

# Dealing with Defects

Final Report



## Dealing with Defects

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# Contents

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<b>Executive Summary</b> .....	<b>i</b>
Introduction .....	i
Objectives .....	i
Methodology .....	i
Legislative change .....	ii
Social and economic impacts .....	ii
Recommendations .....	ii
<b>1 Introduction</b> .....	<b>1</b>
1.1 Background .....	1
1.2 The importance of strata development .....	1
1.3 Defects in strata development .....	2
1.4 Methodology .....	3
<b>2 Literature Review</b> .....	<b>5</b>
2.1 Overview .....	5
2.2 Growth in residential strata development .....	6
2.3 Living in density .....	7
2.4 Life cycle .....	9
2.5 Defects .....	10
2.6 International experience .....	11
<b>3 Major Stakeholders in Strata Development and Schemes</b> .....	<b>14</b>
3.1 Strata stakeholders .....	14
3.2 Stakeholder relationships .....	19
<b>4 Review of Current and Forthcoming Legislation</b> .....	<b>22</b>
4.1 Introduction .....	22
4.2 The Home Building Amendment Bill 2014 .....	22
4.3 Strata Schemes Management Act .....	24
4.4 Environmental Planning and Assessment Act .....	25
4.5 Building Professionals Act 2005 and the Building Professionals Board .....	26
4.6 Conclusion .....	27
<b>5 Analysis of Legislative Change Consultation Submissions</b> .....	<b>28</b>
5.1 Introduction .....	28
5.2 Submissions concerning the Home Building Amendment Act (2014) .....	28
5.3 Submissions concerning the Strata Schemes Management Act Amendments .....	31
5.4 Discussion of submissions .....	34
<b>6 Interviews</b> .....	<b>38</b>
6.1 Introduction .....	38
6.2 Selection .....	38
6.3 Interview questions .....	38
6.4 Findings .....	39

<b>7 Discussion and analysis</b> .....	<b>45</b>
7.1 Introduction.....	45
7.2 Motivational mismatch – Dealing with defects at the ‘legal’ pole .....	45
7.3 Strata system objectives .....	47
7.4 Improving motivational alignment – dealing with defects through the market ‘pole’ .....	48
7.5 Fulfilling strata development objectives in a market based approach .....	52
7.6 Policy implications .....	53
<b>8 Conclusions and recommendations</b> .....	<b>56</b>
8.1 Introduction.....	56
8.2 Legislative change.....	56
8.3 Social and economic impacts.....	56
8.4 Complexity in strata.....	57
8.5 Recommendations .....	57
<b>Appendix A: Summary of association submissions HBA</b> .....	<b>59</b>
<b>Appendix B: Summary of association submissions SSMA</b> .....	<b>69</b>
<b>Appendix C: Individual association submissions HBA</b> .....	<b>73</b>
<b>Appendix D: Individual association submissions SSMA</b> .....	<b>90</b>

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## Executive Summary

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### Introduction

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The preference for apartment development amongst policy makers and consumers is increasing. The NSW government has placed considerable importance on increasing residential density and brownfield development. Considerable residential urban development is occurring, including in renewal areas such as Green Square. Reported sales of new apartments, including 'off the plan', indicate that the market continues to be strong.

Building defects, and their rectification, are a major problem in residential strata buildings developments. Defects cause significant social and economic harm to residents, owners, owners' corporations and other stakeholders within the broad 'strata system'.

The NSW state government is responsible for legislation governing the development and operation of residential strata schemes, principally the *Home Building Act 1989* (HBA) and the *Strata Schemes Management Act 1996* (SSMA). The state government embarked on a general review of this legislation in 2011, in conjunction with a major review of the *Environmental Assessment Act*. Despite the interdependent nature of proposed legislative changes, only some of the recommended amendments have been adopted and will be effected incrementally.

### Objectives

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The project addresses the following objectives:

- Examination and discussion of existing legislation (HBA and SSMA) relating to building defects, their rectification and proposed legislative changes.
- Identification of the key stakeholders and participants, including owners, within the apartment development process and their existing relationships and roles.
- For each stakeholder group, identification of their position and viewpoints with respect to building defects, rectification and liability periods under current and proposed legislation.
- Identification of the social and economic impacts of building defects and the rectification process for each stakeholder group.
- Analysis of the economic and social impacts of the current and publically foreshadowed legislation with respect to building defects and the rectification process.
- Development advice relating to the wider social, economic and policy ramifications arising from current and proposed legislation to the handling of building defects in residential strata developments.

### Methodology

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The research comprised four parts:

1. Desk based research of current legislation and proposed changes and academic literature concerning defects rectification;
2. Review of stakeholder submissions concerning building defects and the rectification process to proposed legislative amendments;
3. Five semi-structured interviews with stakeholder representatives between 30 and 60 minutes long and conducted face to face or via phone;
4. Analysis, commentary and recommendations.

## Legislative change

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Statutory warranties refer to the defined time limit for commencing proceedings to enforce rectification of building defects by the builder. Statutory warranty periods currently differ depending on the nature of the defect. Defects are currently defined as either 'structural' or 'non-structural' with a 2-year period applying for statutory warranty claims on non-structural defects and 6-years for structural defects. Ambiguities about the extent and responsibilities for rectifying these defects in strata developments have been the subject of significant and expensive dispute in recent years.

In an attempt to reduce these disputes, the *Home Building Amendment Act 2014* will introduce revised definitions of building defects, as being either 'major' or 'non-major'. The scope of major defects will be reduced compared with the current definition of 'structural defects'. The *Home Building Amendment Act 2014* is likely to be implemented in early 2015.

To balance these changes, proposed reforms to the *Strata Schemes Management Act 1996*, suggest that a bond be imposed on developers and held in a fund to cover the costs of defects not remedied by the builders<sup>1</sup>.

The most common defects in strata developments are in fire safety systems and waterproofing elements, yet under proposed definitions these would be treated as 'non-major' defects. Home owners are concerned that the reduction to 2 years for statutory warranty claims will expose them to additional costs to repair 'non-major' defects that emerge after the expiry of the warranty period.

## Social and economic impacts

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The economic and social impacts of building defects and the rectification process are significant for owners and building residents and include depreciation of assets, increased maintenance costs, litigation, and stress and health impacts. These are most likely to fall on owner-occupiers of residential strata.

## Recommendations

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The social and economic impacts of un-remediated defects in residential strata developments could be reduced through a number of approaches:

- Reduce the occurrence of defects – improved training and supervision of builders and sub-contractors ensuring buildings are built to a high standard with all materials meeting specifications.
- Improve consumer protection – incorporate measures to ensure consumer protection and remove areas of inconsistency and ambiguity in the legislation.
- Improve consumer capacity – provide training and support to strata owners and executive committee members who may lack the capacity to deal effectively with defect identification and rectification.
- Expose the economic cost of defects rectification to market forces – improving market information and developing new contractual conditions.
- Examine policy implications – placing the strata home owner at the centre of policy development and exploring if a case can be made for the Productivity Commission to examine the national economic consequences of strata building defects.

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<sup>1</sup> NSW Fair Trading (2013) "Strata Title Law Reform: Strata & Community Title Law reform Position Paper", Sydney: NSW fair Trading, pp.17-18.

# 1 Introduction

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## 1.1 Background

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Building defects, and their rectification, are major problems in residential strata buildings. Research indicates that nearly three-quarters (72 per cent) of residents living in strata have experienced one or more defects in their scheme.<sup>2</sup> Defects cause significant social and economic harm to residents, owners, owners' corporations and other stakeholders within the broad 'strata system'.

The NSW state government is responsible for legislation governing the development and operation of residential strata schemes, principally the *Home Building Act (1989)* (HBA) and the *Strata Schemes Management Act 1996* (SSMA). The state government embarked on a general review of this legislation in 2011, in conjunction with a major review of the *Environmental Planning and Assessment Act 1979*. Despite the interdependent nature of proposed legislative changes, only some of the recommended amendments have been adopted and will be effected incrementally. Amongst other matters, the legislative changes address the identification, definition, documentation, rectification and liability of defects.

This research identifies the major social and economic impacts of the current legislation and proposed legislative changes as they relate to building defects on key stakeholders now and into the future. The focus is on the viewpoints of individual parties involved in the development, construction, financing, and management of apartment buildings in New South Wales. The research findings provide the basis of policy advice focusing on defect rectification in residential strata developments.

The project addresses the following objectives:

- Examination and discussion of existing legislation (HBA and SSMA) relating to building defects, their rectification and proposed legislative changes.
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- For each stakeholder group, identification of their position and viewpoints with respect to building defects, rectification and liability periods under current and proposed legislation.
- Identification of the social and economic impacts of building defects and the rectification process for each stakeholder group.
- Analysis of the impacts of the current and publically foreshadowed legislation on the economic and social impacts identified with respect to building defects and the rectification process.
- Development of advice relating to the wider social, economic and policy ramifications arising from current and proposed legislation to the handling of building defects in residential strata developments.

## 1.2 The importance of strata development

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Strata title is becoming increasingly important as a form of home ownership within Australia. An estimated three million people live in strata titled dwellings across Australia.<sup>3</sup> There are more than

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<sup>2</sup> Easthope, H., and Randolph, B. (2009), "*Governing the Compact City: The Challenges of Apartment Living in Sydney, Australia*" City Futures Research Centre, University of New South Wales, Sydney, Australia Published online: 24 Sep 2009

<sup>3</sup> Ibid

72,000 registered strata schemes in NSW with a combined asset value of more than \$350 billion.<sup>4</sup> Across NSW 2 million people live within strata titled dwellings and within 20 years it is expected that half of the state's population will be living or working in a strata or community title scheme.<sup>5</sup> Within inner urban areas, the proportion is already much greater: within the City of Sydney LGA 74 per cent of dwellings are a flat, unit or apartment (almost all of which will be strata titled) and a further 21 per cent are semi-detached, row or terrace house or a townhouse (a proportion of which will also be strata titled).<sup>6</sup> The City of Sydney currently estimates three-quarters of its population live in strata developments.<sup>7</sup>

The trend towards strata living is set to continue. The *Draft Metropolitan Strategy for Sydney* sets out the need to identify more urban renewal areas, locate housing in centres close to transport and where other community infrastructure is already available.<sup>8</sup> The Bays Precinct, identified as a major urban renewal area, is set to deliver thousands of new homes on the edge of the Sydney city centre.<sup>9</sup> Green Square, midway between central Sydney and the airport, is a major renewal area and will become home to over 50,000 residents living in residential strata development.<sup>10</sup>

Research by the Grattan Institute<sup>11</sup> identified a preference for homes near jobs and community facilities amongst Australians living in capital cities. The same research also identified a mismatch between the housing stock available and the types of housing people want to live in. The locational preference was linked to an acceptance of apartment dwellings.

### 1.3 Defects in strata development

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Defects in new strata developments, particularly residential, are increasingly perceived as a problem by residents and their representative organisations, although the actual extent and impact of these defects is often disputed. What exactly is meant by a 'building defect' varies throughout the literature and in legislation. Easthope (2012) provides a simple and useful definition:

*Building defects are building faults that have existed since construction or been triggered later on by faulty original construction or design.*<sup>12</sup>

The link between building defects and regulatory oversight is recognised in the *White Paper – a new planning system for New South Wales* (White Paper). Chapter 8 considers building regulation and certification and observes that:

*Changes are being made to the building regulation and certification system to rebuild confidence in the quality and safety of buildings...*<sup>13</sup>

Of direct relevance to building defects in strata developments, the White Paper adds:

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<sup>4</sup> NSW Government (NSW Fair Trading) (2013) Strata Title Law Reform: Strata and Community Title Law Reform Position Paper ([http://www.fairtrading.nsw.gov.au/biz\\_res/ftweb/pdfs/About\\_us/Have\\_your\\_say/Strata\\_title\\_law\\_reform\\_position\\_paper.pdf](http://www.fairtrading.nsw.gov.au/biz_res/ftweb/pdfs/About_us/Have_your_say/Strata_title_law_reform_position_paper.pdf))

<sup>5</sup> *ibid.*

<sup>6</sup> City of Sydney (2013) Submission to Strata and Community Title Law Reform: Response to Discussion Paper ([http://www.fairtrading.nsw.gov.au/biz\\_res/ftweb/pdfs/About\\_us/Have\\_your\\_say/Review\\_of\\_strata\\_community\\_scheme\\_laws/Associations\\_and\\_other\\_entities\\_submissions/City\\_of\\_sydney.pdf](http://www.fairtrading.nsw.gov.au/biz_res/ftweb/pdfs/About_us/Have_your_say/Review_of_strata_community_scheme_laws/Associations_and_other_entities_submissions/City_of_sydney.pdf))

<sup>7</sup> City of Sydney (<http://www.cityofsydney.nsw.gov.au/live/residents/apartment-living>) (accessed 22 November 2014)

<sup>8</sup> NSW Government (2013) Draft Metropolitan Strategy for Sydney to 2031, Sydney: Department of Planning

<sup>9</sup> Harris, M., Simpson, R. and Phibbs, P. (2014) Megaprojects: A global review and an outline of some planning principles (and appendices) delivered as part of the University of Sydney's Festival of Urbanism (15 October – 6 November 2014)

<sup>10</sup> City of Sydney (<http://www.cityofsydney.nsw.gov.au/vision/major-developments/green-square>) (accessed 9 December 2014)

<sup>11</sup> Kelly, J-F, Breadon, P. and Reichl, J. (2011) Getting the housing we want, Grattan Institute, Melbourne.

([http://grattan.edu.au/wp-content/uploads/2014/04/117\\_report\\_getting\\_the\\_housing\\_we\\_want.pdf](http://grattan.edu.au/wp-content/uploads/2014/04/117_report_getting_the_housing_we_want.pdf))

<sup>12</sup> Easthope, H., Randolph, B. and Judd, S. (2012) Governing the Compact City, City Futures Research Centre, University of NSW

<sup>13</sup> NSW Government (2013) A New Planning System for NSW White Paper, Sydney: Department of Planning

*Waterproofing defects in internal wet areas in high-rise buildings are one of the biggest causes of financial and emotional concern for owners and occupiers.*<sup>14</sup>

In its response to the White Paper, the Building Professionals Board undertook a separate review of the certification process and the role of certifiers in achieving improved outcomes, published as the *Maltabarow Report*.<sup>15</sup> It identified two critical areas relevant to defects and the certification process. The first is fire safety:

*A critical building system appropriately identified as involving complex and high risk technical issues is fire safety, where expert opinion is required in the assessment of alternative fire safety solutions before a construction certificate may be issued.*<sup>16</sup>

The second is waterproofing:

*Another area of concern is waterproofing, where defects are common and where some stakeholders have identified issues with both the certification process and the standards themselves. It is important to differentiate building types in analysing this issue. The White Paper focuses primarily on the residential sector, and this can conveniently be defined to comprise three sectors: one and two storey dwellings (“Mum and Dad” developers), three or four storey medium density (mid-size developers) and multi-storey high rise (big-end developers). Waterproofing is probably the largest source of building defects in all three sectors.*<sup>17</sup>

## 1.4 Methodology

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The research comprises four parts: desk-based research, a review of submissions to legislative consultation, semi-structured interviews and analysis.

### 1.4.1 Desk based research

The desk based research focused on current legislation governing strata development and management (*Home Building Amendment Act 2014* and *Strata Schemes Management Act 1996*) and proposed changes and academic literature concerning defects rectification. The research also included a comprehensive literature review, which examined issues around strata residential development, living in density and the impacts of urban consolidation policies.

### 1.4.2 Review of stakeholder submissions

Review of stakeholder submissions concerning building defects and the rectification process to proposed legislative amendments. Twelve submissions on amendments to the HBA were reviewed, principally from those associations representing the main participants in strata development. The same criteria were employed in selections 17 submissions to the review of the SSMA.

### 1.4.3 Semi-structured interviews

Six semi-structured interviews were conducted with representatives of strata participants. Each interview lasted between 30 and 60 minutes long and was conducted face to face or via phone. The semi-structured interview questions addressed and explored interviewees’ submissions in response to the consultation on the current and proposed changes to relevant legislation.

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<sup>14</sup> NSW Government (2013) A New Planning System for NSW White Paper, Sydney: Department of Planning

<sup>15</sup> Building Professionals Board (2013) Building Certification and Regulation – Serving a new planning system for NSW (Maltabarow Report) ([https://majorprojects.affinitylive.com/public/4699af15dd6daca40c4a59f1b91f4a86/Maltabarow\\_report.pdf](https://majorprojects.affinitylive.com/public/4699af15dd6daca40c4a59f1b91f4a86/Maltabarow_report.pdf))

<sup>16</sup> *ibid*

<sup>17</sup> *ibid*

Not all organisations represented by the interviewees made submissions to the HBA and/or the SSMA consultations. Others had not specifically addressed defects rectification in submissions made. In these instances, questions were adapted but remained focused on relevant changes proposed for the HBA and SSMA.

Research was undertaken through September to December 2014. Desk-based research preceded and informed the stakeholder interviews.

#### **1.4.4 Analysis, commentary and recommendations**

The analysis is derived from the work undertaken to that point, with particular reference to the submissions reviewed and the semi-structured interviews.

The analysis extracts from submissions and interviews themes on the operation of the strata system and management of defects. It moves on to compare these themes with concepts explored in the literature review. Alternative approaches to the reduction of defects are then proposed. Additionally, the impacts of defects on Australian home ownership policy settings are explored. Recommendations are framed based on this analysis and on lessons learned from submission and interviews.

## 2 Literature Review

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### 2.1 Overview

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The academic literature pertaining to strata development is relatively limited. What does exist is recent, generally written in the last decade. It seems that three broad issues have given rise to the emergence of literature on the topic in recent years:

- The ageing of strata buildings built after the introduction of strata title legislation in 1961, and those built before and converted to strata ownership, and the resultant implications of this with respect to;
  - Legislation, which responds poorly to the need for redevelopment as a strata building comes to the end of its economic life and fails to recognise the incompatibility between a building with a finite lifespan and a strata scheme which continues in perpetuity.
  - Buildings that have been poorly maintained and as such need to be demolished for safety and quality of life reasons.
- Accelerating growth of inner urban residential strata development and rising land values, resulting in:
  - Increasingly large, complex and often high-rise residential strata buildings;
  - Increasing proportions of the population living in strata developments and recognition of potential adverse social impacts;
  - Increased investment in strata development and recognition of potential for adverse financial impacts.
  - Changing urban development patterns, inner area densification and the potential for strata buildings to be redeveloped to achieve increased yield.
- A broad agreement that the legislation concerning residential strata development (in NSW) has developed in an ad hoc manner and is poorly placed to achieve the stated outcomes with respect to building quality, governance arrangements and, ultimately, redevelopment.

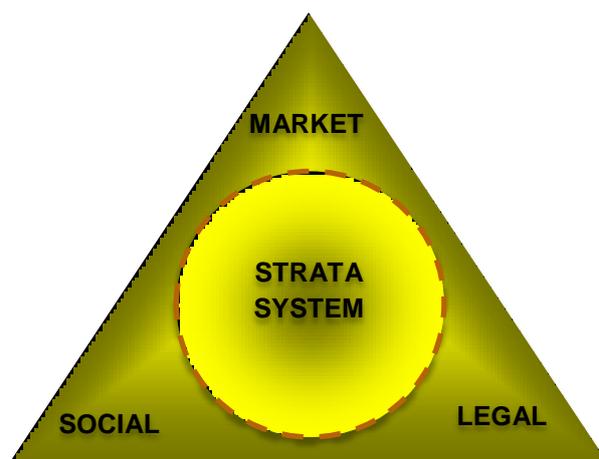
Examining the overall structure of strata living, Easthope and Randolph (2009)<sup>18</sup> explained strata governance as an element of a larger strata 'system', which comprises the strata development itself and the political, economic and regulatory structures that surround and shape it. They detect within this system three governance modalities – markets, hierarchies and networks.

McKenzie (2003) described the operation of American society as a tripartite structure bounded by the market, the state and civil society; a structure he also detects in the operation of strata governance.<sup>19</sup> Employing this analysis and considered as systems of micro-governance, strata schemes can be describe as operating conceptually between three poles, systems or influence modalities, as illustrated in **Figure 1**.

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<sup>18</sup> Easthope, H., and Randolph, B. (2009), "Governing the Compact City: The Challenges of Apartment Living in Sydney, Australia" City Futures Research Centre, University of New South Wales, Sydney, Australia Published online: 24 Sep 2009.

<sup>19</sup> McKenzie, E., (2003) Common-interest housing in the communities of tomorrow, in Housing Policy Debate Vol. 14, Issue 1-2, pages 203-234, see particularly pages 214-219



**Figure 1. Strata ownership concept diagram**

The 'social' pole refers to the operation of civil society and is mostly expressed in the relationships that develop between individual lot owners, the social relationships that affect, or are expressed through, the strata corporation collective, and the social influences that affect the contractual relationships between developer, builder, strata corporation and individual lot owners during construction of residential strata developments.<sup>20</sup>

The 'legal' pole refers to the legislative framework that enables and controls the operation of strata titling, the contractual responsibilities that govern the construction and transfer of developments to collective strata corporations and individual lot owners. The legal pole also references the establishment of, and force granted to, strata corporations that operate as miniature governments.

The 'market' pole refers to the flows of money necessary to build large strata titled developments. It also includes the commercial considerations that affect the degree and cost of access to these financial resources – such as the management of risk. More explicitly, the market pole includes the operation of financial markets, how these are configured to the pricing and construction of strata developments, how individual purchasers obtain access to finance, the cost and availability of insurance as a strategy to manage contractual uncertainties and the contracts that record these arrangements<sup>21</sup>.

## 2.2 Growth in residential strata development

Densification of Australia's capital cities is accelerating and the number and proportion of large and complex residential strata developments in particular are likely to increase.<sup>22</sup> This is a desired outcome of urban policy, such as the draft Metropolitan Strategy<sup>23</sup> and NSW Government initiatives, such as the development of Urban Activation Precincts.<sup>24</sup>

<sup>20</sup> Ibid, page 219

<sup>21</sup> Ibid, page 216

<sup>22</sup> For example: Bunker, R., Holloway, D. and Randolph, B. (2005) Building the Connection between Housing Needs and Metropolitan Planning in Sydney, Australia, *Housing Studies*, Vol 20(5), p771 - 794 and Dredge, D. and Coiacetto, E. (2011) Strata Title: Towards a Research Agenda for Informed Planning Practice, *Planning Practice and Research*, Vol 26(4), p417 - 432

<sup>23</sup> NSW Government (2013) Draft Metropolitan Strategy for Sydney to 2031, Sydney: Department of Planning

<sup>24</sup> Department of Planning and Infrastructure (2012) NSW Urban Activation Precincts Guidelines, Sydney: Department of Planning

Current forecasts suggest that the metropolitan population will grow to 9 million by 2060. Government has acknowledged that the high costs of providing infrastructure and servicing low density, fringe developments are unsustainable as Sydney grows.<sup>25</sup> In addition to the imperatives of government policy, there is emerging evidence that the new 'millennial' demographic prefers to live close to the city centre in medium density strata developments.<sup>26</sup>

The Australian Bureau of Statistics (ABS) Census data indicates that the number of occupied flat/unit/apartment dwellings is increasing, both in quantity and as a proportion of total housing in the Sydney metropolitan area: flat/unit/apartment dwellings increased from 295,471 (22 per cent of occupied dwellings) in 1996 to 391,887 (26 per cent of occupied dwellings) in 2011.<sup>27</sup>

The increase in apartment dwellings, and master planned estates typical of new urban land release areas, has resulted in strata and community title becoming the fastest growing forms of property title in Australia.<sup>28</sup>

### 2.3 Living in density

Given the increase in strata and community title development, the realities of living in medium to high-density developments in close proximity to others must be considered. The realities of living in dense urban development with multiple stakeholders and complex governance arrangements can be challenging, particularly when dealing with complex, difficult and stressful situations such as the rectification of defects.

For some, density is considered to be 'good'. When promoting his vision for a new urban form, Le Corbusier proclaimed:

*In such a town as I have outlined, with a denser population than that of any existing cities, there would be ample provision and opportunity for close human contact; there would be trees, flowers and spreading lawns...What would it matter if beyond these 'consoling' elements and behind screens of trees there stood the tremendous silhouettes of skyscrapers?*<sup>29</sup>

Others have opposed density, favouring a less compact urban form, such as the 'garden city' concept. Freestone (2010) explores the history of planning in Australia and the ongoing debate surrounding urban form and density since colonisation.<sup>30</sup>

Le Corbusier's link between leisure and high-density development, homes in close proximity to parks and sports fields, also pervades marketing literature. Developments are typically sold on the promise of lifestyle outcomes:

*Residents have ready access to Green Square train station, and the town centre itself will provide for their every need, from shopping to entertainment, sport, recreation and even work.*<sup>31</sup>

Fullagar et al (2013)<sup>32</sup> explored the pervasive use of recreational opportunity to sell high-density residential developments, in contrast to low-density suburban housing. They described how

<sup>25</sup> NSW Government (2013) Draft Metropolitan Strategy for Sydney to 2033, Sydney: Department of Planning

<sup>26</sup> see <http://www.nielsen.com/us/en/insights/news/2014/millennials-prefer-cities-to-suburbs-subways-to-driveways.html> (accessed 9 December 2014) and <http://www.smh.com.au/it-pro/love-thy-neighbour-gen-y-embraces-closeness-of-urban-living-20110613-1fztx.html> (accessed 9 December 2014)

<sup>27</sup> Australian Bureau of Statistics (1996) Basic Community Profile, Sydney Statistical Division and Australian Bureau of statistics (2011) QuickStats, Greater Sydney Statistical Area. Note that the Sydney Statistical Division and Greater Sydney Statistical area boundaries are comparable.

<sup>28</sup> Sherry, C. (2013) Lessons in Personal Freedom and Functional Land Markets: What Strata and Community Title Can Learn from Traditional Doctrines of Property, UNSW Law Journal, Vol. 36(1)

<sup>29</sup> Le Corbusier (1929) The City of Tomorrow and its Planning (translated: Frederick Etchells), Dover

<sup>30</sup> Freestone, R. (2010) Australia's Planning Heritage. Australia: CSIRO Publishing

<sup>31</sup> Sydney Morning herald (20 October 2014) First Green Square town centre apartments up for grabs (<http://smh.domain.com.au/real-estate-news/first-green-square-town-centre-apartments-up-for-grabs-20141008-10qwwl.html>) (accessed 20 November 2014)

advertising was used to generate particular stereotypes and sanitised versions of urban living: the *connection with the external environment is multiple, embodied and virtual*.<sup>33</sup>

Easthope and Randolph (2009) consider the realities of high density living in Australian cities. In contrast to the predominance of owner-occupiers in other housing types, ABS data indicates that some 59 per cent of apartments are rented in the Sydney metropolitan area.<sup>34</sup> In addition, high-density apartments are comparatively small and overwhelmingly one- or two-bedroomed.<sup>35</sup> While this reflects demographic trends towards an increased number of smaller households in Sydney, it does not necessarily respond to housing preferences. Too frequently, apartment developments lack diversity, accommodate few families, or if they are do, attract low-income families reliant on small and cheap, accommodation.<sup>36</sup> The nature of these high-density developments can contribute to tensions between community members that can lead to conflict over noise and use of common areas.

The lack of child-friendly apartment developments is further explored by Easthope and Tice (2011), They found that apartments are frequently too small for most families and developments are typically not designed for children. Indeed, developments appear to be designed for other sub-markets including young singles, couples and older 'empty-nesters'.<sup>37</sup>

Although high-density apartments may be sold with the allure of modernity and the promise of recreational opportunity, the occupied reality of conflict between residents can corrode the resilience of communities and diminish individual capacities to deal with complex and financially difficult issues, such as the collective resolution of defects in the buildings occupied.

Sherry (2013) compared the operation of strata governance with the development of property rights,<sup>38</sup> noting that the only way to fulfil state government policy to accommodate 70 per cent of Sydney's population increase within the current urban footprint will be the construction of medium- to high-density strata development. She charts the close links between the development of property concepts and contemporary notions of personal freedom and compares, unfavourably, the 'bundle of rights' represented by strata title with other, less constrained, forms of property title. She sees two consequences arising from intrusive strata governance:

*First, the economic consequence is that with too many owners with rights of veto, land will become an anti-commons... second, by failing to constrain by-law making power with the principle of negative liberty, strata and communities title schemes can create social and political cultures that run counter to mainstream democracy.*<sup>39</sup>

Essentially, Sherry draws attention to fundamental social and economic tensions underlying strata governance systems. She warns that careful attention needs to be paid to minimising these tensions or risk a decline in property freedoms as strata development fulfils government policy in becoming the dominant form of land tenure in Australia's growing cities. The alternative is widespread resistance to urban consolidations policies on the grounds that the financial security afforded by private residential strata property would be diminished.

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<sup>32</sup> Fullagar, S., Pavlidis, A., Reid, S. and Lloyd, K. (2013) Living it up in the 'new world city': high-rise development and the promise of liveability, *Annals of Leisure Research*, Vol 16(4), p280 - 296

<sup>33</sup> *ibid*

<sup>34</sup> Australian Bureau of Statistics:2011 Census of Population and Housing Greater Sydney Region Basic Community Profile ([http://www.censusdata.abs.gov.au/census\\_services/getproduct/census/2011/communityprofile/1GSYD?opendocument&navpos=220](http://www.censusdata.abs.gov.au/census_services/getproduct/census/2011/communityprofile/1GSYD?opendocument&navpos=220))

<sup>35</sup> Easthope, H.and Randolph, B. (2009) *Governing the Compact City: The Challenges of Apartment Living in Sydney*, Australia, City Futures Research Centre, University of New South Wales, Sydney, Australia Published online: 24 Sep 2009

<sup>36</sup> Easthope and Randolph (2009) *op cit*

<sup>37</sup> Easthope, H. and Tice, A. (2011) Children in Apartments: Implications for the compact city, *Urban Policy and Research*, Vol 29(4) p415 - 434

<sup>38</sup> Sherry C, *op cit*

<sup>39</sup> *ibid*

## 2.4 Life cycle

The lifecycle of residential strata developments present challenges to owners and other stakeholders as developments evolve.

Johnston and Reid (2013) described six overlapping phases in the development life cycle of multi-owned (strata) developments: planning, construction, promotion and sales, transition, occupation and termination.<sup>40</sup> They suggest that building defects and rectification tend to emerge early in the development life cycle. Building defects can be caused by building design during the planning phase but that...*unlike other forms of development, the planning phase of most MODs [multi-owned developments] overlaps with other life cycle phases, mainly due to financing constraints and the need to secure off-the-plan sales prior to construction. The planning phase also overlaps extensively with the occupation phase, especially in staged schemes.*<sup>41</sup>

Johnston and Reid also alert to the long-term impacts on residents of operational structures established during the transition phase:

*...the developer is responsible for the governance and management decisions...*<sup>42</sup>

The importance of development life cycle is also explored in Easthope et al (2014). Four stages of development are described: Planning and development, transition to lot owner control, operational life of a scheme and termination. The first two of these stages are particularly relevant to an understanding of building defects and rectification.

Easthope et al maintain that the planning and development stage is ill suited to setting the future trajectories of strata buildings. The development assessment system does not, and arguably cannot, consider the entire life cycle of a building due to the complexity of titling, the multiplicity of stakeholders and the variability of expertise available to identify and respond to issues during a building's life.<sup>43</sup>

Designers, builders and developers lack an incentive to consider the future building life cycle as their involvement typically ends with the transition to lot owner control.<sup>44</sup>

While defects may have their origins in the design and construction of a building, they may not become evident (visible) until sometime after this transition, turning rectification into a protracted, expensive and stressful enterprise:

*Rectifying defects can be expensive and collective action practically and legally difficult to mount, particularly if defects are located in individual lots as well as common property.*<sup>45</sup>

Decisions made by developers during the transition stage can also impose long-term onerous obligations on owners' corporations.<sup>46</sup> These obligations can be amplified when owners' corporations are prevented from identifying and rectifying defects. Johnston et al (2012) detected ... *evidence to suggest that some arrangements implemented by the developer conflict with the interests of the body*

<sup>40</sup> Johnston, N.R. and Reid, S. (2013) Multi-owned developments: a life cycle review of a developing research area, Property Management Vol 31(5) p366 - 388

<sup>41</sup> ibid

<sup>42</sup> ibid

<sup>43</sup> Easthope, H., Warnken, J., Sherry, C., Coiacetto, E., Dredge, D., Guilding, C., Johnston, N., Lamminmaki, D. and Reid, S. (2014) How Property Title Impacts Urban Consolidation: A Life Cycle Examination of Multi-title Developments, Urban Policy and Research, Vol 32(3) p289 - 304.

<sup>44</sup> ibid

<sup>45</sup> ibid

<sup>46</sup> ibid

corporate and the owners,<sup>47</sup> suggesting that some developers may shape these management structures deliberately to their advantage.

The period following registration of the strata plan is particularly important to the consideration of defects and their rectification:

*The key governance responsibilities for developers after registration are those:*

1. *bestowed on the body corporate. However, by virtue of the fact that the developer holds the titles to all lots, or is exercising proxies or, has authority under powers of attorney for the lot owners (as provided for in the off-the-plan sales contracts), the developer becomes the only voting member of the body corporate and therefore controls it; and*
2. *identified in the provisions relating to the agenda items for the first annual general meeting.*<sup>48</sup>

Johnston et al (2012) suggest that the level of control exercised by a developer over the nascent body corporate is particularly relevant to defects rectification. A developer can appoint a body corporate manager. Lot purchasers, particularly those new to strata living, may rely on that manager to arrange defects rectification against the appointing developer.<sup>49</sup>

In certain circumstances, developers that retain partial representation on a body corporate can also block it from pursuing legal action against the developer for defect rectification.<sup>50</sup>

## 2.5 Defects

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The notion of a residential strata development life cycle and the interests of multiple stakeholders are essential concepts to developing a better understanding of the occurrence of building defects, their rectification, and the social and economic impacts that arise.

Defects principally originate during the initial phases of a development life cycle: planning, design and construction. The transitional phase is particularly important if defects remain unrectified post completion, as it defines the conditions under which defects are identified, addressed and paid for. This is also the period during which strata governance arrangements are established; yet it is also the period when new governance participants are at their collective weakest, or largely absent.

Easthope et al (2012)<sup>51</sup> identified a markedly higher proportion of defects in recently constructed residential strata buildings, particularly those completed since 2000. They also noted that: *the most common defects were internal water leaks, cracking to internal or external structures, and water penetration from the exterior of the building...*<sup>52</sup> with negative impacts that included:

- *The health and safety of residents.*
- *The quality and liveability of homes, and hence quality of life.*
- *The capacity of owners, executive committee members and strata managers to deal with other management duties.*
- *The financial costs borne by owners (to cover emergency and other repairs, investigations, legal costs, and re-housing residents).*
- *Property values and rental incomes.*
- *Relationships between neighbours and other stakeholders. Conflicts over funds and responsibilities for defects can occur between owners, executive committees, managers, developers and others.*<sup>53</sup>

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<sup>47</sup> Johnston, N., Guiding, C. and Reid, S. (2012) Examining Developer Actions that Embed Protracted Conflict and Dysfunctionality in Staged Multi-owned Residential Schemes. Paper given at: 18th Annual Pacific-Rim Real Estate Society Conference, Adelaide, Australia, 15 – 18 January, 2012

<sup>48</sup> *ibid*

<sup>49</sup> *ibid*

<sup>50</sup> *ibid*

<sup>51</sup> Easthope, H., Randolph, B. and Judd, S. (2012) *Op.cit.*

<sup>52</sup> *ibid*

<sup>53</sup> *ibid*

In the NSW Government's Planning *White Paper*, waterproofing is singled out as a particular problem in high-rise residential developments.<sup>54</sup> Between Easthope et al (2012)<sup>55</sup> and the *Maltabarow Report*,<sup>56</sup> there appears to be broad agreement that the two major classes of defects in new residential strata development are waterproofing and fire safety systems, with the latter compounded by the adoption of complex alternative design solutions.

Unresolved defects typically escalate and compound, either gradually or rapidly. For example: water ingress can lead to mould growth, the deterioration of internal finishes and furnishings, increasing repair costs if delayed, and if left unchecked, health problems for occupants and disputes between neighbours. In contrast, faulty fire prevention measures may remain latent and only manifest catastrophically when systems fail during the only test that really matters – an actual fire.

Occurring in frequency as a stable proportion of total building numbers, the adverse impacts of building defects are likely to grow as strata developments multiply in Australia's cities. Consequently:

- *Increasing numbers of owners, residents and owners corporations will suffer short and long term problems caused by defects and the necessary costs and efforts associated with rectification.*
- *Court cases and associated costs are will increase, putting pressure on the courts.*
- *Complaints to NSW Fair Trading will increase, putting pressure on government resources.*<sup>57</sup>

While some defects may originate in the complexity of solutions (i.e. the design) others may arise through the use of incorrectly specified materials, unauthorised substitution of materials, incorrect installation, or damage caused by other sub-contractors. There is also the potential for defects to be present in component parts made elsewhere and brought onto site. The roles of the designer, builder and certifier are critical to the minimisation of defects and, where they do occur, early detection and rectification. All these events occur during the first two phases described by Johnston and Reid (2013).<sup>58</sup>

Defects not identified and rectified prior to the occupation certificate will persist into the transitional phase of the development life cycle. Being the 'initial owner', the developer has considerable power during this phase and can influence either the timely identification and rectification of defects, or their suppression. A developer can assert control over a newly formed owners' corporation in order to avoid defect rectification obligations by retaining large lot entitlements, use of proxy votes (voting on another's behalf with permission), and appointing a compliant strata manager.<sup>59</sup> In contrast, individual lot owners may not yet have purchased and be able, thereby, to direct that defects be identified.

Despite having no direct role in strata management, because they have other roles in built environment regulation local governments are increasingly likely to be entrained in disputes over defects rectification in strata buildings.

## 2.6 International experience

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The problem of reducing defects in residential strata properties is not unique to Australia. Seow Eng Ong (1997) investigated the increasing prevalence of building defects in pre-sold strata developments in Singapore.<sup>60</sup> Using game theory, the author developed a mathematical model of 'effort aversion' to describe the economic factors influencing developer incentives and costs over time that contributed to

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<sup>54</sup> NSW Government (2013) *White Paper – A New Planning System for NSW*, Sydney: Department of Planning

<sup>55</sup> Easthope, H., Randolph, B. and Judd, S. (2012) *Op. cit.*

<sup>56</sup> Building Professionals Board (2013) *Op. cit.*

<sup>57</sup> Easthope, H., Randolph, B. and Judd, S. (2012) *Op. cit.*

<sup>58</sup> Johnston, N.R. and Reid, S. (2013) *Op. cit.*

<sup>59</sup> Johnston, N., Guilding, C. and Reid, S. (2012) *Op. cit.*

<sup>60</sup> Seow Eng Ong, (1997), Building defects, warranties and project financing from pre-completion marketing, *Journal of Property Finance*, Vol. 8 Issue 1 pp. 35 – 51

'shirking' behaviour during construction and consequential building faults. Essentially, the analysis sought to uncover market motivations for building defects in order to ... *examine the policy implications of our model of effort aversion. In particular, we focus on three proposals to rectify the problem of excessive building defects:*

- (1) increase the warranty period by statutory requirement;*
- (2) tighten building inspections during the construction phase; and*
- (3) restrict pre-completion marketing.<sup>61</sup>*

Based on their model, the authors predicted that none of the policy measures would likely be effective but suggested a market driven alternative:

*It may be argued that a developer who desires to acquire and/or maintain a good reputation would have added incentive to exert the optimal level of effort so as to increase his revenue from subsequent projects.<sup>62</sup>*

Christudason (2007) reviewed disputes against developers over construction-related defects in common property in Singapore.<sup>63</sup> Though the Singaporean legislative context differs from Australia's, defect rectification problems are similar. Differing contractual rights of individual owners compound dispute difficulties caused by delayed emergence of defects.

*...by the time latent defects in common property in strata developments are manifested, the subsidiary proprietors may comprise of not only "original" purchasers (that is, those who bought their units directly from the developer), but also "subsequent" purchasers who bought their units from the original purchasers. While the original purchasers of units in the strata development may well have a contractual basis for claiming against the developer for defects in the common property, the legal basis upon which subsequent purchasers can claim will have to be in tort.<sup>64</sup>*

Warfel (1999)<sup>65</sup> suggested that the growth of building defects for 'multi family' affordable housing in California was due to cost reductions achieved through construction shortcuts. This combined with increasingly successful litigation resulted in spiralling insurance premiums that approached the full value of claims. A related issue concerned the definition of construction defects, where courts wrestled with concepts of 'reasonableness' and 'fit for habitation'. The success of litigation in the context of market pressures to lower building costs came to define the risk management environment.

*The end result is that the underwriter must include in the price for contractors liability insurance a substantial margin for contingency, transaction costs, and claim costs. Developers naturally insist upon an affordable price. The result is a breakdown in the supply of such insurance.<sup>66</sup>*

Warfel observed a decline in builders willing to develop affordable housing as a consequence. Perhaps echoing the motivations for current and proposed changes to the SSMA and HBA, Warfel suggested alternative approaches to improved construction quality, reduced litigation, and better risk management:

*Clearly, the public interest would be better served if both an improvement in building quality and a consumer-friendly alternative to litigation could be achieved. Indeed, the key to enhancing the availability of quality, affordable, multi-family housing hinges on these concepts.<sup>67</sup>*

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<sup>61</sup> *ibid*

<sup>62</sup> *ibid*

<sup>63</sup> Christudason, A. (2007) Defects in common property of strata developments in Singapore: Representative actions against developers, *Structural Survey*, Vol 25(3/4) p306 - 318

<sup>64</sup> *ibid*

<sup>65</sup> Warfel, W.J, Construction defect litigation, in *CPCU Journal*, Fall99, Vol. 52 Issue 3, p157

<sup>66</sup> *ibid*

<sup>67</sup> *Ibid*

Also in the US, Argue (2013) identified the existence of a 'construction defect industry' that is in *its fourth decade and continues to be a leader in how complex, multi-party litigation can be handled...*<sup>68</sup> Argue also notes that *the cost of defending a construction defect case in court is three to five times greater than the amount that is ultimately paid in settlement.*

Palmer (2012) examined the issue of local authority liability in New Zealand for defective homes. He notes that: *In the past decade in New Zealand, a major problem has arisen from the construction of buildings which suffer from the "leaky home syndrome".*<sup>69</sup>

Palmer also considers the causes and impacts of the recent increases in building defects in New Zealand as being attributed to design trends favouring flat roofs and no overhanging eaves, poor workmanship and the use of poorly considered and specified materials. The consequences are considerable:

*The mould problems and costs of remediation of leaky homes have affected thousands of dwellings and other buildings, and have affected the health and wellbeing of many residents.*<sup>70</sup>

New Zealand experience over the last decade or so is similar to the Australian as to the causes of defects and the operation of building certification. New Zealand certifiers have been found to owe a duty of care *in respect of residential properties in relation to building consents, inspections, and the issue of code compliance certificates.*<sup>71</sup>

Gibbons (2013)<sup>72</sup> explored recent New Zealand case law concerning the rights of strata corporations to vary unusually favourable contracts for strata management and maintenance entered into by a developer prior to the establishment of a strata scheme.<sup>73</sup> In so doing, he highlights in the manner of Sherry (2013)<sup>74</sup> the nature of strata property ownerships as 'a bundle of rights' and obligations that contrasted in degree with the kinds of property rights commonly assumed to subsist in, for example, detached housing. He observes that the interrelationships of these rights underpin many building defect disputes between developers and owners, and between different classes of owners, such as home owners or investors.

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<sup>68</sup> Argue, M.W. (2013) Timing is everything: When is the best time to resolve a construction defect case? *Dispute Resolution Journal*, Vol. 68(1) p 11 - 19

<sup>69</sup> Palmer, K. (2012) Local authority liability in New Zealand for defective homes, *International Journal of Law in the Built Environment*, Vol. 4(3) pp. 203 - 216

<sup>70</sup> *ibid*

<sup>71</sup> *ibid*

<sup>72</sup> Gibbons, T., (2013), Management agreements in multi-unit housing developments, *International Journal of Law in the Built Environment*, Vol. 5(1) p. 40 – 52

<sup>73</sup> Gibbons, T., (2013), Management agreements in multi-unit housing developments, *International Journal of Law in the Built Environment*, Vol. 5(1) p. 40 – 52

<sup>74</sup> Sherry, C. (2013) *op cit*

## 3 Major Stakeholders in Strata Development and Schemes

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Compared with the process of, and participants in, the development of detached housing, the number of participants and complexity of their interrelationships are defining qualities of strata developments.

### 3.1 Strata stakeholders

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There are many stakeholders relevant to residential strata development. It is useful to describe the roles and activities of the main participants.

#### 3.1.1 State government

State governments define the regulatory framework within which strata development operates. State governments develop policy, adopt legislation and regulation, issues licenses, and monitor the performance of many strata system participants. State governments also define urban spatial policies that affect settlement patterns, such as the NSW draft Metropolitan Strategy.

The State also defines some development control instruments and also establishes planning policies that affect strata residential development; most notably *State Environmental Planning Policy No. 65*. The State also has a role in development assessment and consent for defined State Significant Development, which recently included larger residential strata developments with values above defined thresholds.

State governments also affect strata development directly through investment in infrastructure that encourages private investment in medium density residential development. The State also coordinates its incentives in particular locations through special purpose development corporations and with initiatives such as Urban Activation Precinct strategies.

The SSMA and HBA reviews demonstrate a consumer protections role of the State government. Located within the Office of Finance and Services, *NSW Fair Trading safeguards the rights of all consumers and advises business and traders on fair and ethical practice...provide services directly to individuals and businesses to create a fair, safe and equitable marketplace.*<sup>75</sup>

NSW Fair Trading also provides advice and information to owners and tenants in strata development, including the provision of training for Executive Committee members.

The Building Professionals' Board is a government agency concerned with the licensing, standards and regulation of building surveyors and the means by which this group upholds compliance of development with established codified building standards.

#### 3.1.2 Local government

Local government – councils – are responsible for the local implementation of land use policy through the Environmental Planning and Assessment Act. Councils develop Local Environmental Plans (LEPs), for adoption by the State, and Development Control Plans (DCPs) that are both used to regulate development in the municipality. Typically, LEPs and DCPs address matters such as uses, density, built form, height limits, open space requirements, subdivision, car parking requirements and the like. Councils are the assessment and consent authority for most development, other than State Significant Development.

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<sup>75</sup> NSW Fair Trading ([http://www.fairtrading.nsw.gov.au/ftw/About\\_us.page](http://www.fairtrading.nsw.gov.au/ftw/About_us.page)) (accessed 8 November 2014)

Councils are responsible for most residential waste collection services, road maintenance, community and recreational facilities and the provision of many other local services. The regulatory function of councils extends to environmental health, building construction in some instances, and annual fire safety checks for residential buildings. Consequently, councils provide many of the services associated with the construction and ongoing occupation of residential strata development.

Some councils, such as City of Sydney and Willoughby City Council, are now also providing free education seminars for those considering moving into or living in strata.

### 3.1.3 Developer

Residential property developers typically fulfil multiple roles in the development and establishment of residential strata development, though in accumulation these comprise the management of the project overall. Depending on the type and size of the developer, their preferred approach to development and the development itself, a developer can:<sup>76</sup>

- Acquire and consolidate land
- Assess development potential and feasibility
- Retain expert and professional design, financial, planning, and engineering advice
- Develop design concept and project feasibility
- Secure or provide project finance
- Obtain planning approval
- Procure contract documentation
- Undertake marketing and procure sales contracts
- Act as builder
- Contract for construction
- Establish strata management structures
- Transfer lots to individual owners
- Retain assets for investment (e.g.: serviced apartments)
- Influence policies affecting the strata development industry

### 3.1.4 Builder and subcontractors

If a different entity from the developer, a builder will be responsible for construction and related contracting. Typically, a builder will employ sub-contractors for discrete areas of work. The contractual interrelationships between a developer, builder and subcontractors can be complex. A builder is generally regarded as being primarily responsible under contract for the work of sub-contractors; however, litigation concerning building defects rectification is frequently consumed with assigning liability amongst these parties.

### 3.1.5 Architect / Designer

Architects design buildings: *By combining creative design with technical knowledge, architects create the physical environment in which people live, which in turn, influences quality of life.*<sup>77</sup> Architects will assist in navigating the planning approvals process, setting budgets and selecting materials and finishes. They will also inspect construction work as it progresses. In some cases developers may choose to use designers or draughtspersons with a lower skill level to undertake building design.

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<sup>76</sup> Hyecorp (<http://www.hyecorp.com.au/whatispropertydevelopment>) (accessed 9 November 2014)

<sup>77</sup> Australian Institute of Architects (<http://www.architecture.com.au/architecture/national/about-architecture>) (accessed 9 December 2014)

### 3.1.6 Certifier

The Building Professionals Board defines the role of certifiers: *Certifiers mainly determine applications for construction certificates and complying development certificates... carries out critical stage inspections during construction to ensure the building work is in accordance with the development consent and legislative requirements.*<sup>78</sup>

As this definition implies, the certifier does not, and cannot, check the adequacy of all work and materials on a building site. A builder is responsible for supervision, while, along with other building professionals, a certifier undertakes inspections for specific purposes.

### 3.1.7 Owners' corporation

NSW Fair Trading describes the composition and roles of the owners' corporation as ... *made up of all the owners in the strata scheme. Each lot owner is automatically part of the owners' corporation and has a right to participate in the decision making. The owners' corporation comes into existence immediately after a strata plan is registered. At first it may only be made up of the developer, but as each person buys into the scheme, the owners corporation gains more members.*

*The owners' corporation has responsibility for the overall management of the scheme which includes:*

- *financial management*
- *keeping all necessary insurance covers up to date*
- *record keeping*
- *the repair and maintenance of common property*
- *by-laws*
- *employment of a strata managing agent and/or building manager.*<sup>79</sup>

### 3.1.8 Executive committee

The executive committee is elected to act on behalf of the owners' corporation in the day-to-day running of the strata scheme. NSW Fair trading explains:

*The owners' corporation must elect an executive committee which can make many of the day-to-day decisions about running the scheme on its behalf.*

*However, the owners' corporation can overrule executive committee decisions or limit what they can make decisions about.*

*The executive committee is elected at each annual general meeting (AGM). It can have up to nine members and, once elected, decides who is to hold the office bearer positions of chair, secretary and treasurer.*

*You can be elected to the executive committee if you are:*

- *an owner*
- *a company nominee of a corporation that is an owner*
- *a person who is not an owner but who is nominated by an owner who is not standing for election.*<sup>80</sup>

### 3.1.9 Original owner

The original owner is defined as ...*the owner of the scheme when the strata plan is registered and is usually the builder or developer.*<sup>81</sup>

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<sup>78</sup> Building Professionals Board NSW at <http://bpb.nsw.gov.au/certifiers-role/what-certifier-does> (accessed 2 October 2014)

<sup>79</sup> NSW Government Fair Trading (2013) Strata Living, Sydney: NSW Fair Trading

<sup>80</sup> *ibid.*

<sup>81</sup> NSW Government Fair Trading (2014) Fact Sheet: Starting the owners corporation, Sydney: NSW Fair Trading

When expressed at the outset, the understandably narrow pragmatic interests of the original owner can have lasting repercussions on the operation of a strata scheme.

### 3.1.10 Owners and occupiers

Compared with the unitary ownership of detached dwellings, the many owners within strata development are likely to exhibit diverse interests. Owners differ in income levels, lifestyles, work status, family composition, age, and reason for purchase. Some owners may be investors while others will be owner-occupiers.

Investors, despite their absence, are a member of owners' corporation and can be member of the executive committee, however the extent to which they become involved is likely to be complicated by distance and other calls on time (including their principal place of residence). Though membership of the owners' corporation is automatic, participation is not obligatory. Any owner may assign voting rights to a third party (proxy vote).

### 3.1.11 Tenants

Tenants participate in many of the informal strata relationships and are required to comply with by-laws, yet lack the formal rights of owners. Most notably, tenants are not members of the owners' corporation and generally do not have a long-term interest in the development. Instead, the responsibilities and rights of tenants are as defined in the *Residential Tenancies Act 2010*.

Unless directly affected, tenants are likely to have little interest in identifying and reporting building defects. Tenants may comprise a significant proportion of residents in a development, which means that early detection of defects is less likely from 'eyes on the ground'.

### 3.1.12 Strata managing agent

Though some strata schemes can be self managed, others, particularly large and complex schemes, typically engage professional assistance. NSW Fair trading explains:

*Agents carry out some or all of the functions, duties or powers of the owners' corporation including administrative matters such as calling meetings and collecting levies. They should also provide advice and guidance about legislative requirements.*

*A managing agent cannot be given the power to:*

- *delegate their powers, authorities, duties or functions to others*
- *make a decision on a restricted matter (a matter that needs a special or unanimous resolution or is one which the owners corporation has decided must go to a general meeting)*
- *set levies.*

(In addition)

*A managing agent cannot act as a proxy for an owner in votes that would result in their financial or material benefit.*<sup>82</sup>

### 3.1.13 Building manager

Some larger and more complex strata schemes may also employ a building manager or caretaker to deal with the day-to-day issues that confront the use and management of common property. This role can also be combined with concierge services to assist individual residents' needs.

*Caretakers, sometimes called building managers, can also be employed to assist the owners' corporation in carrying out its functions.*

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<sup>82</sup> NSW Government Fair Trading (2013) Strata Living, Sydney: NSW Fair Trading

Caretakers can also operate as letting agents within the building and are often referred to as the building manager. They can assist the owners' corporation in:

- the management of common property
- controlling the use of common property by tradespersons and other non-residents
- the maintenance and repair of common property.

(In addition) a caretaker cannot act as a proxy for an owner if the voting would result in their financial or material benefit for example, to extend their appointment, to increase their pay, or in a decision not to proceed with or to delay legal proceedings involving the proxy holder.<sup>83</sup>

### 3.1.14 Insurers

Compared with detached home building, risk management in strata development is very complex and is generally undertaken through insurance cover.

During construction, insurance typically includes construction insurance, to cover damage or loss of building works and professional indemnity to cover the negligence of professional advisors. Home Owners Warranty (HOW) insurance can be taken out to cover the failure of the builder or individual contractors to fulfil contracts.

HOW is required under the Home Building Act, depending on the scale of works undertaken. Home warranty insurance provides a set period of cover for loss caused by defective or incomplete work in the event of the death, disappearance or insolvency of the contractor. Cover for loss arising from defective work is provided for a period of:

- 6 years from the date of completion of the work or the end of the contract for the work (whichever is the later) for loss arising from a structural defect, and
- 2 years for loss arising otherwise than from a structural defect.<sup>84</sup>

Since 2010 home warranty insurance has been provided by NSW Self Insurance Corporation through the NSW Home Warranty Insurance Fund. NSW Fair Trading is responsible for administering operation of the home warranty insurance scheme.<sup>85</sup>

The nature of HOW cover varies between states. In Queensland, the State operates a HOW scheme, that offers 'first resort' cover, meaning that claims can be made against the insurer before pursuing other remedies. In NSW, HOW is a 'last resort', meaning that recourse to insurance remedy for loss can only occur after other recovery methods, typically litigation, are exhausted. However, HOW is not obligatory for the construction of residential apartment buildings above 3 storeys.

In building disputes, including those concerning defects rectification in residential strata buildings, all three classes of insurance cover may be called upon.

### 3.1.15 Financiers

Financial institutions typically have two roles in strata development.

Firstly, lenders may fund developers to acquire land and build. Funding decisions may depend on development feasibility analysis and the extent of pre-sales.

Secondly, funding individual lot owners to purchase apartments. When assessing how much to lend, institutions are primarily concerned that the security offered is sufficient to cover the loan risk and that the borrower can demonstrate a reasonable capacity to service the loan.

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<sup>83</sup> NSW Government Fair Trading (2013) Strata Living, Sydney: NSW Fair Trading

<sup>84</sup> NSW Fair Trading ([http://www.fairtrading.nsw.gov.au/ftw/Tradespeople/Home\\_warranty\\_insurance\\_page](http://www.fairtrading.nsw.gov.au/ftw/Tradespeople/Home_warranty_insurance_page)) (accessed 22 November 2014)

<sup>85</sup> Home Warranty Fund Insurance (<https://homewarranty.nsw.gov.au/portal/server.pt/community/a%3Bhome/255>) (accessed 22 November 2014)

Though in the extreme, building defects can affect both value of security offered and repayment capacity, there does not appear to be any significant lender assessment of this likelihood.

### 3.1.16 Lawyers

Lawyers participate in the residential development process in a number of ways. Most significantly, lawyers are involved in contractual arrangements between various parties. Legal representation is essential to successful claims against a builder under statutory warranties, and if this fails, in litigation. For strata buildings over three storeys, where HOW is not obligatory, the narrower definition of 'major' defects, and the reduced time during which statutory warranties can be pressed to remedy all other defects, means that owners must resort to litigation to recover costs for significant defects that take time to manifest.

## 3.2 Stakeholder relationships

Though each stakeholder has varying interests and motivations in the development and management of strata development, different stakeholders can often share interests.

For the purpose of this discussion, stakeholders are divided into four functional categories. Within each category, different participants have largely similar roles and interests. Roles and interests between categories differ substantially, sometimes to the point of direct competition. Some stakeholders occupy multiple categories, either simultaneously or at different phases during the strata lifecycle. The categories are:

- Producers
- Funders
- Regulators
- Consumers

In order to highlight the complexity of residential strata development, depicts the stakeholders involved in the development of owner-occupied detached housing typical of the urban fringe and the stakeholders that might be involved in strata residential developments closer to the city centre. The complexity of strata development is illustrated by comparing the numbers of participants in fringe development with inner urban strata development.

A number of stakeholders depicted may not have direct roles in the delivery of residential development but are recorded in the categories for which they offer indirect assistance. For example, though not involved directly in the construction of detached housing, lawyers may act for consumers. Similarly, a financial advisor may assist a developer, whereas a bank operates separately as a funder.

Table 1 - stakeholders in residential strata development

Categories / Stakeholder	Producer	Funder	Regulator	Consumer	Notes	Involvement in non-strata housing?
State Government			✓	✓	Policy, governing legislation and consumer protection	Yes
Local Government (Council)			✓		Mainly development approval	Yes
Developer	✓	✓			May include shareholders	Potentially
Builder	✓				May include shareholders	Yes
Architect/designer	✓				Can take on a range of roles	Potentially
Certifier			✓		Typically appointed by developer	Yes
Original Owner	✓	✓		✓	Developer at start of project	No
Owners' Corporation				✓		No
Executive Committee				✓		No
Owner occupier				✓		Yes
Owner investor				✓		Yes
Tenant				✓		Yes
Strata Managing Agent				✓	Can be appointed by developer	No
Building Manager				✓	Can be appointed by	No

Categories / Stakeholder	Producer	Funder	Regulator	Consumer	Notes	Involvement in non-strata housing?
					developer	
<b>Insurers:</b> <b>Home Owners Warranty</b> <b>Building and contents insurer</b>		✓		✓	If covered	Yes
<b>Development Financier</b>	✓	✓			Some self financed	No
<b>Lawyers/legal advice</b>	✓	✓	✓	✓	Conveyancing role; can act for all parties in litigation	Yes

There are four striking features of this table:

- The number of entities that can operate within the strata delivery system.
- A developer can control numerous functions up to, and potentially beyond, delivery of individual strata lots. Strata owner representatives claim that less scrupulous developers can, thereby, resist legitimate consumer endeavours to identify and rectify building defects.
- A large number of interdependent and independent entities and stakeholders appear within the 'consumer' column, acting directly as consumers or employed by them. The alignments and conflicts of interests within this group complicate the coherent expression of consumer protections and rights, particularly when dealing with the rectification of defects.
- There is potential for significant variation in the consumer experience of strata purchase and ownership. The number of entities, their formal interrelationships, how they function in practice, the diligence and wisdom of strata governance, and even the extent of good will amongst individual strata participants, can all combine in unpredictable ways to affect all aspects of strata living. This variability is at its greatest during the first phases of the strata lifecycle, at the very time when building defects are most likely to become evident and require rectification.

## 4 Review of Current and Forthcoming Legislation

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### 4.1 Introduction

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Legislation affecting strata development has been subject to considerable review over the last two years. The stated motivation for these changes is ... *to ensure that New South Wales, as the birthplace of strata and community title, is once again able to demonstrate world's best practice.*<sup>86</sup>

Residential strata development is impacted to a greater or lesser extent by numerous pieces of legislation, including:

- *Home Building Amendment Act 2014*
- *Strata Schemes Management Act 1996*
- *Environmental Planning and Assessment Act 1979*
- *Building Professionals Act 2005*

Each of these Acts has undergone recent review leading to proposed change. Each review has been undertaken in the knowledge of a broader context of legislative reform:

*The proposed strata reforms were also developed in the context of the Government's broader reform agenda...*<sup>87</sup>

Despite the acknowledgement that the legislation is related, working in concert to achieve specific outcomes, the broader reform process across multiple Acts has proven to be unachievable. While the *Home Building Amendment Bill 2014* has now been passed by both Houses to become the *Home Building Amendment Act 2014*, neither the *Strata Schemes Management Act 1996* nor the *Environmental Planning and Assessment Act* are expected to be amended in the short term.

Should they go ahead, changes introduced in the *Home Building Amendment Act 2014* will now operate in isolation from intended and related amendments to the *Strata Schemes Management Act 1996*. Changes will also pre-date any amendment of the *Environmental Planning and Assessment Act 1979*, should it be amended at all. This is particularly pertinent when examining the legislation in the context of building quality, defects and defect resolution in strata developments.

### 4.2 The Home Building Amendment Bill 2014

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The Home Building Amendment Bill successfully made its passage through the NSW parliament in May and June 2014. It was:

*...the culmination of a comprehensive consultation process. The reform process was undertaken to ensure home building laws reflect current practice and remove any unnecessary red tape for industry while providing consumers with appropriate protection.*<sup>88</sup>

In introducing the Bill, the Minister for Fair Trading, the Hon. Matthew Mason-Cox, described the changes to statutory warranties and in particular the definition of 'structural defect':

*The main issue was that a significant defect may not be a "structural defect" but could still be a "major defect" and worthy of the six-year warranty period.*

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<sup>86</sup> NSW Government (NSW Fair Trading) (2013) Strata Title Law Reform: Strata and Community Title Law Reform Position Paper

<sup>87</sup> *ibid*

<sup>88</sup> The Hon. Matthew Mason-Cox (2014) Home Building Amendment Bill 2014: Second Reading (extract from NSW Legislative Council Hansard and Papers Tuesday 27 May 2014)

*Of particular concern was whether water penetration and fire safety non-compliance fell within the two- or six-year warranty periods, as there has been considerable variation in rulings on these matters depending on the severity of the defect.*

*Reform of the definition of "structural defect" is long overdue. It is necessary to reduce the significant time and money spent by parties on disputes and to ensure more consistent court and tribunal decisions. This will deliver cost savings for home owners, builders and the home warranty insurance fund.*

*The bill replaces "structural defect" with a new concept of a "major defect" for the six-year statutory warranty period. To provide further certainty, the definition will be moved from the Regulation into the Act.*

*A two-step test will be introduced to determine whether a problem is a "major defect".*

*The first step is whether the defect is in a "major element" of the building. Major elements will include structural load bearing elements, but for the first time fire safety systems and waterproofing are also expressly included.*

*The second step considers how severe the consequences of the defect are to the building, such as where it causes, or is likely to cause a building to be uninhabitable or unusable, the destruction of the building, or the threat of collapse of the building.<sup>89</sup>*

The proposed amendments within the Bill defined a major defect:

**Major defect means:**

*(a) a defect in a major element of a building that is attributable to defective design, defective or faulty workmanship, defective materials, or a failure to comply with the structural performance requirements of the National Construction Code (or any combination of these), and that causes, or is likely to cause:*

- (i) the inability to inhabit or use the building (or part of the building) for its intended purpose, or*
- (ii) the destruction of the building or any part of the building, or*
- (iii) a threat of collapse of the building or any part of the building, or*

*(b) a defect of a kind that is prescribed by the regulations as a major defect.*

**major element of a building means:**

*(a) an internal or external load-bearing component of a building that is essential to the stability of the building, or any part of it (including but not limited to foundations and footings, floors, walls, roofs, columns and beams), or*

*(b) a fire safety system, or*

*(c) waterproofing, or*

*(d) any other element that is prescribed by the regulations as a major element of a building.<sup>90</sup>*

Defects in fire safety systems and waterproofing, two of the most common issues in new residential strata developments, are to be subjected to the 'Structural Defect' test. The likelihood of residents vacating a building due to defective fire safety systems is low. Similarly, the failure of waterproofing may not be destructive in nature or necessitate residents to vacate the building.

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<sup>89</sup> The Hon. Matthew Mason-Cox (2014) Home Building Amendment Bill 2014: Second Reading (extract from NSW Legislative Council Hansard and Papers Tuesday 27 May 2014)

<sup>90</sup> Home Building Amendment Bill 2014

In order to obtain the benefits of statutory warranties, 'non-major' building defects must now be identified and proceedings commenced within two years of completion. Only major defects can be rectified under statutory warranties if identified and proceedings commenced up to six years following completion. Waterproofing, which can be a latent defect, and fire safety systems, the most common defect areas, must be addressed within two years of completion unless they pass the severity test necessary to constitute a major defect.

### 4.3 Strata Schemes Management Act 1996

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Strata and community title law reform was subject to community consultation through 2012 and 2013. In September 2012 the NSW Government released a discussion paper: *Making NSW No. 1 Again: Shaping Future Communities*.<sup>91</sup> More than 1,900 submissions were received.<sup>92</sup>

Subsequently the Government released *Strata Title Reform: Strata and Community Title Law Reform Position Paper* in November 2013. At the time the Government anticipated tabling a Bill giving effect to the proposed strata title reforms in Parliament in early 2014.<sup>93</sup> It now appears unlikely the reforms will come before Parliament until after the next State election in March 2015.

These reforms were intended to achieve a number of goals including: *improve governance through greater transparency and accountability and help ensure building defects are identified and rectified earlier*.<sup>94</sup>

#### 4.3.1 Governance

In reviewing the legislation the Government recognised the need for *a sensibly structured regulatory framework that promotes self-governance and democratic decision-making*.<sup>95</sup>

The recommended amendments to the legislation include options to increase participation by owners and tenants and provide for transparency and accountability in decision-making. In particular the proposed amendments deal explicitly with actual and perceived conflicts of interest.

Recommendations also addressed the issue of proxy voting, and in particular the practice of *proxy-farming, where an individual or small group of owners gather large numbers of proxy votes to gain control of the decision making process*.<sup>96</sup> The paper foreshadowed limiting the number of proxies held by one individual to 5 per cent if the scheme had more than 20 lots, or one if the scheme had fewer than 20 lots.

The role of the strata managing agents was specifically addressed, recognising that *a common cause for concern is that owners' corporations are forced by the terms of their agency agreement to enter into service contracts that are not in their best interests*.<sup>97</sup> Two recommendations were included:

- Greater disclosure requirements for agents who receive commissions.
- Limit the terms of strata management contracts to three years with no automatic roll-over allowed.

The second of these proposed reforms would deal with the concern that the developer can appoint a strata managing agent in the initial period under what is effectively a long term contract. Given the

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<sup>91</sup> NSW Government (NSW Fair Trading) (2013) Strata Title Law Reform: Strata and Community Title Law Reform Position Paper

([http://www.fairtrading.nsw.gov.au/biz\\_res/ftweb/pdfs/About\\_us/Have\\_your\\_say/Strata\\_title\\_law\\_reform\\_position\\_paper.pdf](http://www.fairtrading.nsw.gov.au/biz_res/ftweb/pdfs/About_us/Have_your_say/Strata_title_law_reform_position_paper.pdf))

<sup>92</sup> *ibid.*

<sup>93</sup> *ibid.*

<sup>94</sup> *ibid.*

<sup>95</sup> *ibid.*

<sup>96</sup> *ibid.*

<sup>97</sup> *ibid.*

relationship of the developer and strata managing agent in this circumstance, it may be difficult to see how an agent can approach the rectification of defects by the developer in an objective way.

#### 4.3.2 Building defects

The scope of the strata title law consultation and reform process with respect to defects was set out early:

*Issues around the design and construction standards of buildings and the certification process are outside the scope of this review. These matters fall under the separate review of the Planning system. Similarly, issues such as the application of home warranty insurance to multi-storey buildings and the time periods for defect claims are being examined as part of a separate review of the Home Building Act 1989.*<sup>98</sup>

Nevertheless, the review recognised the significant issue of building defects in new buildings:

*...inherent complications in identifying and rectifying defects in new strata buildings as owners often arrive on the scene well after the building work is complete, at different times from each other, and they usually do not have a contractual relationship with the builder.*<sup>99</sup>

The review made three important recommendations relating to the identification and rectification of defects:

- *Include defects and rectification as a compulsory item for discussion at each AGM until the expiry of the statutory warranty periods under the Home Building Act.*
- *Provide that an independent defects report be prepared for the owner's corporation.*
- *Provide that the developer of a high-rise strata building pay a bond [equivalent to two per cent of the contract amount for the building work], which will be held in trust until the independent inspector agrees that identified defects have been fixed.*
- *Restrict the right of the developer and people connected to the developer from voting on matters relating to building defects.*<sup>100</sup>

## 4.4 Environmental Planning and Assessment Act

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As noted above, the design, construction quality and certification of strata development was intended to be addressed through the review of the planning system.

In 2012, the NSW Government commenced a major overhaul of the NSW planning system. The Environmental Planning and Assessment Act 1979, had, over the course of 30 years, been amended over 150 times and had ultimately become '*complex and legalistic, focused heavily on process and not on the outcomes that users of the system are seeking to achieve*'.<sup>101</sup>

Following the Green Paper and consultation, the NSW Government released a White Paper in early 2013. Legislation was subsequently introduced into Parliament and defeated, largely due to the changes in community consultation on new development resulting from the introduction of code-based assessment. It now appears unlikely the proposed legislation will be reintroduced in its intended form.

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<sup>98</sup> NSW Government (2012) Making NSW No. 1 Again: Shaping Future Communities - Strata and Community Title Law Reform Discussion Paper ([http://www.fairtrading.nsw.gov.au/biz\\_res/ftweb/pdfs/About\\_us/Have\\_your\\_say/Making\\_nsw\\_no\\_1\\_again\\_shaping\\_future\\_communities.pdf](http://www.fairtrading.nsw.gov.au/biz_res/ftweb/pdfs/About_us/Have_your_say/Making_nsw_no_1_again_shaping_future_communities.pdf))

<sup>99</sup> NSW Government (NSW Fair Trading) (2013) Strata Title Law Reform: Strata and Community Title Law Reform Position Paper ([http://www.fairtrading.nsw.gov.au/biz\\_res/ftweb/pdfs/About\\_us/Have\\_your\\_say/Strata\\_title\\_law\\_reform\\_position\\_paper.pdf](http://www.fairtrading.nsw.gov.au/biz_res/ftweb/pdfs/About_us/Have_your_say/Strata_title_law_reform_position_paper.pdf))

<sup>100</sup> *ibid*

<sup>101</sup> NSW Government (2012) A New Planning System for NSW Green Paper, Sydney: Department of Planning

While the Environmental Planning and Assessment legislation will remain as it is for the foreseeable future, it is instructive to look at the intentions of the proposed legislation as this also highlights failings within the current legislation.

The Green Paper foreshadowed the need to consider building regulations and outcomes:

*NSW stakeholders have identified issues in the building industry, including:*

- *Accountability of builders and other building practitioners*
- *Liability of those builders and other practitioners*
- *Quality of building outcomes*
- *Cost and effectiveness of consumer protection measures*
- *Confidence of investors and builders*
- *Consistency of regulation.*

*The Government is proposing to undertake a review to identify improvements to building regulation, policy, systems and responsibilities.*<sup>102</sup>

The White Paper identified a number of proposals intended to *rebuild confidence in the quality and safety of buildings.*<sup>103</sup> In particular the White Paper noted:

*Building regulation and certification have been subject to criticism in recent times. Instances of fire protection systems failures and inadequate maintenance, common building defects including waterproofing and fire safety non-compliance, and mistakes made by some accredited certifiers have reduced the quality and safety of buildings, and consequently, the community's confidence in building regulation and certification.*<sup>104</sup>

The defeat of the proposed legislation is likely to result in the continuation of the existing system of building regulation and certification, unless the recommendations made separately in the Maltabarow Report (below) are implemented.

## 4.5 Building Professionals Act 2005 and the Building Professionals Board

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The Building Professionals Board accredits and regulates certifiers in NSW. It is an independent NSW Government authority created under the Building Professionals Act 2005. Through its accreditation scheme, the Board authorises almost 1,500 accredited certifiers to issue development certificates in NSW.<sup>105</sup> The Board also investigates the professional conduct of certifiers to ensure they comply with legislative requirements.

The Building Professionals Board does not licence or regulate builders or other trades people; this is the role of NSW Office of Fair Trading.

The *Maltabarow Report*, arose from a need for the Board to address the role of private certifiers in delivering on the *Planning System White Paper*. The review focused on just one aspect of a broader framework: *certification and its role in ensuring that building work complies with building and planning codes, statutes and regulations. These are designed to ensure that buildings are safe and meet appropriate standards relating to matters such as amenity; fire protection; waterproofing and public health.*<sup>106</sup>

The review recognised the issue of defects: *a consumer problem which has a number of building control, planning and consumer protection aspects is defects in multi-storey apartments, where a*

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<sup>102</sup> NSW Government (2012) A New Planning System for NSW Green Paper, Sydney: Department of Planning

<sup>103</sup> *ibid*

<sup>104</sup> *ibid*

<sup>105</sup> Building Professionals Board <http://bpb.nsw.gov.au/our-role/what-we-do> (accessed 3 October 2014)

<sup>106</sup> Building Professionals Board (2013) Op. cit.

*body corporate will conduct surveys towards the end of a statutory warranty period and where there is considerable concern between owners and builders alike.*

*Given the size and complexity of the building sector and the tendency of parts of government with particular responsibility to operate within silos, this is a difficult task. However, the key principle of assigning the management of risk to those best able to manage it would seem to be a good guide in allocating responsibilities. Another is clarity with which roles and responsibilities are defined. Getting builders to get things right in the first instance would seem to be a better approach than over-reliance on the checking process.*

*The implementation of a new planning system for NSW will need to be supported by a robust building certification scheme. But, securing outcomes does not end there. Reviews of the Home Warranty Scheme and other aspects of the building consumer protection framework, together with mooted changes to the Local Government Act are all elements of a reform process with interdependent parts.*

The Maltabarow Report concluded:

*Accordingly, it would seem to be a good idea for a joint program between the administrations of Planning and Infrastructure, Fair Trading and Local Government to be agreed as the reform process unfolds, to ensure a coordinated approach, with clear assignment of roles and responsibilities to the relevant units within these administrations.*<sup>107</sup>

## 4.6 Conclusion

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The proposed legislative changes governing the development and operation of strata developments are motivated by the interdependent and interrelated nature of regulatory provisions. This interdependency also applies to the management of building defects in residential strata development.

It follows that the balances sought by coordinated legislative changes will be lost if only the provisions of the *Home Building Amendment Bill 2014* come into force. It is not yet clear what the consequences might be, though the diminution of liability to correct building defects appears to favour developers at the expense of homeowners.

Balancing remedies are proposed for the *Strata Schemes Management Act 1996*, particularly the operation of a two per cent retention sum. However, passage of the *Strata Schemes Management Bill 2014* is currently stalled, and may be adopted in mid to late 2015, depending on the outcome of next State election in March 2015.

Proposed replacement of the *Environmental Planning Assessment Act* appears to have been abandoned and individual reform measures now seem likely to be pressed under current legislation.

Despite the recommendations in the *Maltabarow Report* it is also unlikely that there will be any change to the operation of the Building Professionals Board and related legislation in the foreseeable future.

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<sup>107</sup> Building Professionals Board (2013) Op. cit.

## 5 Analysis of Legislative Change Consultation Submissions

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### 5.1 Introduction

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The identification and rectification of building defects will be most profoundly affected by changes proposed for the *Strata Schemes Management Act 1996* and the *Home Building Act 1989*. The NSW Parliament passed the Home Building Amendment Act 2014 in May 2014. Initially intended to come into effect on 1 December 2014, implementation was recently deferred until early 2015.

This section summarises responses to the consultation processes leading up to the development of amendment to the HBA and SSMA. The reviews ran concurrently in late 2012. The consultative processes involved the release of initial discussion papers containing a series of key questions to be answered through the review process.

The HBA review invited submissions from the general public and industry associations in response to an issues paper, *Reform of the Home Building Act 1989*, published by Fair Trading NSW in 2012. The review process attracted almost 100 individual submissions and a further 21 from consumer or industry associations.

### 5.2 Submissions concerning the Home Building Amendment Act (2014)

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Of the total 21 consumer and industry association submissions publicly available, a number were not reviewed as they were submitted by organisations not considered to be central participants in the production, finance, purchaser or regulator sectors of the strata housing system, as described in Chapter 3.

A summary of the responses to individual questions posed by the NSW Government in its review process follows below. These responses are tabulated in **Appendix A**. Individual association responses to all questions directly or indirectly concerning defects are summarised in **Appendix C**.

The submission reviewed were from:

- Australian Bankers' Association Inc.
- Australian Institute of Architects
- Master Builders Association
- Australian Property Institute
- Builders Collective of Australia
- Housing Industry Association
- Institute of Arbitrators and Mediators Australia
- Insurance Council of Australia
- The Law Society of New South Wales
- Property Council of Australia (countersigned by Urban Taskforce)
- Real Estate Institute of New South Wales
- The Owners Corporation Network and Strata Community Australia (joint submission)

### **5.2.1 Should the definition of 'completion' include a specific definition for subsequent purchasers?**

The issue partly concerns whether or not subsequent purchasers should benefit from statutory warranties to the same extent as original purchasers – those that purchase from a developer. It also concerns what event should define the warranty period commencement date.

The Master Builders Association (MBA) considers that only original purchasers should get the benefit of statutory warranties because subsequent purchasers would be in a position to discover emerging minor building faults and pay accordingly. The Property Council of Australia + Urban Taskforce (PCA+UT) holds a similar view. The MBA does accept that warranties for structural defects should benefit subsequent purchasers

The Housing Industry Association (HIA) also has a similar view; it opposes any changes that would grant extended warranties to subsequent purchasers. Other submissions supported extension of statutory warranties – the ABA considered this essential to protect the interests of lenders (see summary of ABA submission, Appendix C).

Most other submissions support clear definitions for when warranty periods commence and expire, regardless of beneficiaries.

### **5.2.2 Is it necessary to clarify that the principal contractor is ultimately responsible for the statutory warranties to the homeowner?**

The question concerns the difficulty in attaching responsibility when enforcing statutory warranties. One suggestion is that a single point of responsibility be defined.

Representing producers, the MBA opposes the notion of single-point responsibility for defects to the head contractor. The submission explains at length the difficulties faced by builders managing complex projects in the face of commercial pressures and poor contractor expertise. For many, the submission explains, working in the building industry is 'just too hard' and they leave.

All others that responded agreed that a single point of responsibility was necessary and/or that building skills should be improved.

### **5.2.3 Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?**

The amendments propose a distinction between 'structural' and 'non-structural' defects in order to treat rectification liability differently. It proposes that 'structural' defects should be covered by a 6 year statutory warranty period: 'non-structural' defects limited to a 2 year period.

All respondents discuss the definitional difficulties of what should or should not be included.

The PCA+UT opposes current definitions of 'structural' that include items such as waterproofing. It is claimed that these kinds of building elements are transitory in nature and would normally require replacement well within a 6 year warranty period. The alternative of more durable items would add to building cost. The PCA+UT considers that the definition of 'structural' should be in the Act, not in regulations, which can more readily be amended.

Other responses range from 'all defects should be rectified' (Australian Institute of Architects – AIA) to the need for clear but not exhaustive definitions.

### **5.2.4 In what ways could statutory warranties be improved (if at all)?**

Statutory warranties offer purchasers a form of consumer protection that cannot be contracted away on purchase.

Most respondents suggest improvements. The Law Society of New South Wales (LSNSW) and the Real Estate Institute of New South Wales (REINSW) both recommend greater harmonisation with national consumer law. The Builders Collective of Australia recommends current 'last resort' insurance cover be replaced with 'first resort' cover in order to reduce litigation.

Representing producers, the MBA and PCA+UT comment on definitional shortcomings that they see as inviting litigation. They also point to failure of some specified building materials that rebound as a builder's liability.

Representing a class of purchasers, the joint submission by the Owners Corporation Network and Strata Community Australia (OCN+SCA) observes that warranties are currently unjust in that builders' responsibilities to repair defects are transferred to consumers.

Within the financial sector, the Australian Bankers Association (ABA) seeks to ensure that rights under statutory warranties transfer to subsequent owners. The Insurance Council of Australia (ICA) refers to recent case law, which has the potential to alter the responsibilities of builders to rectify defects.

#### **5.2.5 Should homeowners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**

A producer contractually required to remedy defects cannot do so if site access is denied. The question seeks comment on whether access should be required by statute.

Most respondents considered that some form of access right should be granted but many considered this would not be automatic if a history of conflict developed between the two parties.

Two producer submissions from the MBA and PCA+UT considered that unreasonable refusal to allow builder access should void the obligation to undertake rectification.

#### **5.2.6 Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading's jurisdiction?**

There is evidence that unscrupulous builders and developers liquidate their companies on completion and sale of developments in order to avoid defect rectification responsibilities. The same individuals then immediately open similar companies and continue trading, leaving the whole cost of defects rectification to strata unit purchasers. This is called 'phoenix company behaviour'.

All respondents oppose this behaviour, though some producers, the MBA, HIA, and PCA+UT, distinguish between legitimate liquidation and outright fraudulent collapse of companies to avoid contractual obligations.

The OCN and SCA consider that criminal sanctions should apply to proven phoenix company behaviour.

#### **5.2.7 Should new rectification work of significant value be covered by a further certificate of insurance? Why?**

It is possible that significant rectification work undertaken towards the end of a statutory warranty period may not be as durable as the original work and fail soon after the warranty expires. The proposition is to require an extended warranty for this kind of work. Not to require an extended warranty may encourage poor quality 'patch up' work.

The ABA, HIA and the AIA agree with extending cover; the ICA suggests that a new contract prevails hence extended cover is required.

As a producer, the MBA opposes extended cover.

The Australian Property Institute (API) and REINSW consider that original contract and insurance conditions should be adequate.

#### **5.2.8 Should the current exemption from home warranty insurance requirements for the construction of multi-storey buildings be retained? Why?**

Home Owners Warranty (HOW) insurance, taken out by the builder to benefit the home owner, providing a form of consumer protection, but is not required for buildings over three storeys.

The Builder Collective of Australia considers that current 'last resort' insurance, such as current HOW products, should be replaced by 'first resort' cover and apply generally to all types of residential property.

The HIA sees no need for HOW. It considers builder default, disappearance or death to be unlikely for large projects with many contracting parties.

The ICA raises a number of related insurance market matters to HOW that it considers require clarification.

Submitters representing purchasers consider that HOW should apply to all residential strata developments.

#### **5.2.9 Does the definition of 'disappeared' for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this (review of Act) paper?**

Under 'last resort' cover, a claim to recover defect rectification losses is complicated by the need for the claimant to show that a builder has disappeared. The obligation is more onerous as the geographic search area becomes larger.

Most responses agree that greater precision is needed and felt that enquiry should be limited to Australia. The OCN+SCA considered the field should be limited to New South Wales.

#### **5.2.10 What are your thoughts around home owners being able to top-up cover? Is this necessary?**

If a builder is not required to provide HOW or a homeowner feels they would like additional cover, should a homeowner be able to take out its own additional – or top-up – cover?

None of the respondents oppose the suggestion. The MBA suggests that homeowners typically prefer to avoid the additional cost of insurance premiums. The ICA explores further refinements to the type of cover provided by HOW.

### **5.3 Submissions concerning Amendments to the Strata Schemes Management Act**

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At the time of review, there were close to 600 submissions to the 2012 review of the SSMA. Most were from private individuals or small businesses represented by individuals. Of a total of 69 consumer and industry association submissions, 17 were selected as representative of participants in the strata scheme process (production, finance, purchaser or regulation) as described above. In the main, the submissions selected were from the same organisations as those selected for the HBA review. Some submissions, such as that from the Australian College of Community Association Lawyers (ACCAL), were excluded as they did not directly address building defects or rectification.

A summary of the responses to the individual questions posed by the NSW Government in its review process follows. These responses are tabulated in **Appendix B**. Individual association responses to all questions directly or indirectly concerning defects are summarised in **Appendix D**.

Submissions reviewed were from:

- Australian Institutes of Architects
- The City of Sydney
- Housing Industry Association
- Law Society of New South Wales
- Master Builders Association
- Owners Corporation Network
- Property Council of Australia
- Real Estate Institute of New South Wales
- Strata Community Australia
- Urban Taskforce
- Strata Unit Underwriters Agency Pty Ltd
- Sydney Business Chamber
- The Committee for Sydney
- Urban Development Institute of Australia
- National Insurance Brokers Association
- The Australian Property Institute
- Australian Institute of Building Surveyors

### **5.3.1 Do you think that a maintenance schedule prepared by the developer would be useful?**

A maintenance schedule defines the kind of regular work a builder suggests is needed to keep a property in good condition and to slow the emergence of problems arising from wear and tear. In 2013, comment was sought from community and key industry organisations on a position paper on SSMA amendments. In September 2014, a community position paper was released on proposed changes. It recommended requiring ... *the builder/developer to prepare a maintenance schedule at registration and supply it to the association.*<sup>108</sup>

Producer submissions from the HIA, MBA, and Urban Taskforce (UT) strongly supported the idea, and suggested that it should be mandated.

Building owner representatives, the PCA and REINSW, the City of Sydney (COS), and the AIA all consider maintenance schedules a good idea.

Purchaser representatives, the OCN and SCA, oppose mandatory maintenance schedules if they displace statutory warranties. They also observe that builders have vested interests in making maintenance onerous and expensive.

The Law Society NSW (LSNSW) opposes mandating the provision of a maintenance schedule prepared by a builder.

### **5.3.2 Should defects be a compulsory agenda item for discussion at the first AGM?**

The agenda of the first annual general meeting of the strata corporation might specifically consider if any building defects required rectification. The time to take action for some classes of defects has been reduced by amended legislation. If builders do not rectify defects within the statutory warranty period, the cost of this work will fall to individual lot owners or to the owners' corporation.

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<sup>108</sup> Ibid, Recommendation 2.5, page 18

With differences only in emphasis, all respondents agreed that defects should be a compulsory item at the first AGM of a strata scheme.

### **5.3.3 Should the law set clear rules for voting on action regarding defects?**

In relation to defects for new strata schemes, the September 2014 community position paper also recommended restricting ...*the right of the developer and people connected to the developer from voting on matters relating to building defects.*<sup>109</sup>

Ownership transfer of strata developments occurs over a period, which may include the period during which annual general meetings are scheduled. Some producers retain strata units and thereby participate in strata development as both producers and purchasers. Consequently, a builder / owner has a conflict of interest when voting to require defects rectification by a producer.

The PCA suggests that builder / owners have the same motivation as owners in a defects-free building, so the conflict of interest therefore does not arise.

The SCA and OCN, representing purchasers, both strongly oppose any participation of builders or related parties when voting on defects rectification. The AIA agrees with this view.

The REINSW and the LSNSW suggest that voting rules concerning defects should not be mandated.

### **5.3.4 Should any other changes be made to the strata laws to more adequately deal with defects?**

The AIA acknowledges a nexus between building defects and faults due to normal wear and tear. It also suggests that strata developments undergo a review of regulatory compliance every 5 years. Building regulations change over time and the ownership structure of strata buildings means they endure.

The COS, which manages one of the highest concentration of strata developments in Australia, considers that the whole issue of building defects warrants further detailed review.

The LSNSW considers that management of building defects is a consumer protection issue; strata laws are about the conferral of management powers.

Both the OCN and SCA, representing purchasers, are concerned to ensure no loss of claim against statutory warranties for defects rectification.

The REINSW considers that strata development build quality has declined in recent decades and steps should be taken to improve it.

Representing producers, the UT and MBA both suggest ways to manage building maintenance more systematically.

The PCA does not consider that participation of builders on the owners' corporation would limit defects rectification.

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<sup>109</sup> Recommendation 2.4, page 18, see [http://www.fairtrading.nsw.gov.au/biz\\_res/ftweb/pdfs/About\\_us/Have\\_your\\_say/Strata\\_title\\_law\\_reform\\_position\\_paper.pdf](http://www.fairtrading.nsw.gov.au/biz_res/ftweb/pdfs/About_us/Have_your_say/Strata_title_law_reform_position_paper.pdf) (accessed 09 December 2014)

## 5.4 Discussion of submissions

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### 5.4.1 General comments

Of the topics raised, issues affecting defects rectification particularly troubled the owners of new strata developments. These issues included the operation of statutory warranties, how defects rectification disputes are resolved, and the extent of consumer protection afforded by homeowners warranty insurance. One of the key issues concerned changes to the definition of 'major defects' for the purpose of rectification liability.

In the review of the SSMA, a significant and contentious issue was a proposal to reduce the number of votes needed to wind-up owners corporation from 100 per cent to 75 per cent. Though not directly related to defects, this proposal did reveal tensions between strata development producers and consumers.

Some owners fear that changes to the SSMA may become a developers' charter that will fundamentally undermine owners' enjoyment of their property. This concern appears to have focused responses on defects rectification liabilities in new strata development. It appears that some communities are suspicious that any dilution of developers' obligations to remedy defects is evidence of wider legislative sympathy to the interests of large development corporations, at the expense of individual rights.

Reflecting on the different roles and responsibilities within the development process and strata scheme management, some organisations submitted to both reviews, some to only one. For example, councils generally responded only to the SSMA review, none to the HBA. This is potentially because councils now have only a peripheral role in dealing with building defects yet they confront strata management related issues on a daily basis. Councils also have a strong planning interest in the proposed wind-up provisions within the SSMA with implications for long-term urban development.

### 5.4.2 Producers – Developers

Developers and builders share many interests and are frequently two faces of the same entity. From a developer's perspective, the construction and sale of strata development has the potential to generate profit, though this is offset by the high risks associated with raising funds, speculating on land, obtaining statutory consents, marketing and sales, and controlling complex and risky building works. Strata development can thus be understood as a process of striking compromises and balancing competing interests. Long-term contractual and statutory obligations appear to be understood in terms of risk 'tails' that persist long after project profit has been crystallised and dis-incentivise industry participation (see summary of comments from the PCA+UT on the HBA, Appendix C).

There are strong market incentives to limit this risk tail. Attempts to do so can be made through litigation (or its avoidance), the framing of favourable strata governance structures, and through policy, such as tighter restrictions on statutory warranties. Many of the submissions by developers and builders observe that increasing the duration and extent of rectification works simply increases project risk and hence cost. Removal of these disincentives would, it is claimed, benefit the state through retention of builders that would otherwise abandon the sector (refer summary of comments from the PCA+UT on the HBA, Appendix C).

### 5.4.3 Producers – Builders

Builders and their subcontractors differ from developers in that their stake in a strata project only concerns its construction and the financial-contractual framework that surrounds it. Building defects that arise during this process are an additional burden on builders and subcontractors as they reduce project profitability in proportion to the extent of re-work required. From a builder's perspective,

defects can arise from poor design, inadequate subcontract work, inappropriate material selection, complete omission and concealment of work, or damage during construction (see comments by HIA, MBA on HBA, Appendix C). Many builders claim that defects revealed after project completion can arise from poor post-construction maintenance; are an artefact of over-pernickety purchasers; or, indeed, arise from simple discovery of poorly supervised construction work for which a builder is responsible (refer comments by MBA on HBA, Appendix C).

A builder's liability to remedy defects is generally defined under contract and in statutory warranties. The sheer variety of defect causes provides ample defence for liability after a project is complete, particularly in the context of litigation that generally seeks to apportion liability amongst the many parties joined. Legislation that limits the duration of a builder's liability, and that further limits the nature of defects for which they are liable, translates into decreased project risk and, hence, increased profitability. Critics of a builder's role in remedying defects generally point to a failure to fulfil the fundamental contractual responsibility to supervise construction properly; the AIA observes that defects are defects and should be remedied under contract. For their part, builders bemoan the poor quality of building trades, poor design, the failure of specified building materials, and unrealistic expectations of home purchasers (refer comments above).

#### **5.4.4 Consumers – owners corporations**

Owners or strata corporations share similar concerns with lot owners but the concerns are expressed at the scale of the entire building (the common property). At this scale defects rectification can be expensive, yet potentially catastrophic if left or if not detected in good time.

When contributing to governance by the owners' corporation, individual lot owners may discover that the producer (developer or builder or both) has imposed on the strata corporation complex, adverse and legally unavoidable management contracts that are commercially advantageous to that producer. For example, contracts might include the locking-in of lengthy management contracts, the favourable uneven distribution of levies, or the inequitable control of common property in favour of developers that retain a property interest (see recommendations by OCN, commenting on SSMA, that developers be excluded for certain classes of votes, Appendix D). Some producers do not support this view (see comments by PCE on commenting on SSMA, Appendix D).

These arrangements concern lot owners collectively, who see commercial advantage being extracted by a producer-dominated owners corporation that prevents the proper and timely identification and rectification of significant defects; OCN describes as "*unjust*" an effective shift of responsibility for correcting defects from producers to owners (see comment on HBA, Appendix C). In the longer term, after the producer has moved on, owners' corporations remain burdened with substantial defects that can only be remedied by raising additional levies for expensive repairs. Again, owners' corporations seek to challenge these practices through consumer protection measures, legislative change or, if feasible, through litigation.

#### **5.4.5 Consumers – individual lot owners**

The voice of individual lot owners was not directly represented in the submissions reviewed; they can only be inferred from the comments of associations representing owners' corporations.

#### **5.4.6 Funders – home purchase lenders**

Defects may affect the operation of a loan, in two ways. Firstly, if after a loan has been advanced defects might emerge that are so extensive as to diminish the value of the security, and secondly, it is possible that defects repair obligations imposed by an owners' corporation on a purchaser exceeds the purchaser's loan repayment capacity (ABA comments on HBA address the need to maintain the

value of security offered by loan applicants, Appendix C). Adequate statutory warranties and home owners warranty insurance would diminish both these risks to lenders.

#### 5.4.7 Funders – insurers

For detached housing development, Home Owners Warranty insurance, which pays for repairs in the event of a builder's default or disappearance.

Though available for strata developments, similar cover is not obligatory for buildings over three storeys and can be further complicated in a couple of ways.

Firstly, the frequency of building defaults combined with high levels of disputation as to liability means that, in extreme cases, insurance claims can approach certainty. Overseas experience illustrates that where defects become commonplace, premiums can approach 100 per cent of the average cost of building faults, rendering the cover almost worthless.<sup>110</sup>

In New South Wales, HOW is offered but is priced to reflect the assessed risk profile of the applicant, typically a builder. This risk is assessed on the information provided by the applicant at the point of application.<sup>111</sup> It is not clear if there exists a separate database that monitors builders' performance over time. If it does exist it would be the commercial property of those insurers that participated in this segment of the insurance market.<sup>112</sup>

There is no 'in-principle' reason why HOW could not be taken out by individual lot owners but there does not appear to be any demand for this kind of cover, as yet (see comment by MBA on HBA, Appendix C). If demand were to emerge, it would typically be assembled through specialist insurance brokers who would then seek a new product from insurance underwriters.<sup>113</sup>

Secondly, the beneficiaries of cover may not necessarily be the owners' corporations or individual lot owners. Developers who contract with a separate builder may name themselves as beneficiaries (see ICA submission, Appendix C). In the event of a builders' default, a developer's accommodation with the insurer to expedite claims may leave less significant yet costly defects for subsequent assigns to correct.

#### 5.4.8 Regulators

Regulators did not provide formal public submissions, but input was obtained through normal processes of interdepartmental consultation. Those regulators and agencies most likely to contribute to discussion on the management of strata building defects would include those responsible for:

- Building standards, e.g.: the Building Code of Australia, SEPP 65 and BASIX;
- The Regulation of building certifiers / inspectors,
- The operation and limitations of statutory development sanctions,
- Consumer protection, e.g.: Fair Trading NSW

The association representing building certification professionals made no comment on the management of building defects.

#### 5.4.9 Dispute resolution professionals

Dispute resolution through arbitration or litigation differs in forum and cost. Often employed during a project, the main attraction of arbitration is to keep the project moving, negate conflict and avoid the substantial cost of legal action. Formal litigation can extend well beyond project completion, but both approaches seek to enforce statutory or contractual interests within a pragmatic legal framework.

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<sup>110</sup> Warfel, W.J, Construction defect litigation, in CPCU Journal, Fall99, Vol. 52 Issue 3, p157, (accessed 09 September 2014)

<sup>111</sup> Interview with Karl Sullivan, ICA, 31 October 2014

<sup>112</sup> Ibid

<sup>113</sup> Ibid

During construction, arbitrators can have formal contract roles to resolve disputes expeditiously in order to keep a project moving (see IAMA comments on HBA, Appendix C). The imperative to keep a project moving is intensified by the *Building and Construction Industry Security of Payment Act 1999*. In this context, they are not well placed to address building defects as construction progresses, often leaving these issues for resolution after project completion.

#### **5.4.10 All parties – Lobby and interest groups**

The interests of participants in strata development are also represented through collective organisations, to which many subscribe as members: many developers are members of the Urban Taskforce; builders commonly join the Master Builders Association; the interests of owners corporations are represented collectively by the Owners Corporation Network and Strata Community Australia.

Each of these bodies actively participates in policy debates that intend to achieve legislative reform to their members' advantage.

## 6 Interviews

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### 6.1 Introduction

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Six semi-structured interviews were completed to inform the research on the social and economic impacts of defects in residential strata development and their rectification.

### 6.2 Selection

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Organisations approached for interviews were selected based on stakeholder interests and submissions to the consultations on proposed legislative change. The interviewee organisations represent producers, funders, regulators and consumers of residential strata development.

The interviews were conducted between October and December 2014 with:

- Karl Sullivan, Insurance Council of Australia on 31 October
- Bruce Bentley, Australian College of Community Association Lawyers, 3 November
- Colin Grace, Strata Community Australia, 7 November
- Robert Marinelli, Building Professionals' Board, 7 November
- Staff member, City of Sydney, 27 November

Interviews lasted between 30 minutes and an hour. All interviews were conducted in person.

Though highly relevant to the topic, interviews with associations representing individual lot owners, owners' corporations and tenants were not conducted because one such agency, the Owners Corporation Network, mentored this research in order to improve understanding of the views of other representative organisations.

### 6.3 Interview questions

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The interview questions were loosely based on submissions each organisation made during the consultations on proposed amendments to both the *Home Building Amendment Act 2014* and the *Strata Schemes Management Act 1996*. It should be noted however, that the organisations represented did not necessarily make submissions to both consultations.

The primary interview questions were:

1. Based on [organisation] recent submission to the consultation process, it appears your views on the rectification of building defects are [state position on defects]. Has this changed at all since you made the submission?
2. We noted that you mentioned [item relating to building defect rectification] in your submission, can you elaborate on this?
3. From the perspective [of your organisation/ the groups you represent/ people you represent] what will be the economic consequences of the legislative changes to your members? How do you think these consequences will be affected by foreshadowed legislative changes, such as those to the Strata Schemes Management Act? What do you think will be the economic impacts of these changes to other strata participants?
4. From the perspective [of your organisation/ the groups you represent/ people you represent] what will be the social consequences of the legislative changes to your members? How do you think these consequences will be affected by foreshadowed legislative changes, such as those to the Strata Schemes Management Act? What do you think will be the social impacts of these changes to other strata participants?
5. Thinking about strata development, are there other measures – legislative or not – that could be put in place to address issues around building defect rectification in the future?

## 6.4 Findings

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### 6.4.1 Occurrence of defects in residential strata development

There was disagreement between interviewees on the incidence of defects in recently completed residential strata development. However, there was broad agreement that defects are more likely to be more openly discussed and visible, due to the changing nature of defect rectification and a higher incidence of litigation. There was also a view that the increasing value of property, the increasingly litigious nature of society, and unrealistic expectations of perfection combine to elevate perceptions of increased frequency of defects.

*I think there's an availability bias that disrupts a true view of that picture. Everybody judges what's happening today as not as good quality as in the past because you can see it and judge it but our industry would give you the same anecdotal response as others that they don't build it like they used to, and in many cases that's because people want something different. And there's a trade off... Very difficult to do that [research] you would have to normalise it for so many factors you know people are more litigious, people are more educated about contracts these days, so are more likely to pursue something under a contract provision. Most of the settlements and arrangements around that would be completely opaque to a researcher. There's no central repository of it yet; very difficult to get that.* [Karl Sullivan, Insurance Council of Australia]

When discussing defects, some drew attention to improvements in overall apartment building quality and the need for better supervision as a corollary:

*Its about having a superintendent, a clerk of works where these people are really and truly inspecting and doing it for the project overall...* [Robert Marinelli, Building Professionals' Board],

The changing legislative framework is also thought to have increased defect claims in courts and therefore the visibility of defect issues:

*In the last, well, let's say 14 years, the recourse to which, what owners have had has been reduced. Whereas prior to back in 2002 there was significant recourse with no last resort policies and no restrictions on insurance over three storeys, people would just get defects, put a claim in to the insurer, and it would all be resolved.* [Bruce Bentley, Australian College of Community Association Lawyers]

Legislative changes, specifically those since July 2002, are thought to contribute to the social and economic costs of defects in residential strata:

*It was fixed up a lot easier pre-2002.* [Bruce Bentley, Australian College of Community Association Lawyers]

*As much bad press as insurers do get, they're a lot easier to deal with than builders and developers... In the old days you didn't have to litigate anyone.* [Bruce Bentley, Australian College of Community Association Lawyers]

Some felt that in recent years major developers;

*...maliciously don't build up to scratch and will hold ownership [of apartments] until the warranty period expires.* [City of Sydney employee, City of Sydney]

Some interviewees raised more general building quality issues:

*The quality of education, the quality of people who are building and the lack of accountability for the people who are working on these buildings is the main issue...* [Robert Marinelli, Building Professionals' Board]

Both the changes in work practices and the effects of the current building boom potentially exacerbate this:

*Removing the criteria for a clerk of works or a superintendent of works who makes sure the contract gets fulfilled, there were no defects, as soon as they threw that out defects got more and more.* [Robert Marinelli]

#### 6.4.2 Definition of defects

There was general agreement amongst the interviewees that the changing definition of defects, particularly the proposed distinction between 'major' and 'non-major' in the *Home Building Amendment Act 2014*, will reduce owners' rights.

*Major is a lot less generous definition than the current structural, which is going to mean that more things will fall into non-major than currently fall into non-structural...* [Bruce Bentley]

The general lack of clarity of the definition of major and non-major defects is also of concern:

*The four of us [leading practitioners] were uncertain and couldn't come to a uniform view as to what the scope of non-major and major will be.* [Bruce Bentley]

Similarly:

*My difficulty is that it is open to interpretation...* [Colin Grace, Strata Community Australia]

Interviewees also supported the inclusion of waterproofing and fire safety systems in the definition of major defects.

*You've got to argue, if the fire safety system doesn't work, you can't inhabit the building, the occupation certificate should never have been issued, therefore it's a major defect.* [Colin Grace, Strata Community Australia]

And:

*There are hundreds of thousands of fire safety defects throughout Sydney, all those buildings are being lived in, so how can you say they are uninhabitable?* [Bruce Bentley, Australian College of Community Association Lawyers]

*While it's [fire safety systems] an element which is eligible for inclusion, the criterion for what has to be wrong for it to be major means that... you're virtually never going to have a fire service problem which is going to be major... And so you're only going to get two years on what is essentially one of the most poorly designed and implemented aspects of building work.* [Bruce Bentley, Australian College of Community Association Lawyers]

External and internal waterproofing was also discussed, particularly the extent to which they should be regarded as 'major defects'. The two-year cut-off for minor defects rectification was criticised as inadequate for some classes of latent defects, for example windows:

*And I always use the window example. If I have a window today that is incorrectly installed, and the lintels, the little bar, are stuffed and the water's pouring in, that under the current statutory warranties I am able to argue is a major defect. The current statutory warranty is seven years, fantastic, and it includes everything.*

*The first thing that will happen is when this new regime comes in and the first cases start running through, is they'll say "Well, yes, well, one, is it waterproofing?", that's number one. Well, it's not a membrane, it's just poorly installed. The second issue is does that make the apartment uninhabitable? And the next bit is, and what I've already been talking to engineers about, is the method of rectification, does that mean that we have to demolish the lintel, demolish the window technically to*

*reinstate a new window, or fix whatever it is to make it that major structural element covered by the six years?*

*Are we destroying part of a building, or is part of a building uninhabitable? Maybe just the bedroom, maybe just the corner of the room. Is that part of the room uninhabitable? Is it one or the other that lets me come into the major defect element? If it doesn't, if the answer is no, it's a general defect, and the general defect as two years. [Colin Grace, Strata Community Australia]*

The ability to check waterproofing during building construction was identified as an issue:

*We do more waterproofing inspections, just to make sure waterproofing is in, the issue isn't whether it's installed, it's the accountability of the people doing the installation. We go, we leave, they tile, they drop something, if its grey coloured paint – is it the right one? Is it paint or is it waterproofing? [Robert Marinelli, Building Professionals' Board]*

### 6.4.3 Timeframes

There was general support amongst interviewees for the standardisation of the two and six-year periods and the adoption of the date of the occupation certificate as the commencement date for the periods relating to defect liabilities. This is seen as removing uncertainty, which can be the subject of legal argument.

A couple of interviewees discussed the nature of building defects and in particular the latent nature of defects. In the recent Brookfield case<sup>114</sup> defects emerged after a number of years.

The changing definitions of defects that are currently classified as structural and subject to a seven year warranty period will be reclassified as non-major with only a two year warranty period was seen as a considerable erosion of rights:

*That's the big rights that people are going to miss out on, where at the moment they can sue for everything for seven years. If that came down to six years, fine, but what they're introducing is the same concept as under the warranty insurance for two years and six years. [Colin Grace, Strata Community Australia]*

The changing definitions in concert with the alignment of timeframes will impact residential strata schemes far more than those living in individual houses:

*To be honest the structural/non-structural divide, the major/non-major divide, for someone who's just had a house built and is living in it, it's not a big issue. I mean, if you live in a house for two years, you're going to make your claim. But when you come to a building which might have 20, 30, 40, 50, 60, 100, 200 occupants stretched out over a vast area of land, it's much more difficult to ascertain what the defects are, because not everyone sees them all. And each individual might only see a few small ones, which they don't agglomerate to understand the extent unless they pay for a huge report. [Bruce Bentley, Australian College of Community Association Lawyers]*

The increasing number of investors and absent owners is expected to exacerbate this problem:

*Typically there is a small group of owner-occupiers fighting defects – they are active and engaged. Absent owners are not interested and tenants bear the brunt of the impacts of defects but are disenfranchised and unlikely to complain. [City of Sydney staff member, City of Sydney]*

The two-year timeframe is seen as inadequate:

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<sup>114</sup> Sydney Morning Herald (9 October 2014) High Court Decision Bad News for Apartment Owners (<http://www.smh.com.au/nsw/high-court-decision-bad-news-for-apartment-owners-20141008-10rw0e.html>) (accessed 12 December 2014)

*Twenty-four months is blown in no time. It is just a totally unreasonable and unrealistic period of time to expect owners' corporations to make decisions to commence those proceedings.* [Bruce Bentley, Australian College of Community Association Lawyers]

#### 6.4.4 Social impacts

The emergence of defects and their rectification can clearly be a stressful process, likely to be varied unequally by those living in the defective building. A small number of owner occupiers have to take on the work to identify defects and work to have them rectified, due to the number of investors / absent owners:

*Absent owners don't care as much, they're not as stressed about defects.* [City of Sydney staff member, City of Sydney]. There are also impacts if people have to move out of their homes to allow rectification work to occur, or if parts of their home (e.g. the bathroom) are unusable.

Interviewees all identified social impacts resulting from defects and the rectification process. Some identified the level of concern over the revision to the *Home Building Act*:

*A lot of clients are panicking...* [Colin Grace, Strata Community Australia]

Others identified defects as causing stress more generally:

*The three most significant issues are defects, pets and forced right of entry.* [City of Sydney staff member, City of Sydney]

*Generally people struggle to resolve conflict and struggle to articulate themselves.* [City of Sydney staff member, City of Sydney]

Defects can have wide social impacts:

*Defects mean communities don't operate harmoniously and consequently the lifestyle is compromised.* [City of Sydney staff member, City of Sydney]

Colin Grace commented on the varying nature of the residential strata development 'community':

*We've got to create communities in these communities, and I've seen some work really, really well. Breakfast Point is one, it works relatively well as a community. It's having the culture in the community scheme. And some that I see work really well are hard work.* [Colin Grace, Strata Community Australia]

It is apparent from these comments that there is strength and resilience in strong communities and this in turn helps the residents deal with defects. However, it is also clear that the emergence of defects and their rectification impacts the ability of the community to establish and operate harmoniously.

#### 6.4.5 Economic impacts

The economic impacts of defects and their rectification in residential strata developments can be considerable. Owners on fixed incomes are considered to be particularly vulnerable, particularly self-funded retirees. People move into strata with particular expectations around costs but find these are unpredictable, particularly in buildings subject to defects:

*In a strata scheme there are no options to manage maintenance costs as there are in a freestanding house.* [City of Sydney staff member, City of Sydney]

People moving into strata do not consider the potential variability of levies in the same way they consider the variability of mortgage repayments. Before taking a home loan, bank advisors discuss the risks associated with interest rates and payments potentially increasing; there is little recognition that strata levies can increase unpredictably, particularly in buildings with defects.

*Low fees are seen as a positive to achieve a lifestyle but can be problematic. People want a bargain and this extends to strata levies. [City of Sydney staff member, City of Sydney]*

It seems there is a view that potential purchasers could do more before buying into strata:

*People don't think through the risks, they don't read reports. Buyers don't do any research into the builder/developer and the quality of their previous developments. [City of Sydney staff member, City of Sydney]*

While there are notable examples of buildings that have been subject to defects but appear unaffected in terms of the desirability of the apartments and therefore purchase prices, other buildings are impacted by defects and this effectively devalues the homeowner's asset. The City of Sydney employee cited an example of a building in Green Square where the lower floors intended to comprise commercial development have not been completed due to financial collapse. The residential portion also has defects. The sale price of the residential units remains lower than comparably sized units in the locality due to the unfinished nature of the building and the presence of unrectified defects.

Where the owner's corporation decides to pursue litigation the cost of legal proceedings has significant financial implications:

*Say you've got \$1 million worth of defects, then rule of thumb it will cost you \$300,000 to run litigation. Once you're below \$200,000, it's probably a bigger percentage. [Bruce Bentley, Australian College of Community Association Lawyers]*

The recent Brookfield case highlighted additional issues. Colin Grace [Strata Community Australia] outlined the potential that the owners' corporation of the residential strata had already settled their defects case, but could only go ahead with the major works with the commercial strata component. The delay in commencing the rectification works has the potential to increase the total cost and therefore render the owners' corporation's settlement inadequate to meet the rectification works attributable to the residential part of the building.

#### **6.4.6 Complex strata schemes**

Some interviewees mentioned the emerging issues of stratum and the failure of the current and proposed legislation to address the resultant complexities. Essentially stratum refers to a number of independent strata plans on one lot. Typically these strata plans encompass both residential and non-residential (commercial) strata plans. The Home Building Act only covers the residential portions of the building. This results in a building that may suffer defects, consisting of different parts that are subject to different legislation. This impacts residential owners, who may be protected by legislation now and into the future, but cannot resolve defects as the commercial portion of the building is not protected and may not be able to meet the financial costs of defect rectification.

The recent Brookfield case was discussed:

*You're going to have those where part of the building built by the same people at the same time with the same issues, and generally the exact same defects, part of the building will be covered by the Home Building Act, and the other part of the building will not be, but the way that the title's structured, they have to share the costs of fixing elements within the building that they share, like the facade, windows, lifts, electrical, fire safety. So we're going to have this silly situation, which is what happened in Brookfield, where Strata Plan A gets \$1 million to do it, or they get the builder back, because the Tribunal's been given more powers in the new Act, which is great, and can give work orders. So they come back and do it. But the same defect in the lower level, built by exactly the same people, have no rights to do anything. [Colin Grace, Strata Community Australia]*

The proposed legislation does not address the issue of stratum and will not resolve the potentially considerable social and economic consequences of defects in mixed-use buildings with stratum

subdivisions. These consequences will fall on residents; owner-occupiers and tenants. This is despite increasing quantity of mixed-use development and a government and community desire for mixed use.

Other complex strata arrangements also exist in situations where there are not different stratum within a high-rise building:

*We've got a residential building, and we have facilities. Now, that's a strata plan in its own right. And it's not a stratum. And this is another strata plan that has facilities. Now, that can be a car park, a marina... [Colin Grace, Strata Community Australia]*

Again the mix of residential and non-residential elements, which is becoming more popular, varies the governing legislation and insurance coverage. As residents seek to mix and match facilities such as car parking and marinas berths to suit their lifestyle so their involvement in strata schemes is likely to increase with consequent impacts on their time and individual resources.

## 7 Discussion and analysis

### 7.1 Introduction

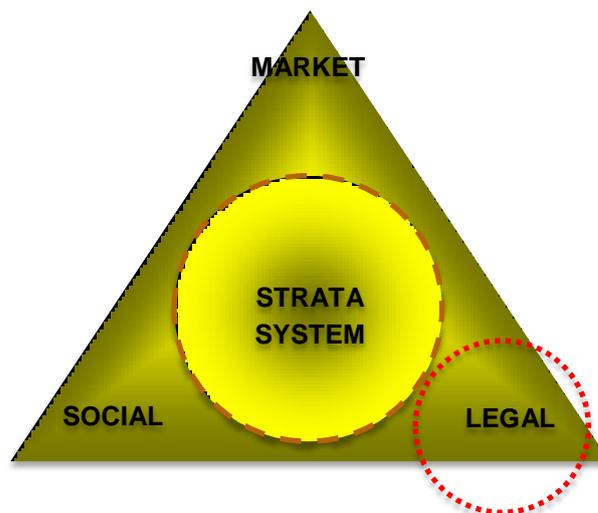
This section re-examines the rectification of defects within the overall strata system context. It commences with a summary of the viewpoints of strata scheme participants concerning building defects, as expressed in submission to the SSMA and HBA reviews and in targeted interviews and discusses how these relate to the market, social and legal aspects of the strata system as a whole. This is followed by a discussion of the potential benefits of moving away from a legal focus and taking a more market-focused approach to dealing with defects in strata properties. The chapter concludes with a brief discussion of the social and economic consequences of un-remediated building defects against an Australian policy context.

### 7.2 Motivational mismatch – Dealing with defects at the ‘legal’ pole

Submissions on amendments to the HBA and SSMA exposed widely different perspectives and undercurrents of mistrust between different strata scheme participants; the parties that are involved in the production, purchase, financing, and regulation of strata developments.

At core, this mistrust appears to originate in conflicting expectations between at least two of the four categories of strata participants; between ‘consumers’, and ‘producers’.

Referring to the tripartite concept diagram, each strata system participant appears to focus on the ‘legal’ pole when addressing defects rectification issues, though this is not surprising given that legislative change is the focus of current reforms, see **Figure 2**.



**Figure 2. Strata ownership concept diagram – legal measures**

What are the features of these tensions and how are they currently expressed? At heart, the conflict appears to centre on the difference between the selling or ‘ticket’ price of dwellings and the actual or ‘real’ cost.

### 7.2.1 The purchaser's perspective

From a purchaser's perspective, the 'ticket' price is conceptually similar to the purchase price for a detached house. Ongoing strata expenditures are conceptually similar to rates: a recurrent outgoing necessary to maintain a fully serviced residence.

Though building defects also occur in detached dwellings, defects in strata development are different in terms of scale, complexity, emergence, cost-to-rectify, and legal remedies. For this reason, a purchaser may even perceive rectification costs as tantamount to renegotiation of the 'ticket' price. Equally, a purchaser may perceive defects due to poor build quality as a species of product misrepresentation; a dwelling product not up to its advertised standard therefore warranting legislated consumer protection (see comments by OCN+SCA on HBA, Appendix C). Purchasers may also perceive expensive maintenance schedules in the same way; as symptomatic of shoddy construction and builder cost shifting (see comments by OCN on SSMA, Appendix D).

In short, a purchaser seeking a simple housing product, as an asset and a home, is confronted instead with a complicated legal process that threatens both these goals, apparently to the advantage of producers. It is understandable then for purchasers to seek protection through regulation and statutory agencies, yet producers would likely see these attempts as increasing the cost of housing, or at least reduce profit margins, which is not in the interests of purchasers.

### 7.2.2 The producer's perspective

For producers – builders and developers – settlement on the 'ticket' price represents the crystallisation of profit at the end of a complex development process. It is understandable, then, that a producer motivated by profit would resist post-sale defects rectification. From a producer's perspective, it is not unknown for some consumers to over-claim for defects in order to bolster owners' corporation sinking funds (see extensive commentary and examples by PCA+UT on HBA, Appendix C, and in original submission). Producers are also acutely alert to poor maintenance giving rise to defects that are not a builder's fault. Equally, defects may emerge early in well-built structures due to poor design, poor material selection and specification, or inadequate manufacturing shortcomings, none of which are the direct responsibility of the builder (refer MBA submission on HBA, Appendix C). Subcontractors may not perform well and cause building faults that emerge long after hand-over and occupation.

In all, a producer's perspective on defects can be that they are yet another call against profits long after a project has been delivered. Producers thus resist exposure to these calls through legislation and deflect responsibilities through regulatory measures, yet in doing so may place themselves in opposition to the class of purchasers they fundamentally hope to attract.

### 7.2.3 The regulatory perspective

By its nature, regulation operates at the 'legal' pole of strata management. Regulation governing building defects typically requires their codification in a way to enable administrative and judicial review.

The difficulty with this approach is well illustrated by the distinctions between major and minor defects. At one extreme, major defects are defined as requiring lot owners to vacate in order for rectification to be effected. Purchasers might object that this definition imposes an asymmetric obligation on owners to abandon temporarily the principal benefit of purchasing a home – that it provide shelter – in order obtain the benefit for which they contracted with a developer in the first place. At the other extreme, extending an obligation to rectify any and all defects for half a decade after building completion may impose an unsustainable and asymmetric obligation on producers, who might claim that buildings eventually fail in minor ways that any purchaser should understand and make plans to manage.

### 7.2.4 The financial institutional perspective

Financial institutions are more remote from the cause and effects of building defects. Generally, the risks and consequences of defects would be managed and reflected in the terms, 'cost', and availability of loan credit, reflecting the relative value of security offered (see submission from Australian Bankers Association, appendix C, that addresses the interests of lenders in the value of security offered).

Financial sector participants in strata development are otherwise substantially buffered from the effects of building defects due to conservative underwriting settings typically embedded in mainstream loan approval products.

Financial institutions principally operate close to the 'market' pole in the strata management diagram. Recourse to legal remedies would typically entail enforcement of loan contracts, the terms of which are typically well understood in a market system.

As an industry, insurance is concerned with the monitoring and averaging of many risk sources. Within the building industry, insurers adjust the extent and cost of cover to reflect longer-term patterns concerning building defects and the performance of individual builders. Insurers cover individual losses with higher premium charges over time. Insurers operate more like lenders closer to the 'market' pole.

### 7.2.5 Summary – motivational mismatch

Competition of interests defines the viewpoints of different strata scheme participants concerning the identification and remediation of building defects.

For consumers, either individually as lot owners or collectively in owners' corporations, un-remediated defects are a social and economic burden on home ownership. For producers, builders or developers, lengthy liability exposure to defects without further financial compensation is a project risk that affects viability. Both parties are motivated to maximise their own interests at the expense of the other through regulation; to lengthen producer liability for defects rectification or to deflect this responsibility to other parties.

Regulators with responsibilities for ensuring safety and adequacy of building standards have limited opportunities to discover building defects that threaten life safety or contribute to detrimental social and economic outcomes for owners and/or residents.

All parties urging legislative amendment to improve their circumstances encounter opposition from other parties. As understood at the 'legal' pole, there exists a 'motivational mismatch' concerning strata building defects rectification responsibilities. The question therefore arises, can alternative approaches to defects rectification be developed that could to align these responsibilities better?

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## 7.3 Strata system objectives

In addition to being complex, the strata system can also be conceived as fulfilling objectives that influence in one way or another the generation or restriction of defects. For the purpose of this discussion, seven fundamental objectives of the strata system are proposed, followed by an account of how each are currently expressed:

1. **Lower dwelling prices** – By providing more stock, and smaller stock, and by more efficiently using land. The objective of lower dwelling prices is fundamentally delivered by the operation of competitive markets, which are expressed in the transaction between producers and consumers; the strata system ultimately operates within regulatory bounds.

2. **Improve building quality and durability** – Numerous statutory instruments and policies define minimum strata building standards: the Building Code of Australia codifies life safety and minimum habitation standards; the Residential Flat Design Code specifically addresses standards for multi unit housing; and the provisions in the HBA and SSMA touch on the management of defects within the context of the construction industry regulation and the operation of strata governance.
3. **Provide consumer protection** – Consumer protection is the explicit responsibility of the Office of Fair Trading (OFT) and the legislation it implements. The OFT coordinated public consultation on changes to the HBA and SSMA.
4. **Explicit risk sharing** – Explicit identification and sharing of risks is conceptually linked to consumer protection legislation. Amendments to the SSMA and HBA intend to redefine and reapportion these risks between producers and purchasers.
5. **Efficient financing** – The cost of finance can be affected by the perceived risk to a lender of the asset being financed. This is well illustrated by the increased levels of finance made available for multi-unit developments after the ‘invention’ and regulation of strata titling. As other forms of multi-unit title were regarded as less securable, and consequently attracted lower funding levels from lenders, legislation allowing and regulating strata titling greatly expanded the market for multi-unit developments.
6. **Clarity of roles and responsibilities** – Current and proposed changes to the SSMA and HBA intend to clarify responsibilities concerning defects rectification.
7. **Fulfil related public policy objectives** – Ideally, regulation of strata development should assist the achievement of other related policy interests, such as planning objectives to increase the density of cities, enhancement of consumer protection, the operation of free markets, and access to acceptable standards of housing.

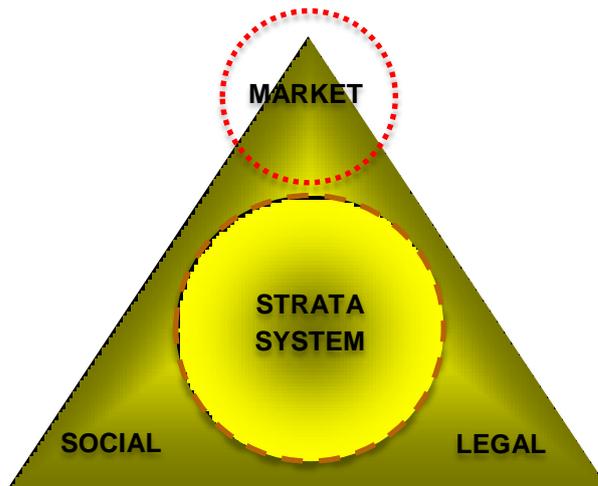
Though these objectives are hypothesised, they are also uncontentious. Additionally, each objective can affect the conditions under which defects in strata developments emerge and are managed.

## 7.4 Improving motivational alignment – dealing with defects through the market ‘pole’

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Against this background, and recalling again the tri-polar structure of strata management systems, it is remarkable that current debates have paid little attention to greater control of defects through the ‘market’ pole, see **Figure 3**. Instead, analyses thus far treated the market more as an output; as a reactive dependant variable on the forces applied or experienced at the other two poles.

In light of the increasingly intractable oppositions between strata participants, mechanisms at the ‘market’ pole therefore warrant further examination to determine if greater motivational alignment could be developed to reduce the adverse impacts of strata building defects.



**Figure 3. Strata ownership concept diagram – market measures**

What characteristics of the strata system affecting building defects might be re-expressed in market-sensitive terms? What legislation-induced market distortions should be removed? In short, what might be the features of a market-based approach to reducing strata building defects?

#### **7.4.1 Clear contractual expression**

Though operating conceptually at the 'legal' pole of the tripartite strata concept diagram, contracts are discussed here as fundamentally and primarily an expression of commercial undertakings. A market-based approach might aim to express strata system objectives in effective contractual terms that clarify roles and responsibilities, simplify enforcement, direct benefits to relevant contracting parties, and, most importantly, enable accurate and thorough pricing of dwellings.

For the sake of simplicity and clarity, contracts would express, define and divide responsibilities at the interface between producer and consumer (e.g. between a developer and purchaser) with responsibilities behind each of these entities (e.g. such as sub-contractors to builders and subsequent purchasers relative to the original purchaser) not traversing that interface or diluting overall party rights.

#### **7.4.2 Recognise transitional nature of ownership and responsibility**

Compared with the immediacy of detached housing transfers, ownership of strata development undergoes a transition over an extended period, from full ownership by a producer to full ownership by lot owners and owners' corporations. Furthermore, the gradual emergence of building defects means that responsibility for building integrity likewise undergoes gradual transition, during which time the producer and purchaser may share responsibility for the end 'product'.

Though principally concerned with how a transition might be managed, recent legislative amendments strive to define sharp thresholds of responsibilities, which are complicated further by causing parties to become antagonistic and competitive when dealing with building defects.

A more constructive approach might make explicit the lengthy transitional nature of initial strata ownership and define thereby a more collaborative approach to defects limitation, identification and rectification.

### 7.4.3 Identify the 'true cost' of dwellings

Currently, the cost of a dwelling is equated to the listed selling price – the 'ticket' price. From the experiences surveyed in this report, additional expenditures the subject of legal disputation and legislative codification frequently arise unexpectedly and often resolve as additional ex-contract costs borne by lot holders (individually or collectively through the owners corporation).

It is important to recognise that these costs are probably inherent in the purchase of a strata lot; it is just that they are not explicitly expressed in the same terms as the price. They are, instead, understood as a mixture of purchase costs, ongoing costs, contractual obligations, financing terms, and, too frequently, unanticipated expenditures. Hence, from the perspective of a home purchaser, the 'true cost' of a dwelling is actually and ultimately the sum of all these costs.

A market-based approach might re-express all priced and non-priced obligations in equal monetary terms. The intention of this treatment would be to subject all contributory dwelling cost components to the discipline of the market. The approach would treat these amounts as contributing to the total cost of comfortable habitation over the period during which the roles and responsibilities of strata participants overlap and are most contested – typically during the first decade after construction. After this period it is generally accepted that builders' responsibilities are fully discharged; that further building work arises from general wear and tear and would therefore be the sole responsibility of strata owners and the owners' corporation.

The total of these costs comprise:

1. **'Ticket' price** - The primary and most apparent cost is the purchase price of the subject unit, which typically includes contractual undertakings to repair defects of defined types during defined periods.
2. **Un-remedied rectification** - Rectification costs borne by the lot holder (directly or through the strata corporation) add to purchase costs. Clearly, these costs would exclude post occupancy rectification costs borne by the builder, either under a construction contract or under statutory warranties. It would also exclude any home owners warranty insurance that a builder may take out, as this would be reflected in the 'ticket' price.
3. **Differential financial costs** - A third cost might be the relative price of finance. If a particular developer were to acquire a reputation for dishonoured rectification work, requiring substantial expenditure by lot holders, then it conceivable that an alert lending institution might impose a premium on base interest rates, require greater security, or impose tougher prudential standards on the borrower. These would add to a purchaser's costs with as higher interest rates compared with a similar dwelling product from a more reputable producer.
4. **Home Owners Warranty insurance** - A fourth would be the cost of transferrable home owners warranty insurance, purchased by the lot holder, named as a beneficiary, and would likely be a new insurance product additional to that offered by a builder as part of its construction contract with a developer. The high or low price of insurance would reflect the likelihood of a particular builder's contractual default to rectify defects, based on historical performance and would comprise, thereby, a clear pricing signal.
5. **Maintenance costs** - The cost of maintenance during the defects liability period, potentially as scheduled by a builder or developer, would comprise the fifth element of the 'true cost' of a strata dwelling. Normally, maintenance costs are treated as a component of strata fees, levied by the owners' corporation once it is established. From the submissions reviewed in this report, disputes concerning responsibilities to rectify defects frequently dwelt on whether or not they arose from poor maintenance

or were due to building faults. For this reason, maintenance costs might be included as a component of the 'real price' in order to expose these costs to the same market discipline.<sup>115</sup>

#### 7.4.4 Improve market information and efficiency

Theoretically, efficient markets require complete information to enable rational participation by all stakeholders. Three ways that better market information might improve a market-based approach to reducing building defects are:

- The systematic and regular collection of market information on defects would enable better pricing of HOW insurance. New producer entrants to the strata construction industry would be charged premiums on 'worst case' costs, but would be motivated to reduce defects in order to offer more competitive products. Improved data on defects rectification costs could therefore be deployed to develop market signals and improve competition between producers.
- Home purchase financiers may consider offering competitive loans based on the likelihood of un-remediated defects in secured property. In contrast with owners of detached dwellings, strata lot owners cannot avoid maintenance and rectification costs imposed by a strata corporation. Consequently, highly geared borrowers are more vulnerable to loan default as a direct result of any unrectified building defects emerging in the common property of strata developments. Better information would enable a lender to factor-in this risk when offering a loan amount. A lower loan amount would send a market signal via an intending purchaser to the producer that its product is too costly due to the likelihood of unrectified building faults.
- Home purchasers armed with reliable knowledge on the track record of developers could make more informed decisions about strata dwelling purchases.

It is common to rate investment products, businesses and governments on the extent of risk to investors and encourage thereby prudent financial practices within rated organisations and drive market competition, for example, Standard and Poors ratings. On the principal that financial instrument pricing commonly considers risk, up-to-date publically available performance information on individual builders and developers in rectifying defects would enable insurers and lenders to tailor financial products more precisely and also reduce the prospects of loan defaults by inadvertently over-extended purchasers.

#### 7.4.5 Remove legislative market distortions

Efficient markets, it is often claimed, operate best with minimal legislative distortion. A market-based approach would ensure that any necessary legislation only conveys neutral market signals, consistent with achieving greater social benefit.

By reducing building faults liability for producers, recent amendments to the HBA might send perverse market signals to reduce build quality and lower overall building industry skills, at least until counterbalancing amendments to the SSMA become operational. If supported by evidence, these market distortions could stymie policy objectives to improve the quality of medium and high density housing.

There is also a public policy interest. If a reputation for substandard building quality develops into consumer resistance to strata development, restructuring the nation's cities to higher density forms will be opposed and limited, thereby, national capacity to generate and reap the benefits of new agglomeration economies.

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<sup>115</sup> Other strata levy components, such as fees to operate common services, are not included here because they relate to the housing product choice as distinct from the build-quality of that product, the subject of this report.

## 7.5 Fulfilling strata development objectives in a market based approach

Recalling the caution of Seow Eng Ong (1997) concerning the limited efficacy of market signals to motivate a builder to reduce building defects, an alternative market-based approach would need to be carefully designed.<sup>116</sup> Properly designed, a market-based approach has the potential to lead to a raft of improvements to the strata system:

1. **Lower overall dwelling prices through competition** - Dwelling purchase contracts expressed as the 'real price' would make plain the competitive price of a producer's product in total. For example, a lower 'ticket price' might be offset with greater insurance and funding costs due to a producer's poor track record and risk to financing. Equally, a lower 'ticket' price might be offset with higher maintenance costs deemed necessary to maintain building quality and prevent early appearance of building faults. A 'real price' would place competitive pressure to lower all its components, not merely the 'ticket' price, in order to attract sales.
2. **Improved building quality and durability** - Higher maintenance costs and greater risk of builder default in defects rectification, reflected in higher financing and insurance costs, would render a producer's products less competitive to a market rival that managed to hold these costs in check. This pricing mechanism would reward those producers that developed dwelling products that were more durable yet attractive to the market.
3. **Provide consumer protection** - By explicitly expressing prices and responsibilities in purchase contracts, the full range of producer and purchaser obligations, along with the terms by which breach would be assessed, should enable simpler enforcement than the lengthy multiparty litigation processes that are a feature of current relationships.
4. **Explicit risk sharing** - A key feature could be the allocation of a single producer party as taking sole responsibility for building faults in the purchase contract. This might be the developer or builder. Purchaser's rights should also be capable of undiluted transfer to subsequent purchasers, or to financial institutions in the event of purchaser default.

Purchasers' share of this risk would be reflected and included in the overall price of the dwelling.

5. **Efficient financing** - Consistently prepared and updated risk ratings of developers and builders concerning the generation and rectification of defects would enable more accurate and competitive pricing of financial products. These might include: statutorily required Home Owners Warranty (HOW) cover; additional HOW taken out by purchasers if a market demand emerged for this type of insurance product; the cost of borrowing to developers and builders; and the cost of lending to home purchasers.

Different producers also represent different levels of risk to lenders, insurers and purchasers. If these risks were more accurately reflected both in the terms of lending to a producer and purchasers, and in the cost of insurance cover, clear pricing signals would then be sent to purchasers to allow comparison of the 'real price' of different strata development products.

<sup>116</sup> Seow Eng Ong, (1997), "Building defects, warranties and project financing from pre-completion marketing", Journal of Property Finance, Vol. 8 Issue 1 pp. 35 – 51, accessed 08 September 2014

This information would likewise encourage producers to reduce their risk profiles and thereby offer more competitively priced products. For individual developers and builders, improved performance concerning defects would attract more favourable risk ratings, hence lower the cost of these financial products and render the product more commercially competitive.

- 6. Clarity of roles and responsibilities, the central role of contracting** - An important component of a functional market approach would need to be clear contracting. The objective of contractual expression would be simple enforcement of clearly expressed contractual responsibilities in order to avoid the complex web of legal and contractual disputes that are a feature of current approaches to the management of building defects.

Contractual expression of roles and responsibilities might:

- Ensure there is a clear nexus between producers and purchasers
  - Explicitly deal with maintenance, defects,
  - Deal with ownerships transition from producer to wholly purchaser owned
- 7. Fulfil related public policy objectives** - The design of any such market-based approach to limiting defects will need to take into account how broader state and national policy objectives could be met. These objectives include:
- Provide for undiminished and secure retirement investment;
  - Grow housing supply capacity;
  - Fulfil sustainability goals (e.g.: compliance with BASIX);
  - Continue to promote urban restructuring (e.g.: higher density, proximity to transport and jobs);
  - Sponsor building innovation.

Additional policy implications arising from residential strata buildings defects are explored below.

## 7.6 Policy implications

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Australia is undergoing a change in the structure of its cities, with growth and increasing densification leading to high density living close to jobs and public transport. This change is supported by the reduction in manufacturing, the rise of services industries and the importance of agglomeration in modern economies. Within Australia this is occurring in the context of our nation's wealth being disproportionately invested in housing in comparison to other nations.<sup>117</sup>

The Urban Taskforce is currently urging the development of 5,000 apartment towers around railway stations to house Sydney's projected population growth.<sup>118</sup> The *Draft Metropolitan Strategy for Sydney to 2031* anticipates an increase of 545,000 households over this period in the whole conurbation.<sup>119</sup> Of this total, it is expected that some 217,000 households will be accommodated within the Central, North and South sub-regions alone. Most of these would be in strata developments as these sub-regions are fully developed with detached housing. Assuming an average of 50 apartments per strata development, this would add about 4,500 new strata developments to inner Sydney over this period. Whether delivered in these locations or to the extent promoted, most new Sydney dwellings will likely

<sup>117</sup> Cummins, P., "Property makes Australians the world's richest, says Credit Suisse" in Sydney Morning Herald 15 October 2014 (downloaded same day)

<sup>118</sup> See [http://www.urbantaskforce.com.au/index.php?option=com\\_content&view=article&id=1825:5000-apartment-towers-around-railway-stations-are-needed-to-house-sydney-s-future-population&catid=71:media-releases&Itemid=123#.VIAOHFasj1o](http://www.urbantaskforce.com.au/index.php?option=com_content&view=article&id=1825:5000-apartment-towers-around-railway-stations-are-needed-to-house-sydney-s-future-population&catid=71:media-releases&Itemid=123#.VIAOHFasj1o) (accessed 04 December 2014)

<sup>119</sup> Draft Metropolitan Strategy for Sydney to 2031 (2013), Department of Planning NSW, see [http://strategies.planning.nsw.gov.au/Portals/0/4\\_Draft\\_Metro\\_Liveable\\_City.pdf](http://strategies.planning.nsw.gov.au/Portals/0/4_Draft_Metro_Liveable_City.pdf), (accessed 13 December 2014)

be residential strata developments in response to purchaser demands for housing proximity to public transport and jobs.

Viewed in this context, high-density residential developments are a form of economic and social infrastructure. Poor quality yet costly housing will waste economic resources that might otherwise be directed towards more productive enterprises. Less-than-durable housing requiring expensive maintenance and premature replacement will therefore ultimately affect national productive capacity and also harm those who have purchased into affected developments.

### **7.6.1 Social consequences of building defects**

In addition to being incorporated within fundamental Australian policy settings, home ownership is also a strongly felt social and cultural ambition.

The strata development industry is subject to many competing interests, each of which have complex technical, legal and economic characteristics. Yet without the fundamental need for housing, the industry would not exist. Its primary purpose is the development of dwellings that are expected to persist for many decades; only the interests of owners endure long after other actors have left the field.

Sherry (2013) highlighted the centrality of property as an expression of personal freedom and to the operation of efficient contemporary market economies.<sup>120</sup> When comparing these concepts she detected in strata laws a contemporary form of long overturned feudal property ownership, in particular the rights of other parties, such as owners' corporations, to exercise control over personal property. Though strata is now a widely accepted form of title, Sherry suggests that this acceptance could be eroded if other-party intrusions become more common through development of onerous strata bylaws. There is a risk that perceptions could be eroded further again if strata titling also becomes associated with physically defective property.

Any legislative reform affecting strata development defects therefore needs to prioritise the long-term value and durability of the resultant strata product from the perspective of strata home owners, whose interests exceed in breadth and duration the interests of all other participants in the enterprise.

### **7.6.2 Economic consequence of building defects**

Legislative amendments concerning defects seek to balance quality and cost only during the first few years after construction, yet as a class of 'residential infrastructure' strata development in cities will persist for up to a century. There is a potential policy mismatch between the understandable yet relative short-term profit-making objectives of producers and the national economic interests in sustainable, durable and resilient cities. If regulatory changes promote faulty buildings, the consequences are particularly difficult to correct as the multi-owner governance structures of strata development mean that buildings are likely to endure much longer even than free-standing residential counterparts.

Australians are likely to live longer, yet the workforce participation rate is declining. Erosion of housing value, or increase in maintenance costs, will mean that a smaller proportion of privately accumulated wealth will be available to fund retirees, with consequential call on publically funded systems, such as the pension.

If systematic monitoring reveals a proportional increase in strata dwellings defects following recent legislative changes, there may be merit in re-examining the adequacy of regulatory controls, particularly how they assist the achievement of state policy objectives to increase the density of urban living and improve sustainability.

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<sup>120</sup> Sherry, C. (2013) op cit

In addition, if systematic analysis uncovers widespread increases in the frequency of defects and costs to repair more generally, the impacts on national savings may warrant investigation.

From its website:

*The Productivity Commission is the Australian Government's principal advisory body on all aspects of microeconomic reform. **The Commission's work covers all sectors of the economy. It extends to the public and private sectors and focuses on areas of Commonwealth as well as State and Territory responsibility.** The statutory functions of the Commission are to:*

- **hold public inquiries and report on matters related to industry and productivity, including safeguards procedures**
- *provide secretariat services and research services to government bodies such as the Council of Australian Governments*
- *investigate and report on complaints about the implementation of the Australian Government's competitive neutrality arrangements*
- **advise the Treasurer on matters related to industry and productivity as requested**
- **initiate research on industry and productivity issues**
- *promote public understanding of matters related to industry and productivity.*(emphases added)

*The Commission may also undertake any other activities incidental to these functions and has some flexibility in how it performs these functions.*<sup>121</sup>

A case for the Productivity Commission to inquire into the effect of strata development defects on national prosperity might be assembled by:

1. Ascertaining the extent of un-remediated building defects in recently completed residential strata development;
2. Diagnosing if recent NSW legislative changes amount to latent market signals to increase defects;
3. Reviewing the contribution of housing to national prosperity;
4. Estimating the current and potential contribution of strata development to that prosperity;
5. Estimating the potential impacts of strata defects on national wealth and productivity.

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<sup>121</sup> See <http://www.pc.gov.au/about-us/role> (downloaded 14 October 2014)

## 8 Conclusions and recommendations

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### 8.1 Introduction

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This report has examined the existing legislation as it relates to building defects and their rectification principally the *Home Building Amendment Act 2014* and *Strata Schemes Management Act 1996* and proposed legislative changes. In particular, the changes that will impact the definition of building defects and the timescales in which proceedings must commence to enforce rectification.

The preference for apartment development amongst policy makers and consumers is increasing. The NSW government has placed considerable importance on density and brownfield development. Considerable residential urban development is occurring, including in large renewal areas such as Green Square. Reported sales of new apartments, including 'off the plan', indicate that the market continues to be strong.

### 8.2 Legislative change

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It is clear that the introduction of the *Home Building Amendment Act 2014* sometime early in 2015 without the protections foreshadowed in the consultation of reforms to the *Strata Schemes Management Act 1996*, namely bond paid by developers, will have negative consequences. These consequences will manifest in increased social and economic pressures on residents living in residential strata developments.

These consequences arise primarily through the further erosion of consumer rights under the incoming legislation. This is focused on the changing definition of defects; the introduction of major and non-major defects and corresponding timeframes for commencing proceedings to enforce rectification by the builder or developer to six and two years, respectively. The criteria by which defects are to be classified as major and non-major brings ambiguity to the definitions and there is agreement this will lead to costly and stressful litigation.

The changes to the definitions of defects and the accompanying timeframes will put pressure on owners in the early years of a strata development. The two year timeframe in particular is likely to be challenging. These challenges will be exacerbated in large schemes with a high proportion of investors / tenants. The two year timeframe does not account for the latent nature of many defects; these defects may not manifest within the two year time period applicable to non-major defects. Beyond the two years the onus will be on owners' corporations to prove defects to be major, within a six year rectification period.

### 8.3 Social and economic impacts

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The economic and social impacts are most likely to fall on owner occupiers of residential strata, many of whom may have moved into apartments relatively unaware of the governance arrangements and the ongoing financial demands of strata levies. Defects increase costs and may also devalue property assets. Of the stakeholders identified, strata apartment owners are particularly vulnerable to the detrimental impacts of unrectified defects. The presence of defects threatens the harmonious operation of the strata scheme, which in turn impacts the functioning of the owners' corporation to seek recourse to the developer or builder. The commencement of litigation can represent a significant financial risk to owners with an uncertain outcome. By definition, owners are also likely to be the least experienced of the stakeholder groups in dealing with defects and their rectification.

The prevalence of defects in fire safety systems and waterproofing elements within residential strata development and the ambiguous nature of the definitions in the forthcoming legislation is likely to increase litigation. The inability to rectify these defects quickly, that is, without resorting to litigation, will potentially lead to people living for extended periods in apartments without adequate fire safety systems or that may be prone to damp with associated health and wellbeing implications.

## 8.4 Complexity in strata

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The existing and proposed legislation relating to building defect rectification fails to adequately consider the increasingly complex nature of strata and the existence of commercial and residential stratum. For residents in stratum developments with defects the implications are considerable, with the potential to magnify the social and economic impacts. Given the policy focus on mixed use development by both state and local government this is a considerable omission.

## 8.5 Recommendations

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The detrimental social and economic impacts of un-remediated defects in residential strata development could be reduced through a number of approaches. The following recommendations are based on the research undertaken, in particular the review of the changing legislative context and the interviews.

### 8.5.1 Reduce the occurrence of defects

The best way to reduce the social and economic impact of defects is to reduce their occurrence. Work with producers to:

1. **Improve technical designs** – favour durability and longevity when designing strata developments.
2. **Improve materials and product selection** – ensure that specified products and materials are suitable for the purpose.
3. **Improve on-site supervision** – ensure that the works are undertaken and the materials used are as specified and comply with building standards.
4. **Improve builders' education** – ensure that builders and sub-contractors develop and maintain high-level skills in building practices.
5. **Improve certification** – develop inspection and certification protocols that ensure building quality.

### 8.5.2 Improve consumer protection

Strata dwellings are functionally identical to detached housing and should therefore be accorded the same consumer protections. Continue to seek:

1. **Coordinated legislative implementation** – introduce the proposed bond to be paid by developers in SSMA at the same time as HBA amendments become operational.
2. **Information for consumers** – collect and make available to consumers comprehensive information on the performance of producers in preventing and correcting building defects.
3. **Removal of regulatory inconsistencies** – ensure same legislative treatment of complex strata developments, such as developments with commercial and residential stratum.

4. **Better alignment of defects definitions with consequences** – include some fire safety and waterproofing defects in definitions of ‘major defects’.

### 8.5.3 Improve consumer capacity

Strata governance is primarily the responsibility of owners’ corporations, some of which may lack the capacity to deal effectively with defect rectification processes. Different strata ownership classes (e.g.: owner occupiers, investors, corporate owners) may be more or less concerned to detect and rectify defects. Improve consumer capacity by:

1. **Educating strata purchasers** – help purchasers to better match strata developments to lifestyle aspirations, e.g.: what to look for when buying off the plan.
2. **Developing community resilience** – work with strata communities to minimise adverse social impacts when dealing with defects.
3. **Expanding strata management training** – expand existing education programs for lot owners and strata committee members, with a focus on managing defect rectification processes within the prescribed timeframes.

### 8.5.4 Expose the economic cost of defects rectification to market forces

Explore how market forces might be applied to increase alignment of motivation between contracting parties to reduce the social and economic costs of defects.

1. **Develop contracting approaches** – develop new contracting structures that include all costs of strata development and define responsibilities of parties to reduce and rectify defects.
2. **Improve market information** – initiate and maintain accurate information on the performance of developers and builders for finance, insurance and consumer protection purposes.
3. **New commercial protections** – explore the development of new insurance products against defects.

### 8.5.5 Examine policy implications

It is essential that governments recognise that provision of homes is the primary reason for the existence of the residential strata building industry. The particular importance placed by Australians on home ownership has national economic consequences that could be affected if building defects that are costly to rectify increase in proportion to strata developments.

1. **Restore the centrality of home ownership to policy settings** – strata development production reforms must recognise that home ownership is the end product of the strata system and therefore the interest of the homeowner should be paramount when developing policy affecting building defects.
2. **Identify the national economic cost of defects** – undertake systematic and thorough research on the extent, growth and costs of defects in new residential strata developments in NSW. If it is discovered to be extensive, develop a submission to the Productivity Commission seeking an enquiry into the impact of defects on national investment in housing, particularly in the context of urban consolidation policies and the role of home ownership in retirement savings.

## Appendix A: Summary of association submissions HBA

### HOME BUILDING ACT REVIEW

<b>Should the definition of 'completion' include a specific definition for subsequent purchasers?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	Yes
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	When the building is occupied
<b>MASTER BUILDERS ASSOCIATION</b>	No, too complex and should be limited to 'structural' only
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	Agreed, but same definition also for subsequent purchasers
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	-
<b>HOUSING INDUSTRY ASSOCIATION</b>	No, would over-extend warranty cover
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	Builder/developer should identify strata plan registration prerequisite but NOT OC
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	Separate definition is not practical, but cover should extend to new owners
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Changed definition is welcome but opposed for subsequent purchasers as too complex
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	Needs to acknowledge staged completion and explicitly apply to subsequent owners
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Single definition for all, perhaps us OC
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Single definition in Regulations, define when HOW commences

<b>Is it necessary to clarify that the principal contractor is ultimately responsible for the statutory warranties to the home owner?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	-
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	-
<b>MASTER BUILDERS ASSOCIATION</b>	Oppose exclusive attribution of liability to head contractor
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	Yes, builder should stand by its work
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	A 'get it right' model would require maintenance of building skills
<b>HOUSING INDUSTRY ASSOCIATION</b>	-
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	-
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Yes
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	-
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Yes
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Yes and written evidence of same should be supplied to the home owner

<b>Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	No, needs to be more flexible
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	All defects should be rectified
<b>MASTER BUILDERS ASSOCIATION</b>	Distinguish between real defects and those due to poor maintenance or design
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	Yes, but retain definitional flexibility
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	-
<b>HOUSING INDUSTRY ASSOCIATION</b>	'Structural defect' needs clear but not exhaustive statutory definition
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	-
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Difference between structural and non structural is artificial and problematic
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	Proposed terminology supported; currently includes replacement materials (w'proofing)
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Distinction is problematic and promotes disputes or unfair exclusion
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Proposed definition opposed, unfair exclusions, will lower consumer protection

<b>In what ways could statutory warranties be improved (if at all)?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	Ensure coverage transfer to subsequent owners
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	Adequate at present
<b>MASTER BUILDERS ASSOCIATION</b>	Imprecise terminology encourages litigation, imported building products often fail
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	<i>'No comment'</i>
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	'Last resort' cover has failed; suggests 'first resort' cover should apply generally
<b>HOUSING INDUSTRY ASSOCIATION</b>	Should commence on issue of final OC, not be staged; should be left to common law
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	OCSP 72535 v Brookfield shows need to clarify statutory warranties
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Harmonise with Australian consumer law, including 'consumer guarantees'
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	Warranties too broad, invite litigation; need to address materials suitability
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Align with Australian consumer law
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Currently unjust; shifts builders' responsibilities onto consumers

<b>Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	No where live disputes, litigation or criminal proceedings are running
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	Issue would not arise under architect-controlled contracts
<b>MASTER BUILDERS ASSOCIATION</b>	Yes, or builder should be relieved of rectification obligation
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	Yes, except for previous violent behaviour
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	-
<b>HOUSING INDUSTRY ASSOCIATION</b>	Yes, and right expressed in contract
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	-
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Broadly supported except if violence or threatening behaviour is likely
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	Yes, Act should require it or void builders' obligation if refused, unless violence is likely
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	-
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Yes, subject to strict controls; extended statutory warranties and HOW should apply

<b>Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading's jurisdiction?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	Yes
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	-
<b>MASTER BUILDERS ASSOCIATION</b>	Yes, but distinguish from legitimate liquidations
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	Yes, a register should be established
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	-
<b>HOUSING INDUSTRY ASSOCIATION</b>	Yes, but some insolvencies are legitimate
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	-
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Should be prevented, perhaps with 'show cause' requirement under national licensing
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	Agree, damages industry, but legitimate collapse should not be penalised
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	-
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Strong legislation and penalties needed, including criminal prosecution

<b>Should new rectification work of significant value be covered by a further certificate of insurance? Why?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	Yes, the 'clock' should be reset
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	Yes, if work is extensive and close to contract end
<b>MASTER BUILDERS ASSOCIATION</b>	No
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	Shouldn't be needed if contract runs properly
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	Suggests 'first resort' cover should apply generally
<b>HOUSING INDUSTRY ASSOCIATION</b>	Yes if work is larger than original cover
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	Arguably, a new contract prevails hence new extended insurance is needed
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	No, original insurance should be sufficient
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	-
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Original cover should explicitly include all rectification work
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	-

<b>Should the current exemption from home warranty insurance requirements for the construction of multi-storey buildings be retained? Why?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	-
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	-
<b>MASTER BUILDERS ASSOCIATION</b>	-
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	-
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	Suggests 'first resort' cover should apply generally
<b>HOUSING INDUSTRY ASSOCIATION</b>	HOW not needed for large projects with complex contracts and many parties
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	ICA address related cover issues, see discussion
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	No, consumer protection is needed for owners of high-rise, as for free-standing
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	-
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Exemption is opposed as strata owners are in same position as any other home owners
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Exemption opposed as it fails to protect particularly vulnerable consumers

<b>Does the definition of ‘disappeared’ for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?</b>	
<b>AUSTRALIAN BANKERS’ ASSOCIATION INC.</b>	Term is too vague, needs tighter definition
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	‘Cannot be found in Australia’ is better
<b>MASTER BUILDERS ASSOCIATION</b>	Agreed with proposal
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	Needs to be codified and limited in scope
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	-
<b>HOUSING INDUSTRY ASSOCIATION</b>	Yes
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	Litigation possible interstate but difficult overseas
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Yes and it should mean that the licensee cannot be found in Australia
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	-
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Amend to mean after reasonable enquiry licensee cannot be found in Australia
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	Amend to refer only to licensees that cannot be located within NSW

<b>What are your thoughts around home owners being able to top-up cover? Is this necessary?</b>	
<b>AUSTRALIAN BANKERS' ASSOCIATION INC.</b>	-
<b>AUSTRALIAN INSTITUTE OF ARCHITECTS</b>	-
<b>MASTER BUILDERS ASSOCIATION</b>	Legislation allows it, some owners try to opt out of any cover to reduce premium cost
<b>AUSTRALIAN PROPERTY INSTITUTE</b>	-
<b>BUILDERS COLLECTIVE OF AUSTRALIA</b>	Suggests 'first resort' cover
<b>HOUSING INDUSTRY ASSOCIATION</b>	-
<b>INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA</b>	-
<b>INSURANCE COUNCIL OF AUSTRALIA</b>	Suggests refinements generally for insurance cover
<b>THE LAW SOCIETY OF NEW SOUTH WALES</b>	Yes, if they wished, and to work with builder how to share the cost of top up cover
<b>PROPERTY COUNCIL OF AUST. + URBAN TASKFORCE</b>	-
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Yes, so long as the onus for taking out basic cover remains on the licensee
<b>THE OWNERS CORPORATION NETWORK + SCA</b>	-

## Appendix B: Summary of association submissions SSMA

### STRATA SCHEMES MANAGEMENT ACT REVIEW

<b>Do you think that a maintenance schedule prepared by the developer would be useful?</b>	
<b>AUSTRALIAN INSTITUTES OF ARCHITECTS</b>	Yes, should be part of a suit of documents supplied to owners and body corporates
<b>THE CITY OF SYDNEY</b>	Should be considered, perhaps mandated but with appropriate legislative provisions
<b>HOUSING INDUSTRY ASSOCIATION</b>	Yes, lengthy discussion describes benefits
<b>LAW SOCIETY OF NEW SOUTH WALES</b>	No
<b>MASTER BUILDERS ASSOCIATION</b>	Supports the idea, suggests mandating preparation and supply
<b>OWNERS CORPORATION NETWORK</b>	No, builders have vested interest in making it onerous and expensive
<b>PROPERTY COUNCIL OF AUSTRALIA</b>	Supports mandating supply for consideration at first AGM
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Would be valuable if expertly prepared; also need independent defect report
<b>STRATA COMMUNITY AUSTRALIA</b>	Oppose mandatory supply unless without encumbrances (eg: override stat. warranty)
<b>URBAN TASKFORCE</b>	Maintenance an obligation, maintenance schedule demonstrates compliance

<b>Should defects be a compulsory agenda item for discussion at the first AGM?</b>	
<b>AUSTRALIAN INSTITUTES OF ARCHITECTS</b>	<i>"Yes. A list of defects should be prepared by an independent advisor..."</i>
<b>THE CITY OF SYDNEY</b>	-
<b>HOUSING INDUSTRY ASSOCIATION</b>	Supported, owners should identify defects and mitigate losses as soon as possible
<b>LAW SOCIETY OF NEW SOUTH WALES</b>	Yes, take care to allocated defects to the correct parcel (common property, stratum)
<b>MASTER BUILDERS ASSOCIATION</b>	Conditionally yes, though supply of many documents at first AGM is burdensome
<b>OWNERS CORPORATION NETWORK</b>	Yes, with extensive discussion on party obligations
<b>PROPERTY COUNCIL OF AUSTRALIA</b>	Yes
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Yes, and the builder advised immediately
<b>STRATA COMMUNITY AUSTRALIA</b>	Yes, and agenda item should extend for 2 years
<b>URBAN TASKFORCE</b>	Maintenance an obligation, maintenance schedule demonstrates compliance

<b>Should the law set clear rules for voting on action regarding defects?</b>	
<b>AUSTRALIAN INSTITUTES OF ARCHITECTS</b>	Yes, it should override contrary provision in sales contracts
<b>THE CITY OF SYDNEY</b>	-
<b>HOUSING INDUSTRY ASSOCIATION</b>	-
<b>LAW SOCIETY OF NEW SOUTH WALES</b>	"No"
<b>MASTER BUILDERS ASSOCIATION</b>	-
<b>OWNERS CORPORATION NETWORK</b>	Yes, developers / builders should be prevented from voting on defects
<b>PROPERTY COUNCIL OF AUSTRALIA</b>	Illogical reasoning to restrict builders / developers voting on defects
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	No, it should be left to the owners corporation
<b>STRATA COMMUNITY AUSTRALIA</b>	Yes, voting on defects should exclude developer / builder or other related parties
<b>URBAN TASKFORCE</b>	-

<b>Should any other changes be made to the strata laws to more adequately deal with defects?</b>	
<b>AUSTRALIAN INSTITUTES OF ARCHITECTS</b>	Defects from construction vs. wear and tear; maintenance; 5 year regulatory compliance
<b>THE CITY OF SYDNEY</b>	The whole management of defects
<b>HOUSING INDUSTRY ASSOCIATION</b>	-
<b>LAW SOCIETY OF NEW SOUTH WALES</b>	Strata laws not the consumer protection correct forum, except granting of powers
<b>MASTER BUILDERS ASSOCIATION</b>	Mandatory maintenance schedule with clear formal submission pathways
<b>OWNERS CORPORATION NETWORK</b>	Table updated defects inspection at second AGM; mandatory documents from builder
<b>PROPERTY COUNCIL OF AUSTRALIA</b>	Objects to suggestion that developers on OC stymie defects appraisal
<b>REAL ESTATE INSTITUTE OF NEW SOUTH WALES</b>	Newer buildings have more defects than older ones will lead to urban renewal crisis
<b>STRATA COMMUNITY AUSTRALIA</b>	Define procedure to ensure no loss of claim against statutory warranties
<b>URBAN TASKFORCE</b>	Sinking funds are essential

## **Appendix C: Individual association submissions HBA**

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Submissions on proposed amendments to the Home Building Act (1989), Office of Fair Trading (see:[http://www.fairtrading.nsw.gov.au/ftw/About\\_us/Have\\_your\\_say/Review\\_of\\_home\\_building\\_legislation/Submissions\\_home\\_building\\_legislation.page](http://www.fairtrading.nsw.gov.au/ftw/About_us/Have_your_say/Review_of_home_building_legislation/Submissions_home_building_legislation.page) downloaded 18 September 2014)

**AUSTRALIAN BANKERS' ASSOCIATION INC.**

**AUSTRALIAN INSTITUTE OF ARCHITECTS**

**MASTER BUILDERS ASSOCIATION**

**AUSTRALIAN PROPERTY INSTITUTE**

**BUILDERS COLLECTIVE OF AUSTRALIA**

**HOUSING INDUSTRY ASSOCIATION**

**INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA**

**INSURANCE COUNCIL OF AUSTRALIA**

**THE LAW SOCIETY OF NEW SOUTH WALES**

**PROPERTY COUNCIL OF AUSTRALIA (countersigned by URBAN TASKFORCE)**

**REAL ESTATE INSTITUTE OF NEW SOUTH WALES**

**THE OWNERS CORPORATION NETWORK and STRATA COMMUNITY AUSTRALIA**

**AUSTRALIAN BANKERS' ASSOCIATION INC. (numbering and text as per submission)**

- 6. Should the definition of 'completion' include a specific definition for subsequent purchasers?**  
*"Yes – This will provide protection to the lender in situation where the lender is offered as security an applicable property post completion of construction and/or rectification."*
- 7. Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?**  
*"We do not support legislative definition of 'structural defect: as such a definition could not encompass all examples. The benefit of the status quo is that the concept is presently 'high level' and not subject to a list which may preclude some items being considered to be structural."*
- 8. In what ways could statutory warranties be improved (if at all)?**  
*"Statutory warranties can be improved by ensuring that subsequent owners are covered for the statutory period. This will provide protection for the lender in situations where the lender is offered as security and applicable property post completion of construction."*
- 9. Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**  
*"This would be inappropriate for the following situations:*
  - In a case of dispute where the parties could not be reconciled – a new contractor may be appropriate; or*
  - For an old contractor to gain access if the contract is the subject of civil or criminal proceedings."*
- 10. Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading's jurisdiction?**  
*"Yes, we support this initiative."*
- 11. Should new rectification work of significant value be covered by a further certificate of insurance? Why?**  
*"Yes, we believe there is benefit to 'resetting the clock' for the statutory insurance period for those works/structures impacted."*
- 12. Does the definition of 'disappeared' for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**  
*"We agree that the term 'disappeared' is too vague, and should be replaced with text similar to 'unable to be prosecuted in Australia'."*

**AUSTRALIAN INSTITUTE OF ARCHITECTS (numbering as per submission)**

**6. Definition of 'completion' and subsequent purchasers**

Observed that completion and satisfactory completion coincide under contracts without independent contract administration. The commencement of the warranty period should be when the building can be occupied and is free of major defects is a workable basis for the commencement of the warranty period, for the original owner. However, this date may not be known to subsequent owners, therefore the use of a more identifiable date such as OC would be workable.

**10. Definition of 'structural defects'**

Acknowledge a distinction between structural and detailed defects but all defects should be rectified if they breach statutory warranties.

**11. Statutory warranties**

For home building existing statutory warranties are adequate.

**13. Compel home owners to allow licensees back on site to rectify defects**

Would not arise under architect administered contracts with defects liability periods but for other contracts it would be fair to allow builders back on site.

**32. Extended cover for new rectification work**

*"...new rectification work of significant value performed near the end of the period should be under extended cover."*

**41. Definition of 'disappeared'**

*"'Cannot be found in Australia' is a more logical definition."*

**MASTER BUILDERS ASSOCIATION (numbering as per submission)**

**6. Should the definition of 'completion' include a specific definition for subsequent purchasers?**

A new definition for 'completion' is not supported for subsequent purchasers, as it would add complexity. Additionally, extension of statutory warranties to benefit subsequent purchasers should be restricted only to structural defects as all other defects should be detectable and hence priced under "*the doctrine of caveat emptor*."

**7. Is it necessary to clarify that the principal contractor is ultimately responsible for he statutory warranties to the home owner?**

Master Builders support the proposal and oppose exclusive attribution of liability for defects to the head contractor.

**10. Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?**

The act needs to distinguish between defect and maintenance. Many defects are repaired under contract when they were caused not by inadequate building but inadequate maintenance or even of natural building movement, such as 'drying out'. Further, in the definition of major defects the inclusion of those 'attributable to defective design' exposes builders as the design process is not included in the definition of 'residential building work'.

**11. In what ways could statutory warranties be improved (if at all)?**

Use of subjective terminology, such as 'workmanlike' and 'fit for purpose' unacceptably exposes builders to vexatious claims. Increasing use and specification of imported building products and materials exposes builders further from inferior product performance and as the only entity capable of being sued in Australia.

**12. Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**

If builders remain exposed to a 6-year tail of contract liability then they should be allowed to return to the site to discharge that obligation; "*...that the builder retains license to attend the property*" and hence owners should select their builder carefully. Further "*it could be considered that where the homeowner obstructs the licenses in performing their obligations under the contract, or obstructs the licensee in complying with a rectification order, then the owner foregoes the protection afforded by the Statutory Warranties.*" However, some allowance should be made for relationships that break down.

**13. Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading's jurisdiction?**

Master Builders support provisions to prevent phoenix company activity but note that only some liquidations are fraudulent. Home Owners Warrantee cover acts as de facto licensing; cover is often denied to those builders associated with liquidated companies.

**32. Should new rectification work of significant value be covered by a further certificate of insurance? Why?**

Master Builders oppose this extension of HOW for rectification work.

**41. Does the definition of 'disappeared' for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**

Master Builders agree with the proposal.

**42. What are your thoughts around home owners being able to top-up cover? Is this necessary?**

Legislation currently allows it but experience is that owners prefer to 'opt-out' of cover to reduce the premium cost.

**AUSTRALIAN PROPERTY INSTITUTE (numbering as per submission)**

- 6. Should the definition of ‘completion’ include a specific definition for subsequent purchasers?**  
Agreed – is fundamental to a contract but a workable definition is needed.  
Disagreed – a separate definition of completion for subsequent purchasers is opposed as the builder should stand by its work and be covered by a mandatory insurance scheme.
- 7. Is it necessary to clarify that the principal contractor is ultimately responsible for the statutory warranties to the home owner?**  
Agreed, the builder is ultimately responsible for the work of subcontractors. Only when the builder disappears should sub-contractors be joined.
- 10. Should ‘structural defect’ and other terms be further defined in the Act? If so, which ones and what would be the definition?**  
Agreed, a clear but non-limiting definition is needed, perhaps similar to Queensland examples.
- 11. In what ways could statutory warranties be improved (if at all)?**  
*“No comment”*
- 13. Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**  
Yes, perhaps adopting the Queensland example but with a rider dealing with violent or threatening behaviour.
- 27. Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading’s jurisdiction?**  
*“The state could assemble a register of phoenix company directors (natural persons) which could then be passed onto the Commonwealth as the national occupational licensing system becomes implemented. People appearing on such a register would be prevented from registration.”*
- 32. Should new rectification work of significant value be covered by a further certificate of insurance? Why?**  
It shouldn’t be needed as the builder would be obliged to perform under the contract. However, if the original builder fails to rectify then the cost of additional insurance should be borne by the original builder.
- 41. Does the definition of ‘disappeared’ for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**  
The term needs to be codified as applying only within NSW. *“Home owners should not be unreasonably expected to search the entire world for a builder who absents his responsibilities.”*

**BUILDERS COLLECTIVE OF AUSTRALIA**

Submission mostly refers to construction of individual houses.

Describes current warrantee model as insurance of 'last resort' that has failed because it delivers limited cover for home owners, is costly or unobtainable for builders and promotes litigation.

A 'get it right' model would include:

- Impartial regulator to register (builders?)
- Building skills maintenance as a pre-requisite for re-registration
- Plain English contracts
- Single and timely dispute resolution
- Consumer protection to rectify defects quickly
- An overall 'whole-of-industry' approach

## **HOUSING INDUSTRY ASSOCIATION (numbering as per submission)**

### **5.1.1-4 Subsequent purchasers**

The "HIA supports the current position regarding warranties extending to subsequent purchasers (but) cautions against any statutory definition of completion for subsequent purchasers which has the effect of giving subsequent purchasers an extended warranty period beyond that enjoyed by the original purchaser." The HIA offers a definition of completion as being the earliest of a number of alternative completion events.

### **5.1.6 Nature of defect**

Defects can arise from specification by owner of materials that subsequently fail, so the builder should not be liable for the defect. "While a purchaser can inspect approved plans and specifications, they have no right to inspect the building contract which covers them".

### **5.1.12 In what ways could statutory warranties be improved (if at all)?**

For multi-occupancy structures, "...the warrantee should commence on practical completion of the building as a habitable edifice rather than separately in respect of the foundations, structure, fit-out etc".

### **5.4 Home owners' obligations to mitigate loss under statutory warranties**

If the owner fails to maintain the property adequately then the builder should be relieved of defects liability to the extent of failure arising from poor maintenance.

### **5.5 Definition of 'defects'**

What is meant by 'structural defects' needs to be clearly defined, preferably using similar definitions to those in Queensland. An exhaustive definition would be counterproductive, as it would invite self-interested interpretation and risks unintended exclusions.

### **5.6 Improvement of statutory warranties**

Breach of warranties should be left to definition by common law.

### **6.3 Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**

Though there may be no common law right for a builder to return for repairs it would be a matter of contract to allow this to occur, hence owner refusal to permit access would be a breach of contract and may be taken to have failed to mitigate a loss. Some home owners take premature possession, then prevent access for a builder to repair, and then complain to Fair Trading and seek access to statutory warranties. The builder should be allowed to access the site to repair defects.

### **8.1 Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading's jurisdiction?**

The HIA agrees with this intention but notes that "...not all insolvencies are the same". Some are due to poor business practices rather than poor occupational skills. Collapse may even be due to faltering cash flow from clients.

### **10.2 Should new rectification work of significant value be covered by a further certificate of insurance? Why?**

"That depends on whether the work is being repaired by the original builder or by a rectifying builder. HIA believes that if the work is simply a repair by the existing builder of their work then this is covered by the original certificate of insurance, however if the work is being carried out by a new rectifying builder and is over the warranty threshold then an additional certificate of insurance should be issued for that work".

### **10.6 Should the current exemption from home warranty insurance requirements for the construction of multi-storey buildings be retained? Why?**

HOW intends to cover consumer losses primarily in the event of a builder default, disappearance or death. For large multi-storey buildings these outcomes are covered in contracts and numerous expert professional indemnity policies.

**10.12 Does the definition of 'disappeared' for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**  
"Yes and yes", though assessed on a case-by-case basis.

**INSTITUTE OF ARBITRATORS AND MEDIATORS AUSTRALIA (IAMA)**

Overall, IAMA supports amendments that are likely to avoid or limit disputes between home owner and builders.

IAMA opposes the use of cost-plus contracts as being too risky.

For strata developers, the developer / builder should identify the completion date as a pre-requisite for registration of a strata plan. However, the date should NOT correspond to the date of OC as this refers only to the date after which the building is habitable and not the date upon which the works have been completed as per the building contract.

Alternative dispute resolution options should be compulsory before recourse to courts, rather than being expressly forbidden as currently. This should apply to all classes of dispute. IAMA is "*uniquely placed*" to facilitate speedy resolution of disputes and could even act with delegated legal authority. As a fallback, binding expert determination should apply to disputes up to \$500,000.

## **INSURANCE COUNCIL OF AUSTRALIA (ICA)**

### **Key issue 2: Statutory warranties**

A separate definition for the date of completion of work is not practical for subsequent purchasers due to the complexities of identifying the duration or extension of risk liability.

Subcontractors should be responsible for their own work with the beneficiaries of statutory warranties enforceable by both a home owner and a successor in title. There exist implementation difficulties however.

### **Key issue 6: Home Warranty Insurance**

The duration of liability and transferability of home warranty insurance – particularly in relation to extensive repair work and if the property is sold – is complex and would require statutory codification. For example:

*“... when a statutory warranty is breached and the contractor returns to rectify the defects caused by the breach, arguably this is not work done under the original building contract. Rather, it is work done under an agreement between the homeowner and the contractor that the contractor shall be allowed to rectify the defects in consideration for the homeowner not exercising their right to sue the contractor for damages for the breach. If that is the case, the ICA submits that the agreement between the homeowner and contractor may be seen as a new contract under which the rectification work is done.”*

Courts have determined that a builder ‘disappears’ when they leave the state yet if they merely retire to another state they can still be litigated, compared with a move overseas.

### **Other matters not raised in the HBAA review**

#### **Developers or builders as lot owners**

Where builders or developers continue to be lot owners and part owners of the strata corporation they have rights to recover against warranty insurance for defective work for which they may be the authors. For example:

*“The problem is highlighted where, for example, the developer and builder construct a 100 unit strata scheme covered by home warranty insurance but do so with significant defects. The developer and builder sell a small fraction of (say 10) of the lots and retain the other 90. The Strata Plan is registered and the owners’ corporation then claims upon the insurer seeking (say \$20m) to repair the defects to the common area on the basis that the claim is made by the owners’ corporation, not the developer or builder. Assuming the lots all had equal unit entitlement, the developer and builder would, if the insurance responds, enjoy the indirect benefit of \$18m in insurance cover through their ownership of 90% of the lots. We strongly submit that this is an unintended consequence of the Act which should be clarified through amendment.”*

The ICA recommends amendments to ensure that builders and developers not benefit thereby at the expense of insurers.

#### **Recovery rights**

Where a complex claim is made just prior to the expiry of a statutory warranty period the insurer must pay (under a ‘first resort’ policy) yet will have insufficient time to assess and commence subrogated recovery action against a builder. It is in a builder’s interest, then, to delay addressing claims until this time, as it would avoid both the obligation to undertake repairs and the prospect of litigation by an insurer.

*“The ICA strongly submits that the Act be amended to provide insurers with rights*

*similar to those provided to the Fair Trading Administration Corporation (FTAC) under the Building Services Corporation Legislation, and those provided to the Building Insurers' Guarantee Fund under Section 103N of the Act - which creates a statutory debt obligation by the builder to the insurer in the event the insurer pays a valid claim."*

### **Negligence**

*"The ICA notes the decision of McDougall J in Owners Corporation Strata Plan 72535 v Brookfield (Brookfield) where His Honour found that a builder and developer of a residential unit development owed no duty of care to the owners corporation in respect of the defective construction of the building and as a result, had no liability in the tort of negligence for that defective construction. The basis for His Honour's finding (that no duty of care was owed) was essentially that where the legislature, through the Act, has imposed a statutory liability on builders and developers (through the Part 2C Statutory Warranties), 'the courts should be slow to substitute their own judgment for that of the legislature'. ... The only alternative to extending the time for proceedings to be commenced would be to address the Brookfield decision by an amendment to the Act which expressly recognises the existence of a duty of care or expressly preserves any such common law duty - notwithstanding the existence of the statutory warranty regime."*

## THE LAW SOCIETY OF NEW SOUTH WALES (numbering as per submission)

### General comments

After the fundamental change in 2010, where the NSW Self Insurance Corporation took over as sole provider of home warranty insurance, the government should take the current review as an opportunity to improve consumer protections. It should consider changing the scheme runs from insurance of 'last resort' to one of 'first resort' and to reinstate home warranty cover to multistorey buildings.

*"The removal of that coverage exposed many owners in strata schemes (who in some respects are even more vulnerable than owners of cottages or two-storey dwellings) to major difficulties in pursuing recovery of losses from defective building work."*

### 6. Should the definition of 'completion' include a specific definition for subsequent purchasers?

Changes to definition of 'completion' are welcome. In respect of strata schemes, a requirement to deliver details of a building contract at the first meeting of the owners corporation should be a condition imposed on the developer only, simply because it is in the best position to do so.

However a specific definition of completion for subsequent purchasers is opposed, as it would introduce unnecessary complexity

### 7. Is it necessary to clarify that the principal contractor is ultimately responsible for the statutory warranties to the home owner?

Yes

### 8. Do you think maintenance schedules should be required for strata schemes and why?

Strongly opposed as the Strata Schemes Management Act 1996 imposes a strict obligation on owners corporations to properly maintain common property. Additionally, the imposition of a maintenance schedule could strengthen the case of some builders seeking to avoid liability for building defects on the grounds of a failure to undertake basic maintenance (as the source of defects).

### 10. Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?

A distinction between structural and non-structural defects is artificial and problematic.

### 11. In what ways could statutory warranties be improved (if at all)?

Statutory warranties could be harmonised with national Australian Consumer Law and augmented for matters not covered by that law. Harmonisation could extend to renaming as 'consumer guarantees', which would thereby be more meaningful to consumers.

### 13. Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?

Broadly supported, perhaps adopt the Queensland approach, but permit non-compliance in circumstances where violent or threatening behaviour.

### 14. What are your thoughts about alternative dispute resolution?

Strongly supported as litigation through the courts is very costly. Parties should be free to choose the appropriate mechanism.

### 15. Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading's jurisdiction?

Steps should be taken to prevent the practice. National licensing will commence in 2013, which will require applicants to show cause why they should be licensee to a new company. Preclusion on the grounds of a prior company going into liquidation might be too absolute, but it may be reasonable if a pattern of phoenix activity became apparent.

### 32. Should new rectification work of significant value be covered by a further certificate of insurance? Why?

No, the original certificate of insurance should cover it. Requiring a new certificate would merely add cost.

**36. Should the current exemption from home warranty insurance requirements for the construction of multistorey buildings be retained? Why?**

No, though the exemption is based on the assumption that developers utilise a greater level of industry professionals it "... *does not, unfortunately, obviate the need to provide people who reside in multistorey developments with the same level of consumer protection granted to people living in freestanding single residences.*"

**41. Does the definition of 'disappeared' for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**

Yes and it should mean that the licensee cannot be found in Australia.

**42. What are your thoughts around home owners being able to top-up cover? Is this necessary?**

Home owners should be allowed to if they wished and to work out with the builder how to share the cost of top up cover.

**PROPERTY COUNCIL OF AUSTRALIA (numbering as per submission)**

**(also signed by CEO Urban Taskforce)**

**Introductory remarks**

**Problems with the current scheme**

The current scheme is designed to protect consumers from bad workmanship but the current scheme encourages legal action for damages that when awarded are not directed defects rectification but retained in sinking funds.

Uncertainty over the definition of 'structural defect' and 'completion' amplifies the scope for and cost of litigation.

This combines to require greater provision for legal costs, which has resulted in reduced profitability and affordability for all participants; accounts for the significantly higher building costs in NSW; reputable construction companies abandoning the NSW market; and overall increase in housing costs within NSW.

**Proposals to benefit consumers, the industry and the state**

Legislative suggestions would increase consumer benefits by mandating maintenance (reduced likelihood of disputation on defects), faster defects rectification, expedited dispute resolution.

Construction industry benefits would include greater certainty as to extent of claims, quicker dispute resolution, the right to rectify, and hence reduced legal fees.

State benefits would include retention of reputable builders, reduced court burden, stimulation of home building market.

**6. Should the definition of 'completion' include a specific definition for subsequent purchasers?**

The definition of 'completion' needs to acknowledge the various stages and meanings of the term in contracts (eg: in phased completion projects and the like). The defined completion date should be conveyed to subsequent purchasers in order to avoid time and costs wasted on otherwise time-barred claims.

**9. Should home owners' obligations relating to maintenance be further clarified by legislation?**

*"Strongly support the introduction of mandatory 'maintenance schedules' for all strata buildings."* Only owners can undertake maintenance and prevent deterioration that might subsequently be claimed as defects. Ongoing maintenance ensures early discovery of genuine defects.

Any award of damages for rectification should only be used for that purpose, not placed in a sinking fund.

**10. Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?**

The terminology in the issues paper is supported. The current definition of 'structural defect' includes elements that are not, such as weatherproofing components. There may be external components that require servicing or replacement with the 6 year warranty period, which if included in the definition of 'structural defect' would require builders to replace them under statutory warranties or else, over-engineer components with resulting increase in construction costs.

**11. In what ways could statutory warranties be improved (if at all)?**

Warranties are too broad in scope and invite interpretation under litigation. Amended definitions for material suitability are proposed.

**13. Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**

Yes, the Act should be amended to require owners to provide access for builders to rectify defects (except for circumstances where violence is threatened). If owners refuse then the builder should be relieved of the obligation to rectify defects under both the contract and the Act.

**27. Do you agree with the proposals to help prevent phoenix company activity?**

Agreed that phoenix company activity damages the industry but there are concerns about 'reaching back' to directors involved in the management of a company 12 months prior to its collapse, as it may entangle directors involved in genuine (ie: not sinister) restructuring behaviour.

## REAL ESTATE INSTITUTE OF NEW SOUTH WALES

### **Should the definition of 'completion' include a specific definition for subsequent purchasers?**

The should be a single definition of completion for original and subsequent purchasers, based on industry accepted principles and criteria. Issue of the occupation certificate may be a suitable time.

### **Is it necessary to clarify that the principal contractor is ultimately responsible for the statutory warranties to the home owner?**

Yes

### **Do you think maintenance schedules should be required for strata schemes and why?**

No, owners corporations are currently obliged to maintain common property in a state of good and serviceable repair.

### **Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?**

The distinction between structural and non-structural defect is problematic and promotes dispute or results in unfair exclusion of some claims.

### **In what ways could statutory warranties be improved (if at all)?**

Statutory warranties might be aligned with Australian consumer law.

### **Should new rectification work of a significant value be covered by a further certificate of insurance?**

It should be covered under the original certificate it should extend to cover the original work and any rectification work.

### **Should the current exemption from home warranty insurance requirements for the construction of multistorey buildings be retained?**

The current exemption is opposed and it should be repealed on the grounds that the ultimate owners are essentially the same as owners of smaller buildings that are not exempted.

### **Does the definition of 'disappeared' for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**

The definition should be amended to mean that after reasonable enquiry the licensee cannot be found in Australia.

### **What are your thoughts around home owners being able to purchase top-up cover? Is this necessary?**

Home owners should be able to purchase top-up cover, so long as the onus for taking out basic cover remains on the licensee.

**THE OWNERS CORPORATION NETWORK and STRATA COMMUNITY AUSTRALIA (numbering as per submission)**

- 8. Should the definition of 'completion' include a specific definition for subsequent purchasers?**  
There needs to be single definition of 'completion' in the Regulations to define when HOW cover commences in relation to defective or incomplete works.
- 9. Is it necessary to clarify that the principal contractor is ultimately responsible for the statutory warranties to the home owner?**  
Yes and written evidence of same should be supplied to the home owner.
- 10. Do you think maintenance schedules should be required for strata schemes and why?**  
The practice of good builders inspecting works at completion should be encouraged. Lot owners should be informed about their rights and responsibilities concerning defects and rectification
- 12. Should 'structural defect' and other terms be further defined in the Act? If so, which ones and what would be the definition?**  
Government should reconsider the distinction between 'structural' and 'non structural' defects as the proposed amendment will decrease consumer protection at a time when building defects are emerging as a serious problem.
- 13. In what ways could statutory warranties be improved (if at all)?**  
The current situation is unjust as it shifts responsibilities from builders / developers to owners and insurers.
- 15. Should home owners be required to allow licensees back on site to rectify defects? In what circumstances would this be inappropriate?**  
Licensees should be provided the right to return to rectify defects subject to strict controls. The remedial work must be covered by a new statutory warranty period and new extended home owners warranty cover.
- 21. Do you agree with the possible proposals to help prevent phoenix company activity in the building industry? Is there anything else that can be done bearing in mind NSW Fair Trading's jurisdiction?**  
Strong legislation and penalties are needed to prevent phoenix company activity that avoid defect rectification responsibilities, including limitations on re-registration as a company director, monitoring by Fair Trading in conjunction with ASIC, and possible criminal prosecution of builders permitting construction that does not comply with the BCA to the extent that it could endanger life.
- 30. Should the current exemption from home warranty insurance requirements for the construction of multistorey buildings be retained?**  
The current exemption is opposed on the ground that it fails to protect a particular class of consumers that are more exposed to risk and loss than owners of detached homes.
- 35. Does the definition of 'disappeared' for the purposes of lodging a claim need to be clarified? Do you agree with the proposal put forward in this paper?**  
It should be amended to refer only to licensees that cannot be located within NSW.
- 37. Supplementary clauses from OCN**  
The definition of 'structural defect' should be enlarged to include, at least, reference to fire safety and water- and weather-proofing. Detailed wording is offered.

## **Appendix D: Individual association submissions SSMA**

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### **SUMMARY OF SUBMISSIONS ON STRATA SCHEMES MANAGEMENT ACT**

Submissions on proposed amendments to the Strata Schemes Management Act, Office of Fair Trading (see:

[http://www.fairtrading.nsw.gov.au/ftw/About\\_us/Have\\_your\\_say/Review\\_strata\\_community\\_scheme\\_laws/Submissions\\_strata\\_community\\_scheme\\_laws.page?](http://www.fairtrading.nsw.gov.au/ftw/About_us/Have_your_say/Review_strata_community_scheme_laws/Submissions_strata_community_scheme_laws.page?) (downloaded 09 October 2014)

AUSTRALIAN INSTITUTES OF ARCHITECTS  
THE CITY OF SYDNEY  
HOUSING INDUSTRY ASSOCIATION  
LAW SOCIETY OF NEW SOUTH WALES  
MASTER BUILDERS ASSOCIATION  
OWNERS CORPORATION NETWORK  
PROPERTY COUNCIL OF AUSTRALIA  
REAL ESTATE INSTITUTE OF NEW SOUTH WALES  
STRATA COMMUNITY AUSTRALIA  
URBAN TASKFORCE  
STRATA UNIT UNDERWRITERS AGENCY PTY LTD  
SYDNEY BUSINESS CHAMBER  
THE COMMITTEE FOR SYDNEY  
URBAN DEVELOPMENT INSTITUTE OF AUSTRALIA  
NATIONAL INSURANCE BROKERS ASSOCIATION  
THE AUSTRALIAN PROPERTY INSTITUTE  
AUSTRALIAN INSTITUTE OF BUILDING SURVEYORS

## AUSTRALIAN INSTITUTES OF ARCHITECTS

(Copied from submission)

### **31. Do you think that a maintenance schedule prepared by the developer would be useful?**

*“Yes, this should be an essential document and should be partially covered by new requirements of the Work Health and Safety Act 2011 No.10. There is also the potential for the new Home Building Act to address this issue, so that all other building elements are taken into account. Each apartment should have a schedule of fittings and fixtures both at the original sale and in all future sales to allow for renovations. Body Corporates should also have as-built drawings and specifications for their future use.”*

### **32. Should defects be a compulsory agenda item for discussion at the first AGM?**

*“Yes. A list of defects should be prepared by an independent advisor for the use of the Body Corporate.”*

### **33. Should the law set clear rules for voting on action regarding defects?**

*“Yes. The rules should over-ride sale contract and common law to clearly set out the developer’s responsibilities. Defect periods should be maintained at six years for structural faults, as is proposed for the new Home Building Act. Developers holding on to a significant number of apartments should not be able to override the need for completing defects in a specified period. By the same token, it is the responsibility of the Body Corporate to notify the developer of all defects as soon as possible after occupation. The training programs for licensed and registered strata managers need to emphasise these responsibilities, so that the developer is not treated as a de facto maintenance contractor.”*

### **34. Should any other changes be made to the strata laws to more adequately deal with defects?**

*“A clear distinction needs to be made between the repair of defects arising from the construction phase of a building and those that result from wear and tear. Another issue is regulatory compliance in a regulatory environment in which the bar is being raised over time. Maintenance is a neglected issue throughout the construction sector. It should be a permanent item on the AGM agenda, particularly for buildings covered by older strata schemes. In addition, there should be a minimum five year check against compliance with changing regulatory requirements, particularly fire, access and safety issues.”*

## THE CITY OF SYDNEY

(Copied from submission)

### **Question 31. Do you think that a maintenance schedule prepared by the developer would be useful?**

*“The establishment of a building maintenance system, in the same way as the current requirement for a sinking fund, is worth consideration, particularly for a new apartment building. Such a system would potentially increase costs as it would be an additional requirement for the owner’s corporation. If a maintenance system were mandated in the new laws then appropriate penalties for non-compliance would need to be considered, otherwise there would be limited value for its introduction.*”

#### **Recommendation:**

*Options for a model of building system maintenance are developed in consultation with local government and the strata sector. These options should include both mandatory and voluntary models.”*

### **Question 34. Should any other changes be made to the strata laws to more adequately deal with defects?**

*“Defects are a significant concern that many strata schemes have to address especially in new apartment buildings. A major issue is that the expertise required to identify and prepare a report is often costly and technically outside the knowledge of many owners. Owner’s corporations may not have sufficient skills and understanding to grasp the complexity of resolving major defects or correctly maintaining buildings. The impact of defects on the liveability of buildings can also create major social discord amongst residents. Defects can impact upon:*

- *The health and safety of residents;*
- *The quality and liveability of homes, and hence quality of life;*
- *The capacity of owners, executive committee members and strata managers to deal with other management duties;*
- *The financial costs borne by owners (to cover emergency and other repairs, investigations, legal costs, and re-housing residents);*
- *Property values and rental incomes. In some cases, owners may seek damages claims for these losses;*
- *Relationships between neighbours and other stakeholders can suffer. Conflicts over funds and responsibilities for defects can occur between owners, executive committees, strata managers, developers and others.*

*Un-remedied defects can also result in further ongoing damage and deterioration to the property. For example a leak that is not fixed can result in water damage to resident’s properties, mould growth and weakening of the building structure in the long term. It is worth considering where major defects impact on structural and health issues individual schemes should have a mechanism to fast track the repair of defects. Developers/builders could be required to take responsibility for the operational efficiency of the building for at least five years after commissioning. This may solve defects issues caused by short cuts taken in design and construction. The discussion paper suggests developer’s present maintenance schedules and defect inspection plans at the initial Annual General Meeting, which is good at face value. However without developer responsibility to make good any defects, maintenance schedules from developers could be deliberately onerous and responsibility for defects identified will default to the owner’s corporation. Developers are required to provide building management information under the current Act, for example electrical line diagrams, mechanical diagrams, equipment and maintenance manuals. For many buildings in the City of*

*Sydney Smart Green Apartments program only basic information is available. Strengthening the requirements for developers/builders to hand over the correct documentation to new owners should be considered.*

**Recommendation:**

*The current requirements for developers to provide information on building management should be reviewed, with the objective of developing consistent information provision requirements to better enable buildings to respond to maintenance, repairs and energy efficiency mechanisms.”*

## HOUSING INDUSTRY ASSOCIATION

(Copied from submission)

### 31. Do you think that a maintenance schedule prepared by the developer would be useful?"

*"Building defects, repairs and maintenance are a key issue requiring attention in the Review. Although it appears common practice to attribute all building problems to the builder and developer, the need for major repairs can be strongly related to the level of maintenance that a building has received throughout its life. Owners corporations are ultimately both legally and financially responsible for the management of major repairs and maintenance*

*in their strata scheme. Should, as a result of poor management, the reserves and insurances of the owners corporation not cover the full costs of major repairs and maintenance, each owner will be financially responsible for the remaining costs. HIA considers that it is good practice for each strata building to have a maintenance plan or schedule, prepared on expert advice. Well-presented building maintenance schedules have the potential to not only provide owners corporations with detailed information on regular maintenance requirements for common property and individual lots but it will also help to clarify whether an issue with the building is a defect or whether it has occurred due to a lack of appropriate maintenance.*

*When properly implemented and complied with, a maintenance schedule can help increase the longevity of building, help maintain the value of the building and will reduce instances of defects to which the builder must attend to, from occurring. From an owner's perspective this can also be of great value. Yet whilst the provision of schedules is recommended, HIA does not believe that it is possible or desirable to effectively mandate that builders or developers provide these documents. There has been no costing of any of the red tape or compliance impact. Further, it is unlikely that a one size fits all approach will be appropriate or possible. The types of strata buildings for residential alone includes high rises, mixed-use buildings, townhouses, community villages, residential complexes, and duplexes all of which will have different maintenance issues and requirements. Importantly there must also be a positive duty on the owner's corporation to comply with the plans including communication between the executive committee, building managers and owners and tenants, implementations of these plans and effective budget planning. HIA has concerns about enforcement of such a legislative requirement. Instead HIA submits that where a builder or developer voluntarily provides a written maintenance schedule and the homeowner fails to follow that schedule, the builder should have a statutory defence against any warranty claim that arose due to the owner's failure to follow the schedule. Finally, as an alternative to further regulation and the introduction of mandatory building maintenance schedules HIA notes that section 62 of the Strata Schemes Management Act 1996 places the responsibility of maintenance on the owner's corporation and strengthening of these provisions would override the need for compulsory maintenance schedules and remove the need for an additional legislative burden surrounding home building. These provisions could include strict guidelines on what must be maintained and how regularly maintenance should occur."*

### 32. Should defects be a compulsory agenda item for discussion at the first AGM?"

*"HIA supports the addition of defects as compulsory agenda item for discussion at first AGM. The builder is liable for defects for 6 years for structural items and 2 years for non-structural items. It is important that owners/ owners corporations can identify items that are defects and mitigate their losses by contacting the builder as soon as is practicable."*

**LAW SOCIETY OF NEW SOUTH WALES**

(Copied from submission)

**Do you think that maintenance schedule prepared by the developer would be useful?**

*"No"*

**Should defects be a compulsory item for discussion at the first AGM?**

*"Yes, but care must be taken as regards those parts of the common property which may be a shared facility in a strata management statement where the strata scheme is a stratum parcel."*

**Should the law set clear rules for voting on action regarding defects?**

*"No"*

**Should any other changes be made to the strata laws to more adequately deal with defects?**

*"The strata laws are not the correct forum for protection of owners corporations regarding defects, except to give owners corporations the power (if that power is necessary) to take an assignment of warranties and retention sums under building contracts (this would require amendments to other legislation). The Home Building legislation is the forum for some changes and requires review, particularly in the areas of statutory warranties and insurance."*

## MASTER BUILDERS ASSOCIATION

(Copied from submission)

### Questions:

31. Do you think that a maintenance schedule prepared by the developer would be useful?
32. Should defects be a compulsory agenda item for discussion at the first AGM?
33. Should the law set clear rules for voting on action regarding defects?
34. Should any other changes be made to the strata laws to more adequately deal with defects?

*“Master Builders supports the proposal of a maintenance schedule to be provided to the Body Corporate. Furthermore, the maintenance schedule should be readily available as a public document to the extent that a simple pro-forma document could be provided to each lot owner, depending upon the size and type of development. We notionally support a regulatory requirement for a maintenance schedule to be issued by the builder, to the extent that without some mechanism to ensure compliance, it will simply add to the documentation required to be provided at the first AGM; however there is little or no compliance process to support the requirement. Consequently only those conscientious developers are likely to comply with additional obligations in providing a maintenance schedule for the property. We submit that it would be worth examining the requirement for a copy of the maintenance schedule to be provided by the builder to the Principal Certifying Authority and attached to an Interim Occupation Certificate or Occupation Certificate. Such a requirement may require an amendment to the Environmental Planning and Assessment Act; however this being the case, a reference note in the new Strata Act would assist in awareness of the requirement. We understand that the issue of Occupation Certificates are currently being examined by the Building Professional Board. Master Builders currently provides “handover kit” for residential projects; however it was not developed for strata. The “handover kit” includes a detailed maintenance manual, but importantly, provides a professional folder for the inclusion of a copy of the approved plans, contract, certificates, warranties etc. We submit that in conjunction with an obligation for the owners corporation to retain a copy of the maintenance schedule, that maintenance/defects should be a standing agenda item for the owners corporation. Master Builders is most concerned that there does not exist a statutory right for the builder to attend to defects. We are also concerned about managing agents appointing other builders and contractors to undertake work during the statutory warranty period when no notification of such defects has been made to the original builder. This issue may be addressed through the current review of the Home Building Act 1989.”*

### Building Inspections

*“The Discussion Paper makes several references to building consultant reports and indeed, presents an option to require schemes to have a building inspection report carried out by a building inspector or quantity surveyor every five years. We have a particular concern regarding the quality of building reports and indeed the competency and experience of persons undertaking inspections and the compilation and wording of such reports. There is currently no regulation in NSW of persons undertaking property inspections and preparing defect reports. The quality of such reports is also questionable and more often substantially made up of disclaimers. We submit that persons undertaking property inspections require particular expertise and experience on a wide range of existing buildings. For example, a licensed builder may not necessarily be competent for the role as their training and experience is in the construction of new buildings rather than identifying defects in existing buildings. Where reports are required to provide a cost schedule for the repair of defects, we find that costs are often substantially inflated rather than reflecting actual current industry rates. Furthermore we see provisions of the National Construction Code or referenced Standards being wrongly applied or interpreted in relation to the age or approval date of the property. There is also a question of the value and quality of such reports when the property inspector is appointed or recommended by managing agents. There is concern that there is potential for the payment of commissions or fees between managing agents and property inspectors for referrals or*

*continuity of work, which in-turn are passed on to the Owners Corporation. We submit that there needs to be greater accountability and responsibility placed on persons preparing strata building reports. We note the Issues Paper relating to the review of the Home Building Act proposes the establishment of a panel of independent experts under the statutory position of a Building Disputes Adjudicator. We submit that if established, owners corporations would be obligated in only using building experts from the panel for property inspections, establishing defects claims and expert opinion.”*

#### **Delayed building defect claims**

*“A growing concern for Master Builders are delayed defect claims in strata which are orchestrated by the coming together of lawyers, building consultants and managing agents. There appears to be an approach developed in relation to building claims, whether the building is indeed directly responsible for the items of claim, so that the plaintiff will get some benefit by an award; or the builder will be forced into so called ‘negotiation’ in order to avoid expensive and protracted litigation. One strategy for delayed defects claims is to address outstanding maintenance work which in turn has lead to defects being claimed against the builder, alleging a breach of statutory warranty. However other claims are driven for financial gain, where a builder may be willing or ordered to attend to defects, however, access to the premises is prevented as a strategy to have a rectification order replaced with a monetary order. Where monetary orders are made, a process must be established to ensure that the where possible, awarded sums are expended on the work the subject of the order. Such funds should not be allowed to be simply “squirreled” away in sinking or administrative funds”.*

## **OWNERS CORPORATION NETWORK**

(Copied from submission)

### **22. Should the meaning of common property be changed? If so, which approach do you favour?**

*“No change should be made. The concept is well established. Problems that arise in relation to the application of the definition of common property can be resolved by clearly defining maintenance obligations and usage rights.”*

### **23. Should owners be responsible for all internal repairs within their lot and/or work which only benefits or affects them?**

*“Common services and building elements (e.g. waterproofing) which service or affect more than one lot are the responsibility of owners corporations irrespective of their location on common property or within a lot. The single line of responsibility of the OC for maintaining the integrity and serviceability of the building should not be made more complicated. Making individual owners responsible for such building elements would result in potential ambiguity about which party is responsible for maintaining the serviceability of the building, for example, the diagnosis and repair of water leaks. This would inevitably result in disputes and a flood of red tape when problems occur and the responsible party is difficult to identify. To be congruent, services located outside a lot which are for the exclusive use of a lot owner (such as a lot’s electrical fuse box), should be the lot owner’s responsibility. The lot owner should be responsible for all non structural elements of the walls, ceilings and floors together with fixtures in a lot.”*

### **24. Should the absolute obligation to maintain common property be changed to take account of the age and life of the scheme and the funds available?**

*“No. Any change to the absolute OC obligation to maintain and repair could lead to structural deterioration of a building and have implications for safety. That said every day owners corporations have to make judgements about the extent to which building elements are to be restored to “as new” condition.”*

### **25. Should owners or occupants be responsible for any damage to common property they cause?**

*“Yes. Whilst the owners corporation has an obligation to repair and maintain common property, where damage is the result of the negligence or actions of owners or occupiers, the cost should be recoverable by OCs from owners (for damage caused by themselves and their occupiers) in the first instance via debit to the owner’s levy account, and failing cooperation, through intervention by the CTTT. Where owners have an obligation to pay for damage done to common property by their tenants or occupiers, this obligation should not prejudice the right of the owners corporation to seek recovery from the tenant, occupier or other party which caused the damage. Any insurance excess paid by the owners corporation in respect of a claim for damage caused by an owner or occupier should be recoverable from that owner in the same way. Owners can opt to recover such costs from their tenant under their tenancy agreement.”*

### **31. Do you think that a maintenance schedule prepared by the developer would be useful?**

*“No. Developers may have a vested interest in tabling an onerous maintenance schedule to facilitate a legal abdication of developer responsibility for defects under the warranty period.*

*All strata schemes (including new schemes) should be obliged to have building defects inspections by at minimum a certified builder to provide a condition report as a basis for to*

*their 10 year Sinking Fund Plan.”*

**32. Should defects be a compulsory agenda item for discussion at the first AGM?**

- *“Yes. Within 2 months after the establishment of the scheme or issue of a certificate of practical completion (which ever comes first), the developer shall commission an independent assessor to prepare a defects report covering common property and all individual lots and this report is to be supplied to the OC, completed or not, at the first general meeting.*
- *The developer is to retain an independent assessor, on behalf of the OC, to:*
  - *prepare a 5 year forecast of administrative and sinking fund budgets and levies. (The first year’s budget must make provision for the cost of an independent building defects assessment and report (see below))*
  - *set the Administrative and sinking fund levies for the first year to realistically cover the cost of running the building including all non-warranty maintenance contracts and repairs*
  - *certify that the levies for the first year are a reliable guide to purchasers for ongoing levy levels and provide reasons why levies for the next 2 years may increase*
  - *review and certify the budgets and recommendation for the Administrative and sinking fund levies for the second year, as preparation for the first AGM.*

*Unless satisfied by the defect report provided by the developer, within 6 months of first occupation the OC should appoint its own independent assessor to inspect the building and report on construction defects in common property and all lots. The report is to be supplied to the OC for consideration at the first AGM or the next general meeting, whichever occurs first after completion of the report. The commissioning of this report should be a mandatory motion for the first AGM, unless this has already been done.”*

**33. Should the law set clear rules for voting on action regarding defects?**

*“Yes. The developer & builder and any interests associated with them should not be empowered to vote on defect matters as there is a clear conflict of interest.”*

**34. Should any other changes be made to the strata laws to more adequately deal with defects?**

- *“At all annual general meetings prior to the expiry of 2 year statutory warranty for non-structural defects and the 5 year statutory warranty period for structural defects, a motion must be placed on the agenda in which owners resolve on whether to commission / update a Report on defects.*

*The law needs to stipulate the documents that need to be handed over to the owners corporation and the timeframe for doing this – as built plans, copy of construction contract, all manuals & maintenance schedules. Penalties for non-compliance with the above need to be increased substantially to a level where non-compliance is not an economically viable option.”*

## **PROPERTY COUNCIL OF AUSTRALIA**

### **DEFECTS (Questions 31 and 32)**

#### ***Maintenance schedule***

*The Property Council supports the suggestion that developers should be required to provide a maintenance schedule for consideration and adoption at the first AGM of new strata schemes. In our joint industry submission on the review of the Home Building Act 1989 earlier this year, we strongly supported the proposal for the introduction of a mandatory maintenance schedule for all strata buildings.*

#### **Duty to comply with the maintenance schedule**

The owners corporation should be legally required to budget for scheduled maintenance. This measure would reduce disputation in any action against the developer / builder and thereby preserve the interests of the owners corporation.

#### **Defects as a compulsory agenda item**

Yes, it should be a compulsory item at the first AGM. Builders' retention money should be used to repair defects in the first 12 months.

### **OTHER ISSUES (Question 34)**

*The Discussion Paper suggests that some developers use their influence, either directly or indirectly, to delay or stifle action over defects until the statutory claims period expires, in order to avoid liability. The discussion paper's reasoning is illogical. It says that a developer that is still trying to sell part of its asset is willing to devalue the asset by deferring maintenance a buyer will see during inspection reports, reading strata minutes etc. Changes to strata laws, including removing the ability for a developer to vote on motions relating to defects, should not be made based on this illogical argument.*

## REAL ESTATE INSTITUTE OF NEW SOUTH WALES

(Extracts copied from submission in italics)

*“...As a fundamental measure to addressing building defects in newly constructed schemes, building laws and the certification process under those laws need to be strengthened to promote the construction of good quality building with good quality materials. The balance between the need to construct multiple dwellings in short period of time and the quality, safety and longevity of the construction needs to be addressed by government on a policy level.*

*Construction laws should set an adequate minimum noise transmission specifications for building materials used in schemes. Developers and builders should be held accountable for defects within the statutory framework, including by requiring developers to hand over to the owners corporation and independent building report and a 10-year sinking fund forecast prepared by an appropriately qualified professional.*

*Schemes should be encouraged to be proactive with defect rectification and repairs and maintenance, including by strengthening the 10-year sinking fund provisions and ensuring schemes comply with them.”*

### **33. Do you think that a maintenance schedule prepared by the developer would be useful?**

It would be a valuable document for the owners corporation provided it is prepared by the builder or someone suitably qualified. An independent building report on the structure of the building should be a prescribed document and handed over by the developer to the owners corporation.

### **33. Should defects be a compulsory agenda item for discussion at the first AGM?**

Yes, and the developer advised immediately of those identified defects. A 10 year sinking fund plan should be prepared by an independent quantity surveyor or similarly qualified professional, paid for by the developer and handed over to the owners corporation for adoption at the first AGM.

### **34. Should the law set clear rules for voting on action regarding defects?**

No, it should be left to the owners corporation.

### **35. Should any other changes be made to the strata laws to more adequately deal with defects?**

*“The primary issue of the quality of the construction work and materials used needs to be addressed in the building legislation. It is submitted that buildings building in recent years will not have the same longevity as buildings built in the first three-quarters of the 20<sup>th</sup> century. This will result in an urban renewal crisis if the building quality issues are not urgently addressed.”*

Issues of noise transmission, waterproofing, structural and safety matters need particular attention. Schemes should be granted powers under section 62 of the SSMA to change materials or otherwise bring the building up to current standards if required.

## **STRATA COMMUNITY AUSTRALIA**

(Copied from submission)

### **4.8 Are reforms needed to address the competing interests of stakeholders? If so, what should they be? (Q 8)**

*“All owners have a duty to maintain the common property properly and equally for all owners, whether they are a resident or not. In the context of three of the most common competing stakeholder scenarios, SCA (NSW) makes the following observations:*

#### **4.8.1 Developers v Owners**

*Getting builders to correct faults is a challenging exercise. Strata managers often find themselves in a potentially compromising position once they have been appointed by the owners at the first AGM to be then requested to write to the developer/builder (the entity that first engaged the strata manager) in relation to defects. Mandating that the developer/builder remains on the executive (as a non-voting member) for the first year of operation may overcome such a conflict. Further, that the developer deposit a 10% retention fund for two (2) years.*

#### **4.8.2 Mortgagees and Covenant chargees v mortgagors/owners**

*The ‘priority vote’ should be dispensed with as it is very rarely used and only causes confusion to owners. The requirement that notices and minutes of general meetings being required to be sent to mortgagees should also be abolished. The only exception could be where a motion for the termination of a strata scheme was on an agenda. Mortgagee and covenant-in-charge may only have a priority vote if and when that charge has been expressed by court order.*

#### **4.8.3 Investors v resident owners**

*Some investors are excellent owners so to give them a lesser vote (as suggested in the Discussion Paper p.6) would be unfair and also create conflict between the stakeholders at meetings. It would be preferable to enforce the requirement that the amounts determined in a sinking fund analysis must be levied and not amended. This will ensure both developers and investor owners contribute fairly to future repair and maintenance.”*

### **6.12 Do you think that a maintenance schedule prepared by the developer would be useful? (Q 31)**

*“SCA(NSW) does not support the notion of seeking a maintenance schedule from the developer unless that schedule came without encumbrances such as being an override to statutory warranty protection for the owners. However, it is essential that the developer provides the scheme with all service manuals, plans and specifications relating to the scheme.”*

### **6.13 Should defects be a compulsory agenda item for discussion at the first AGM? (Q 32)**

*“Yes, at the first AGM a discussion in relation to defects should occur and that this agenda item should continue for the first two (2) years of a scheme.”*

### **6.14 Should the law set clear rules for voting on action regarding defects? (Q 33)**

*“Yes, as noted above there should be no entitlement to vote on defects by the developer, builder or any person associated with them, as there would be a clear conflict of interest in their voting.”*

**6.15 Should any other changes be made to the strata laws to more adequately deal with defects? (Q 34)**

*“Yes, there needs to be provisions that ensure that a scheme does not miss out on the opportunity to lodge a claim under the Home Building Act (HBA) building warranty provisions. That is, schemes need to commission independent defect inspection reports in time to be able to lodge claims within the current statutory two (2) year non-structural warranty period and six (6) year structural warranty periods. The two (2) year warranty period may expire soon after the first AGM and that scenario has been considered in Q32 above. With respect to the six (6) year structural warranty period, provisions should be inserted into the strata/community laws to protect and alert owners of the requirement to hold a general meeting three (3) months prior to the expiry of that deadline. At this meeting, owners (excluding any builder or developer interests) would resolve to commission a building condition report to identify defects and to serve same on the builder/developer prior to the expiry of the warranty period.”*

## URBAN TASKFORCE

(Copied from submission)

### 3. Building maintenance is the responsibility of all owners

*“The Urban Taskforce supports the principle that all building owners be responsible for building maintenance. Individual owners must be responsible for the maintenance of their building (strata titled lot) and collectively, all owners are responsible for the maintenance of common property. Owner’s corporations are responsible for the management and control of common property thus “common property” must be identified easily and with certainty. However, it is not always easily identifiable. It may be more easily categorised through the mandatory lodgement of a schedule identifying all common property with the strata plan, to be updated as needed through a by-law. This will ensure the issue is addressed early in the strata scheme and will limit conflict and uncertainty. Owner accountability for the ongoing care and maintenance of strata buildings is a logical centrepiece of strata law reform. Building longevity and functionality is significantly affected by the quality and frequency of maintenance. The Urban Taskforce supports the suggestion that developers/builders be required to present a maintenance schedule for consideration and adoption at the first annual general meeting of new strata schemes. In fact, the legislation should make maintenance schedules for all strata buildings mandatory. Such schedule should be prepared by the builder, identifying the required maintenance. While the builder is able to prepare the maintenance schedule, the owners are better placed to coordinate maintenance works and will be the party to suffer in the event that maintenance is not implemented. We support the idea that the maintenance schedule be linked to the sinking fund plan and the requirement for the sinking fund to be adequately financed by the owners, during the life of the scheme. In this regard, owner’s corporations should be required by law to apply the accumulated proceeds from sinking funds to the provision of maintenance in accordance with the maintenance schedule. Furthermore, owner’s corporations should be required to establish the rates of contribution to the sinking fund based on the estimated costs of compliance with the maintenance schedule, adjusted to take account of inflation and other factors likely to increase the cost of compliance with the maintenance schedule over time. Consideration should also be given to a compulsory maintenance levy. Such a levy would require an amount to be allocated to maintenance on an annual basis and require that this budget be spent. This would ensure the ongoing upkeep of the building and force an owner’s corporation to properly maintain the building.”*

### 4. Sinking funds are an essential building management tool

*“Many strata buildings have become neglected through the inadequate contributions by owners to the upkeep of the premises. Large strata schemes are inevitably also large buildings that require constant maintenance and repair as well as proper asset management. This creates problems with management and funding. Large strata schemes require a realistic sinking fund to be established immediately upon registration of the strata plan. The Urban Taskforce agrees that legislative reform is required in this area. The continuation of a 10-year sinking fund plan has merit. However, we suggest that the sinking fund plan be prepared by an appropriately qualified asset or facilities manager perhaps with the assistance of an engineer, building surveyor or quantity surveyor. This plan should be reviewed at least every 2 years. Levies could then be set accordingly. The amount to be contributed to the sinking fund could be based on expert advice obtained on an estimate of funds required to protect against foreseen and predictable upgrade and maintenance. An alternative could be to simply collect a percentage of the administrative fund.”*

**STRATA UNIT UNDERWRITERS AGENCY PTY LTD**

Submission discusses the nature and type of cover needed for strata schemes once established. It does address rectification of defects and only by way of illustration does it explore the consequences of damage to common property and individual lots.

**SYDNEY BUSINESS CHAMBER**

Submission expresses support for Sydney-side growth initiatives, including amendment of strata laws to ease wind-up of strata schemes in favour of higher density redevelopment.

**THE COMMITTEE FOR SYDNEY**

Submission supports reform to allow easier termination of schemes to enable replacement of old rundown strata buildings, but does not comment on defects rectification of new buildings.

**URBAN DEVELOPMENT INSTITUTE OF AUSTRALIA**

Submission discusses merit of replacing old rundown strata buildings but does not comment on defects rectification of new buildings.

**NATIONAL INSURANCE BROKERS ASSOCIATION**

Makes no submission on the management of building defects.

**THE AUSTRALIAN PROPERTY INSTITUTE**

The submission does not address defects and remediation issues.

**AUSTRALIAN INSTITUTE OR BUILDING SURVEYORS**

Single page letter advises that “...*the majority of issues discussed fall outside the range of responsibilities of the Institute’s members*” and then proceeds only to address the right of access to investigate complaints about overcrowding.