly being 'changed' to one degree or another. The question is how fundamental and detrimental the changes are. Most standard contracts provide that <u>if</u> a change is notified to a buyer then the buyer has the right to rescind within a finite period of days This is done because it is important both to the developer and to its financier that if a buyer has a right to rescind arising from a significant change, that the buyer exercises its right promptly so that any remarketing and sale can occur within a reasonable period of time so that there can be some certainty of a completion in respect of the relevant apartment when time comes for settlement.

  Whether a change should be notified immediately is unnecessary. However, the requirement that a substantial change be notified should carry with it the following:

  (a) notification should occur no later than 14 days before completion;

  (b) the change should be in respect of a change to the relevant apartment – it is too onerous for a developer to guess whether changes to other parts of the scheme have any impact on a buyer;

- **the schedule of unit entitlements (for strata and community schemes) – Dentons response** – the registered strata plan will contain final details of the schedule of unit entitlements. This is already happening and we see no reason for elevation of this issue to a need for disclosure of change or variation other than in the ordinary course;

- **the by-laws or management statement – Dentons response –** the by-laws and management statement can be searched during the post registration phase. Whether the change has a material impact should be limited to whether the change affects the purchaser's unit.

  A prudent lawyer acting for a purchaser would be required to review the registered plan, by-laws or management statement to determine whether any changes have been made and to inform his/her client.

  The Law Society/REINSW contract requires that a schedule of unit entitlements be attached. However, this provision is regularly deleted because the attachment of a schedule of unit entitlements is typically premature in circumstances where values of units will change and are discernible at an early stage and changes are typically marginal.

Question 7 – Are there any other changes to the scheme that developers should be required to notify purchasers of?

Dentons response – Schedule of finishes – we say this because most contracts allow the developer some flexibility to substitute finishes of at least the same or equivalent quality. This allows the developer some flexibility to include different items where there are supply problems with the initially nominated item or where savings can be generated by purchase deals available from suppliers in

respect of items of equivalent value. Usually such changes are discernible upon final inspection and issues can be raised at that time. In our experience issues are very rarely raised. This is not as a consequence of any power imbalance because typically the focus is on defects at this point and that particular area of activity between vendor and purchaser is extremely active around settlement and afterwards.

Question 8 – Should notification of changes be required to be made at a set time before settlement can be enforced?

Dentons response –we would say at least 14 days before completion. With significant changes the issue should be left to the discretion of the developer. For reasons earlier stated if a change is very significant and a right to rescind would be applicable then clearly it is in the interest of all parties that the right be known at an early stage.

Question 9 – What period of notice is appropriate, 14 or 21 days?

Dentons response –14 days is adequate.

Question 10 – Should the developer be required to provide a copy of the registered plan to the purchaser before a notice to settle can be issued?

Dentons response – experience indicates that sometimes for some days the LRS is unable to complete the processes necessary to have the registered plan available to be searched by the purchaser. For similar reasons the vendor is in the same position. However, the vendor is in a position to provide a copy of the pre-registration lodgement version of the plan (and the surveyor). It is suggested that the Minister look into directing LRS to have all strata plans available on a dedicated website once they have been lodged for registration. Most, if not all, lodgements are now electronic and generally conducted by surveyors. Any scrutiny of the plan can take place without an obligation for developers to do what traditionally was a responsibility of a purchaser. Dentons see no purpose to the erection of a barrier to settlement which only delays the possibility of settlement at a time when both parties are usually focused on completing.

Purchaser's remedies for changes to the disclosure statement

Question 10 – Should the purchaser's ability to terminate a contract be based on the purchaser demonstrating 'material prejudice'?

Dentons response – for significant issues which affect a purchaser's property (ie the apartment) this presently represents industry practice and for that reason no change is recommended. However, if 'material prejudice' is to be legislated then the test must be objective and the remedy limited to rescission, not a claim for compensation. We say this because rescission is a test of the seriousness with which the purchaser regards the relevant change. If a purchaser is willing to walk away from its purchase and the change is substantial then the test could be said to be satisfied. However, in our experience rescissions rarely happen other than for significant reductions in space or such a fundamental change in the configuration of the unit that it is plain to both the purchaser and the developer that the property being sold is fundamentally different. In these rare circumstances after a rescission or the threat of one, the parties are free to renegotiate terms on the basis that the developer will be inclined to deal with an existing customer in a bid to come to a market quality arrangement.

Question 11 – Should any statutory termination scheme include as an alternative a claim for compensation?

Dentons response – no, for reasons stated in response to Question 10.

Question 12 - Cooling-off period – should the cooling off period be extended for off-the-plan contracts?

Dentons response – we are seeing quite a number of cooling-off extensions given where purchasers enter into contracts at launch days. Again however, caution needs to be taken here – there is a

serious question as to whether 'launch days' will be the norm over the next 5 years. We have seen an historic spike in off-the-plan sales contracts which has prompted the Minister's review. However there is no certainty that a similar spike will occur having regard to the political and economic environment associated with in-bound off-the-plan investment. Dentons' alternative proposal would be that having regard to the acceleration towards e-contracts there should be:

- a five business day cooling-off period for e-contracts actually sent to a solicitor / conveyancer electronically; and

- 10 business days for paper contracts.

Question 13 – If so, should the cooling-off period be 10 or 15 days?

Dentons response –presumably the days to which this section refers are business days. In that case 10 is more than adequate.

Deposit

Question 14 – Should legislation mandate that the deposit be held in the trust account of a stakeholder?

Dentons response – no. As an alternative Dentons would suggest that a modified form of contract would be explicit as to the amounts of the deposit, who the stakeholder is and whether or not it is released. The reference to release should have a link to a warning appearing in the contract stating that a released deposit is an unsecured loan to the developer. Dentons considers that preventing a purchaser from releasing a deposit reduces the inherent flexibilities associated with releases of deposit in circumstances where the developer is either fully or significantly self-funded and looks to its customers as a significant source of initial capital for the project. Provided the warning is in place this reduced measure should be sufficient.

Jurisdiction

Question 15 – Should NCAT be allowed to make orders as suggested?

The potential for NCAT to be used as a weapon by purchasers to delay completion is extremely high particularly in a market where buyers find compliance with their completion obligations unpalatable due to a slow real estate market or restricted lending conditions.

The construction of the contract, the factual matrix and the questions as to whether or not material prejudice can be objectively demonstrated and whether or not that material prejudice relates to the property or some other feature of the development have immense potential for delay.

Delay at the point of completion can be destructive particularly in circumstances where the developer is fully exposed to its financier.

Dentons' position is that in circumstances which merit it, the appropriate relief can be obtained in court and in circumstances where the purchaser's position is justified, it can refuse to complete, caveat its title and seek a declaration. The real danger here is that NCAT will be a refuge for lawyers looking to extract concessions in circumstances where changes have occurred but the purchaser is not in a position to settle. Serious consideration should be given to an effective cost regime and the right to be represented. There is simply too much evidence and law for the parties to be unrepresented and for there to be no sanction for a party which uses the system to extract concessions. At the completion stage vendors are quite often as vulnerable as purchasers.

Question 16 – Should a condition be inserted in a contract for sale requiring parties to attempt to settle disputes through arbitration?

Dentons response –– again, for issues of major concern such as defects, most contracts have a right for issues to be determined by an independent expert. The question of whether or not arbitration should be resorted to should account for two issues:

- whether the arbitration occurs before or after completion; and
- the Minister should understand that the costs of arbitration are usually extremely high.

Question 17 – Should legislation be introduced requiring parties to attempt to settle disputes through arbitration?

Dentons response –– no.

Sunset clauses

Question 18 – Should the definition of Sunset Date be expanded so that it covers other termination events?

Dentons response –No objection for government to give some consideration to a reference by the Court to an independent expert in circumstances where a developer wishes to be released from its contracts if it is to become insolvent by building the project. Government should satisfy itself as to whether the Court has adequate jurisdiction under its 'just and equitable' jurisdiction to determine in a developer's favour in circumstances where the developer will, because of the prices of the development, become insolvent if it proceeds. See earlier discussion,

Question 19 – Are there some termination points the developer should be allowed to use to end a contract without seeking approval of the Court? If so, what are they?

Dentons response – in essence the developer should be allowed to terminate (and on appropriate occasions the purchaser should be allowed to terminate) where critical events outside either party's control fail to be satisfied within a nominated period. Parties should be allowed to contract for these matters. In particular development approval, financial feasibility and finance. These are all legitimate reasons why a project may not be able to proceed. Almost exclusively these events are used for genuine commercial reasons and occur relatively early in the development phase. It is only when developments have been delayed by planning or finance issues that contract prices come under close review. The prospect of other trigger points like DA, finance and viability being an area of focus for the Courts is jumping the gun. There is no history of there being any ills in this area and the potential for damage being done to the necessary flexibilities developers require in order to operate their business would be disproportionately great.

Discretionary power of the Supreme Court to award damages

Question 20 - Should section 66ZL be clarified or amended to allow the Court to make an award of damages to purchasers if the circumstances so require?

Dentons response –– although the legislation has been salutary, there remains no evidence that the misbehaviour complained of is right. With respect, government has no business extending powers to the making of an award of damages in circumstances where the Court has considered it just and equitable that the contract be terminated.

On balance, the prospects of any significant abuse arising are extremely low and do not warrant further change to the law. Rather, the Minister should turn his mind to enlarging the Court's power to order that in circumstances where projects will be sterilised because of the circumstances, ie purchasers want to continue but the developer is unable to, that a tribunal can direct the parties to mediation with development experts who might define the amounts by which prices would have to rise

in order for the developer to make sufficient profit to remain clear of insolvency. This would be significantly more workable for the real issue of sterilised sites, looming insolvencies, etc.

Thank you for the opportunity of making this submission.

Please feel free to direct your enquiries to John Grimble john.grimble@dentons.com