In good company

Are investors best to avoid company title properties? **Peter Cerexhe** explains the where, what and why of this peculiar form of ownership.

IF you've ever seen the Peter Weir movie *Green Card*, with Gerard Depardieu in his greatest moment of shambolic but romantic Gallic charm, you'll have an idea about company title and one of its key pivot points: control over which *outsiders* can enter the apartment building. Tenants, and indeed owners, must step up for scrutiny by the board before the ownership transfer or lease/licence is approved.

This is something we just don't have to put up with when it comes to modern strata or unit titles. You buy it, you own it. You wouldn't believe an anachronism like this one (dating, I believe, from late 19th Century New York) could still be alive and well in the 21st Century but it's there in company title property, albeit with some flexibility as outlined below.

Company title is primarily an east coast phenomenon for older properties in New South Wales, Victoria and pockets of Queensland although there are small parts in most states. I know of one marina in Sydney Harbour that runs this way, so it's not restricted to residential property either.

It's only since 1961 that a truly modern, democratic method of property ownership for apartment blocks has existed in Australia. That's when the *Conveyancing (Strata Titles) Act* came into force in NSW. Other states followed.

It really was a revolution. Until that time our system of dividing ownership of property was horizontal – if you owned property you could stand on the patch of dirt itself. Land was subdivided by drawing lines on a two-dimensional plan. Individual lots were created which could then be sold or otherwise transferred to others.

But what happened when you wanted to move up in the world, to create a vertical subdivision, to go 3D? Then you have units with no direct physical contact with the ground. There was a legislative gap when governments didn't develop a set of laws and rules to handle this situation. The interim answer, if you like, was the use of the legal structure of a company.

What it means

A company is a separate legal entity. This means that, just like a person, it can buy, sell and own things. A company can have rights and obligations. So if a company purchased a block of land and constructed an apartment building, that was fine and fitted within prevailing legal structures.

Torbreck was the first company-titled multi-storied home unit development erected in Queensland.

LUISA DI GIROLAMO

What company title does is to take this situation and then issue shares to those buying into the company – and in return the purchaser receives an exclusive right to occupy part of the development: an apartment, a car space, a storage room or all of the above.

The company documents (Memorandum and Articles of Association) set out the broad rules under which the company would proceed. A separate contract might then establish more specific matters about the relationships between all the owners/shareholders. The documents would contain rules about control and shareholder meetings, levies, insurance, transfers of property (shares), tenancies, use of the common assets (pool, lift etc.).

But of course the laws establishing and regulating companies were designed for businesses and investment scenarios, not for ordinary folk who just wanted a roof over their head. You can understand there's a friction point between the regulation of these two worlds. Indeed you might call the whole company title thing a kind of legal fiction, using the rules and laws of companies to enable a vertical subdivision of land for people's homes.

Understand, therefore, that if you buy a company title property, you are stepping outside the world of normal property ownership. You're not buying property as such – you're buying shares in a company which owns property. You won't have a title certificate or deed in your filing cabinet – you'll have a share certificate. This, in itself, is enough to make some financial institutions nervous; they don't like entering unfamiliar territory. They won't have all the usual pieces of paper to stick in their mortgage files.

©Australian Property Investor magazine - www.apimagazine.com.au. Reproduced with permission.

It's the next step which adds fuel to the company title fire: the approval processes. One of the liberating moves of the strata titles laws was to give the apartment/lot owner a large degree of independent control over their unit. With company title property you, as a shareholder, can only transfer those shares (i.e. sell the apartment) or give occupancy rights (i.e. lease the apartment) with approval of the Board of Directors.

This approval isn't automatic. Indeed the directors have an obligation to discharge for the benefit of the company. In my experience, although approval is almost routine in practice, it's a tense wait for the transacting parties and details have to be provided about the 'outsider'. The process might also take a bit of time, particularly if office bearers want to get together to make their decision. In the conveyancing process this is something which shouldn't be left to the last minute. Importantly, such approval can't be withheld unreasonably – but it will be time consuming and potentially expensive to force the issue as you would have to go to court.

What lenders think of company title

Company title irritates lenders because the transfer is open to delay and the uncertainties of the approvals process. And if you're purchasing as an investor, every time you want to lease the premises you're opening the door to delays and interrogation. This could cost you your tenant and it will certainly limit the supply of potential purchasers.

For instance, what if your lender requires a formal valuation report on your proposed company title apartment? Strictly speaking, this involves a valuation of shares, not real estate. And relevant factors for the valuation include the financial strength of the corporation, creditors, any disputes (and the higher cost of taking these through the courts for resolution rather than to a tribunal or consumer affairs process).

A strata body corporate/owners corporation and a company Board of Directors share many similarities but at law directors have more extensive obligations, not just to their co-owners but also to government corporate regulatory authorities. Along with this comes more power for the company board, which can be used to make your building a work of art – beautifully maintained, a haven of peace, capturing style and heritage values. This might catch you up in significant ongoing expense compared to a modern strata/unit title block.

If you buy a company title property, you are stepping outside the world of normal property ownership.

It's no help that most of the uncertainty is unreasonable. The reality is that some proportion of potential purchasers will be turned off by company title. Increased risk is always taken into account by lenders and mortgage lender insurers. While you should have no problems finding a mortgagee and an insurer, you should anticipate a tighter loan-to-value (LVR) ratio. That means you'll need a larger deposit or simply a greater allocation of equity from another of your properties. Experts suggest you should allow yourself an extra 5 per cent equity in the deal (eg. the maximum LVR for lenders mortgage insurance might drop from, say, 90 per cent to 85 per cent).

By comparison, strata or unit/subdivision titles laws are made specifically to cover property ownership. They introduce multi-lot subdivision, whether on the ground in a row of townhouses or vertical in a tower. A basic set of standards and bylaws is established. Processes are legislated for meetings, raising levies and chasing late payment. There are ways to handle the flashpoint issues of noise, pets, nicking each other's car spaces, air conditioners out windows, timber flooring and laundry hanging over balconies. Government-established dispute resolution processes are available.

IN VICTORIA

Victoria had buildings subdivided under strata title which was essentially what we're referring to here as company title, but also had stratum title which was a mix of the two, with the owner having freehold title to their apartment plus shares in a private company which owns and manages the common areas.

These systems were replaced by the *Subdivision Act, 1988*. Around the country there are other 'primitive' apartment title systems too, such as lease schemes and tenancy in common agreements.

Tips and tricks

The purchasing of company title requires greater care.

- Check with your solicitor about cooling off periods and warranties, as well as with your accountant about the full impact of purchasing and owning company title, such as land tax and stamp duties.
- Ensure you get experts to check the company books – much like a strata records inspection – but you should also look into such matters as whether tenancies (licences) are permitted, pets, use of balconies, use of common property, and how car spaces are allocated. Check for the circumstances under which exclusive use of an apartment or car space can be revoked and whether there's the equivalent of a sinking fund to provide for future liabilities. The board can make rules which are idiosyncratic for the building, so ensure you can live with the requirements.
- Anecdotally the majority of owners are owner/occupiers rather than investors; many are retired. Investigate the apartment block ownership profile if you're interested in the property for its development or renovation potential – the residents may be asset rich but cash poor and disinclined to spend large sums of money.
- You may have problems using the property as security for anything other than a basic mortgage. Consider the difficulties you might confront should you want a reverse mortgage (where the lender provides a guarantee not to push the compounding debt into negative equity) or other equity gobbler, a car loan or finance for a business. On every occasion you'll have to argue that the lender will be secure – it will never be taken as a given. ■

Peter Cerexhe is author of *Smarter Property Improvement* and *Smarter Property Investment* (Allen & Unwin).