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*strata managers and consultants*

# ASSIGNMENT OF MANAGEMENT RIGHTS



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## BACKGROUND OF MANAGEMENT AGREEMENTS

Larger body corporate communities (larger than around 15-20 lots) generally have a contract for caretaking services.

Where a smaller development would engage independent contractors to maintain the gardens and grounds, swimming pool etc, in larger developments these services are usually bundled into a caretaking service contract.

This is a contract directly between your body corporate and the service provider, it is not a service provided by BCsystems (though we can assist the committee to manage this contract).

The contractor in this arrangement is often called:

- Caretaker
- Building manager
- On-site manager

Regardless of the name used by the contractor, all of these arrangements are considered a caretaking service contract arrangement. They are often referred to as 'management rights'. These contracts are originally established by the developer, and are often for a long-term. In the majority of large bodies corporate, these contracts are for a 25-year period.

Like all long-term contract arrangements, it is very beneficial to both parties to maintain a good working relationship. The purpose of this advice is to equip the committee to understand the current assignment process, and assist to navigate any negotiations which may arise during the process.

## HOW MANAGEMENT AGREEMENTS CAN BE BOUGHT & SOLD?

The nature of these long-term (often 25 year) contracts makes them a valuable asset for the caretaker. As long as the caretaker does the duties correctly and doesn't breach the agreement terms, the contract guarantees a long-term income from the body corporate. That asset nature of the long-term contract means there is a market to buy and sell these contracts.

Generally, the first contract for a new building is created by the developer, and the developer then sells the management rights to the first caretaker for the building. The developer keeps the proceeds of this sale - that is part of their profit on the development of the entire body corporate community.

The ownership of one of these contracts is generally called "management rights". What that means is the owner of the management rights is the person or company who has the contracts with the body corporate, and is entitled to earn the revenues that those contracts provide.

The process of buying and selling a management rights business is similar to any other business. There are specialist real-estate agent or brokerage services, specialist accountants

and other consultants, solicitors, and bankers who all work in this industry.

Management rights business derive their value from the length of the agreement with the body corporate, the amount of remuneration that the body corporate pays for the services, the profit margin, and any other related incomes. If your caretaker lives on site or has an office in the building, those real estate assets are generally part of the sale and get transferred to the new manager if the business is sold.

The body corporate is only a passive participant in the sale of management rights from one caretaker to another. The body corporate's contract is what creates the value, but the body corporate is often not aware that the current manager is selling their management rights, until it comes time for the legal process called "assignment".

## WHAT IS AN ASSIGNMENT?

We have established that the management rights business involves the body corporate, without the body corporate there would be nothing for the caretaker to buy or sell.

The asset is an agreement between the body corporate and the caretaker.



*In this diagram, the original contract was entered into between the body corporate and the developer. The developer then immediately sold the management rights to Caretaker company 1, who then sold to Caretaker company 2, and so on. The arrows represent each assignment of the management rights.*

## WHAT IS AN ASSIGNMENT? (CONT.)

When a new management rights operator buys the management rights business, the service agreement with the body corporate needs to be transferred into their name. That agreement with the body corporate is how the new caretaker will earn their income from providing the body corporate with the services in the agreement.

That process of transferring the contract into a new name is called an "assignment". Effectively the outgoing caretaker assigns all of their rights and obligations under that contract to the new caretaker.

Caretaking service contracts allow for this assignment process within their terms and conditions, and the process is also prescribed in the legislation that regulates bodies corporate.

The body corporate is a party to the agreement, and the body corporate has a right to consent to the assignment or transfer. This opportunity to consent is designed to give the body corporate a chance to ensure that the new caretaker (the buyer of the management rights) will be able to perform the duties which are required under the agreement.

The mechanism for this 'assignment' is by a deed, called a "Deed of Assignment".

## WHAT IS THE COMMITTEE'S ROLE?

The committee for the body corporate is the body corporate's day-to-day decision-making body. When the body corporate has an obligation or opportunity, it is up to the committee to manage that process.

Normally the first time the committee becomes aware that their current caretaker is planning on selling is after the current caretaker has already lined up a prospective buyer, and agreed on a price for the sale of their management rights business.

The current caretaker (or their solicitor) will generally present the body corporate with a "Deed of Assignment" and will ask the body corporate to sign it.

This kicks off the process of due diligence and consideration on whether or not to consent to the assignment.

## TIMELINES

Similar to buying and selling property, time is of the essence and often each party is anxious to achieve each milestone in the process as quickly as possible.

By law, the body corporate has 30 days to consider the request for consent to an assignment,

so it should not be rushed.

The 30-day period is held to start from the day when the body corporate has all of the information that it can reasonably require to make a properly informed decision.

Timelines are often the subject of pressure from the existing caretaker, proposed new buyer or their solicitors. It is something which is best left to the body corporate's solicitor to manage and advise on.

## GETTING LEGAL ADVICE

The reason why this assignment process exists may be relatively simple to understand, but the legal mechanisms which make it happen can be very complex.

Making a technical mistake on a caretaking agreement transaction could cost the body corporate very heavily.

It is therefore extremely important that the body corporate engage an independent solicitor to act for the body corporate's best interests, and to assist the committee to navigate the assignment process. Whilst BCsystems as your strata manager will be involved in the process to provide administrative and committee support, we are not solicitors and cannot give legal advice.

The body corporate's solicitor should:

- Obtain an undertaking from the caretaker to cover the body corporate's costs
- Advise the committee about timelines in the process
- Review the proposed deed document and give advice about its wording
- Advise what the body corporate's rights are
- Advise whether the decision can be made at a committee meeting or general meeting
- Request relevant information/documents about the proposed buyer
- Investigate whether a transfer fee may be applicable

## WHO PAYS?

This will depend on the individual caretaking agreement. Typically the body corporate is entitled to be compensated by the caretaker for its reasonable legal and administrative costs in considering the assignment. After all, it is a process which is imposed on the body corporate by the caretaker.

To avoid disagreement, the body corporate's solicitor should ask for an undertaking from the caretaker to pay the body corporate's costs in the process. In addition to the legal advice costs, the body corporate will incur other administrative costs (e.g. advice time, additional meetings to consider the motions), and that is also typically recoverable from the caretaker.

## WHO IS THE NEW MANAGER?

This is the key issue to be considered by the committee in an assignment process. Whilst the committee knows the current caretaker by working with that contractor, the proposed new caretaker is generally an unknown person or company.

If the body corporate consents to the assignment, the body corporate will be in a long-term agreement with this new person or company, and will be required to work together with the new caretaker closely. The success of the body corporate as a community often rests heavily on the performance of the caretaker.

When the existing caretaker advises the body corporate of their intention to sell, and seeks consent for an assignment, the caretaker should supply the buyer's details to the body corporate to consider. This part of the process is functionally similar to carrying out a job interview, when you only have one applicant for the position.

There are different elements to this review:

Reviewing business structure	Reviewing resume & references	Conducting interview
By body corporate's solicitor	By committee	By committee
<p>Most management rights are owned by companies or trusts:</p> <ul style="list-style-type: none"> <li>• What is the legal structure of the entity?</li> <li>• Who are its directors?</li> <li>• Who are its guarantors?</li> <li>• What is its financial position?</li> </ul>	<ul style="list-style-type: none"> <li>• Do the individuals have experience?</li> <li>• Can the individuals perform the required duties?</li> <li>• Do the references provided stand up to scrutiny?</li> </ul>	<ul style="list-style-type: none"> <li>• Are the individuals personable?</li> <li>• Can the committee work with these caretakers?</li> <li>• Do the individuals understand the duties?</li> </ul>

When the committee undertakes these due-diligence steps, it is important to document the committee's findings and evaluation.

## INTERVIEWING THE PROPOSED NEW CARETAKER

The interview of the proposed new caretaker is not a mandatory step, but it is very beneficial for the body corporate committee to understand how the proposed new caretaker intends to work.

Without interviewing the proposed new caretaker, the committee would be taking on a long-term service contractor without understanding an important element of the caretaker's skill set.

Caretaking service contractors take a vital role in community management – acting as a liaison between the owners, residents, committee and other contractors. A caretaker can independently set the tone for community living, and can be make-or-break for some schemes, particularly holiday rental body corporate developments.

Consider this scenario:

- The current caretaker has been there for 5 years.
- The contract duty is not specific about gardens, and instead says "maintain gardens to a high standard".
- The committee thinks the current gardening standard is around 70% of what it should be, and has gradually declined over the last 5 years.
- The committee does not interview the proposed new caretaker, and consents to the assignment.

The new caretaker comes in, and receives handover training and instruction from the former caretaker. The old caretaker tells the new caretaker that the gardens are costly to maintain, and that he has been gradually reducing the number of gardening visits whilst maintaining quality. The old caretaker suggests that the new caretaker continue gradually reducing this service.

In this scenario, the committee has lost its best opportunity to reaffirm its expectations with its new contractor. It may take another 2-3 months for the new caretaker to settle in before the committee raises the garden issue, and by that time the new caretaker has already factored the reduced gardening cost into their business plan.

Whilst the committee can always enforce its contract terms, often these differences of opinion can arise, and the earlier these are flagged and addressed the better overall.

Had the committee interviewed the new caretaker, it could have asked:

*"what are your impressions of our gardens, and what would you do in the first 2-months to improve the current 70% standard to 100%"*

That type of question, and the resulting discussion is very valuable for the committee and the new manager to understand each other's position and opinion about the services required.

## WHAT DECISION NEEDS TO BE MADE BY THE COMMITTEE?

The body corporate is effectively being asked one simple question:

*Do you consent to the assignment of the management rights to the proposed new caretaker?*

Like all body corporate decisions, there are some legal caveats on what the body corporate can and cannot decide, and all decisions must be reasonable.

In this transaction, the body corporate must not unreasonably withhold its consent. That effectively means the body corporate can only refuse to give consent if it has a good reason.

Given the stakes involved in these transactions and the possibility that the body corporate's decision may be challenged, if a body corporate is even considering withholding consent to an assignment, the committee should discuss this in-depth with the body corporate's solicitor.

With any high-stakes decision, it is even more important to ensure that all steps have been followed perfectly, decision-making correctly documented, and communication carefully managed.

## TRAINING

The body corporate is not required to provide a handover or training for the new caretaker. The new caretaker should be qualified to carry out their duties autonomously.

Any general training or handover training about the building's particular requirements should be provided by the existing caretaker to the new caretaker.

In some cases, if the committee is not convinced that the proposed new caretaker will be able to do all the duties immediately due to a lack of experience, the committee can arrange for the new manager to receive professional training at their own cost.

This is something to discuss with the body corporate's solicitor as it must be handled carefully.

## WHAT IF THE COMMITTEE DOESN'T WANT THE CARETAKER TO GO?

The committee may have a great working relationship with a caretaker who goes above and beyond for the body corporate. Unfortunately for the committee, it's up to the caretaker to decide if and when they sell their business and move on.

The committee must make an objective decision about whether the proposed new caretaker can meet the contract duties, even if the committee will miss the outgoing caretaker. The committee can't withhold or delay approving an assignment because the committee doesn't want to let go of the current caretaker.

## WHAT IF THE COMMITTEE IS NOT HAPPY WITH THE AGREEMENT?

This process involves the handing-over of the existing caretaking agreement as-is from the old caretaker to the new caretaker. The existing agreement is assigned as-is and without substantive changes.

If the body corporate is not satisfied with the terms of the agreement, for example if the committee believes the duties should be changed, the body corporate is prohibited from withholding consent to an assignment process as leverage to get the current caretaker to agree to other changes.

Each time an assignment is proposed, the assignment must be considered on its own merits, that is the transfer of the existing as-is agreement from the current caretaker to the proposed new caretaker.

The body corporate can negotiate changes to the original caretaking agreement (including duties, remuneration, contract length or any other clauses) directly with the caretaker at any other time during the contract (just not during an assignment process).

## WHAT IF THE COMMITTEE IS NOT HAPPY WITH THE CARETAKER?

If the committee is not happy with the current caretaker, an assignment process means the current caretaker is moving on. This may come as welcome news for a committee if the relationship has broken down.

It is important however for the committee to not get too excited, as there are no guarantees that the proposed new caretaker will be an improvement on the outgoing caretaker. After all, the outgoing caretaker has selected the new caretaker, and may not have the body corporate's interests in mind when making that selection.

Even if the body corporate committee is happy for a caretaker to move in, it is crucial that the committee not lose focus on the importance of carrying out proper due-diligence on the proposed new manager.

## WHAT ABOUT RENTALS MANAGED BY THE CARETAKER?

Most management rights include a rental arrangement with owners. This is generally called a letting authority.

Under this arrangement, the caretaker can also provide on-site rental and property management services. Each owner who participates in that arrangement has their own separate agreement with the caretaker, which is not controlled by the body corporate. If the caretaker has a letting authority, that will nearly always be assigned in addition to the caretaking service agreement, generally they will be listed together on a single deed of assignment.

The caretaker would also communicate this transfer separately with each of their rental clients.



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