

## EXECUTIVE SUMMARY

This submission is made by the Owners Corporation Network (OCN), an independent non-profit association of thousands of apartment owners run by apartment owners for apartment owners. OCN welcomes this inquiry by the Public Accountability Committee (**the Committee**) and the opportunity to provide a voice on behalf of apartment owners affected by building defects.

In addressing **the Committee's** terms of reference, it becomes clear that apartment owners have been let down badly by successive Governments and the building industry for the past few decades. This has resulted in far too many instances of personal hardship and serious economic consequences. Confidence in apartment ownership, based strata title, is being undermined despite it being central to meeting the housing needs of Australia's rapidly growing urban areas.

To address this a major refocussing of Government on both the building industry and strata title regulation is required. Elevating and better co-ordinating of both these areas within Government together is recommended. In this regard OCN recommends:

1. Reforming oversight of the housing sector (including apartments) by establishing a new senior "Minister for Housing, Strata and Building Quality".
2. Establishing a specialist strata title department or Commissioner reporting directly to this Minister to develop policy and oversee and administer all strata title regulatory functions.
3. Establishing a Building Commission reporting to this Minister to oversee and implement the reform of the residential building industry.

Resourcing of these responsibilities is crucial. While this consolidation of functions would produce efficiency savings, the level of overall resources provided to support them is a key measure of the Government's commitment to critical reform and delivering the associated economic benefits.

The other key finding to emerge in this submission is the urgent need to assist apartment owners who are the victims of the current flawed framework. It is widely accepted that it will take a number of years to complete the necessary reform of the building industry. In the meantime, thousands of apartment owners are dealing with serious financial, safety and amenity issues resulting from existing buildings. Furthermore, many more buildings will be completed before reform is effective.

To address this and help restore confidence in the industry:

1. An assistance package for apartment owners facing hardship needs to be implemented urgently. This should be funded by those responsible, the building industry and Government.
2. Degraded statutory warranties under the Home Building Act can and should be restored as a matter of urgency. The case for retrospective application of restored warranties is strong and should also be examined.

To arrive at these conclusions the following aspects of the Inquiry's Terms of Reference were expressly considered in this submission:

1. The adequacy of consumer protections for owners and purchasers of new apartments/dwellings.
2. The current status and degree of implementation of reports into the building industry.
3. The role of strata committees in responding to building defects discovered in common property.

A summary of that analysis and findings follows.

### **Improving consumer protection for new apartment owners**

New apartment owners are a particularly vulnerable group of consumers unable to exert an effective influence over the build quality of new apartments. There are many reasons for this vulnerability including:

1. Apartment buyers have no real information about the technical and financial capability of the developers and builders delivering their apartment complex.
2. Apartment buyers have no direct influence over the design and construction of their buildings in the same way as commercial and Government clients often do.
3. The handover process from developers to apartment owners can be easily exploited by developers and builders to avoid meeting defect warranty obligations.
4. Apartment buyers are generally new to apartment living and are poorly equipped to manage the complex set of rights and obligations that come with a new apartment.

The urgent actions to help vulnerable consumers are set out above i.e. to provide an urgent hardship support package and reinstate degraded statutory warranties. The following initiatives should also be pursued:

1. Introducing and enforcing a new class or category of builder/contractor and developer licences for construction of high-rise apartment buildings.
2. Implementing the proposed statutory duty of care of all parties involved in the construction of buildings to subsequent building owners.
3. Reforming NSW building regulations to provide for decennial liability and insurance.
4. Improving the information provided to prospective purchasers about the purchase decision.

### **Execution of reform initiatives recommended by various reviews**

Confidence in the Government's execution of recommended reforms would be evidenced by:

1. Ensuring the proposed Building Commissioner has the capability, resources and authority to drive and implement the first round of reforms.
2. Establishing arrangements for the longer-term development and implementation of a robust building industry reform program with stakeholder input that sufficiently prioritises consumers.

### **Support for and oversight of strata committees**

Democratically elected strata committees undertake a crucial role on behalf of apartment owners within a strata scheme. There is also a wide variation in the capability and motivation of committees. The rules for managing the interplay between the rights of individual apartment owners and the shared responsibilities within a building are complex. The imposition of major defect rectification responsibilities on committees only compounds this. Potentially challenging disputes are inevitable.

Furthermore, the regulation and oversight of both building construction and strata arrangements have not kept pace with the rapid growth in apartment living and building defects. This is most apparent in dispute management services including:

1. The lack of professional support service for committees in new buildings that is completely independent of the developer, builder and the strata manager engaged by them.
2. The effectiveness of regulatory oversight and enforcement of strata law.
3. Providing more accessible training and support for strata committee members (**Annexure C** is a past proposal by OCN to Government on this matter).

It is these shortcomings that highlight the need for more focused and better resourced arrangements for policy development, regulatory oversight, strata law enforcement, and training and support for strata committees within Government. As recommended above, establishing a specialist strata department or commissioner reporting directly to a senior Minister such as a “Minister for Housing, Strata and Building Quality” would be a major step forward in addressing this.

## DETAILED SUBMISSION

### The Owners Corporation Network and this Inquiry

This submission is made by the Owners Corporation Network (OCN), a non-profit association of thousands of apartment owners run for apartment owners by apartment owners.

OCN welcomes this inquiry by the Public Accountability Committee (**the Committee**) and the opportunity to provide a voice on behalf of consumers in the residential construction marketplace. We particularly welcome the focus on consumer protections, the vital roles of strata committees, and the progress or otherwise in implementing the recommendations of the various reports into building construction.

OCN has been pressing for building reform for around 20 years. All too often our voice has been drowned out by building industry advocates and successive Governments focused on the quantity of housing at the expense of quality. The true cost of this to consumers is uncertain but runs into billions of dollars.

Inquiry after inquiry has recommended reform. Our members have battled with developers, builders and insurers, and their sanity, to protect the value and amenity of their homes. Data has rolled in on the extent of the problem, firstly from NSW Sydney Futures<sup>1</sup> and, recently, in the paper of Nicole Johnston from Deakin University and Sacha Reid of Griffith University<sup>2</sup> (**Johnston-Reid report**).

Then came the people driven from their homes at Opal Towers, Mascot Towers and elsewhere, bringing this issue starkly into the open in NSW.

### Introduction and submission structure

OCN believes that it is best placed to comment on the following three areas of **the Committee's** terms of reference and will deal with each of these in turn in this submission.

1. The adequacy of consumer protections for owners and purchasers of new apartments/dwellings (**Section 1**)
2. The current status of implementation of reports into the building industry (**Section 2**)
3. The role of strata committees in responding to building defects discovered in common property (**Section 3**)

In addressing these matters reference will be made to the following attached documents:

1. Terms of reference for this Inquiry (**Annexure A**)
2. OCN's recent submission to the Government's "Building Stronger Foundations" discussion paper (**Stronger Foundations paper**) (**Annexure B**)
3. OCN's submission to the NSW government proposing a support package for strata committees (**Annexure C**)
4. A research paper entitled "Decennial Liability Insurance - the solution to the Strata Living Crisis in New South Wales" (**Annexure D**)

---

<sup>1</sup> H. Easthope, B. Randolph and S. Judd, 'Governing the Compact City' City Futures Research Centre Faculty of the Built Environment University of NSW First published May 2012

<sup>2</sup> N. Johnston from Deakin University and S. Reid of Griffith University "An Examination of Building Defects in Residential Multi-Owned Developments", June 2019

The paper in **Annexure D** includes a good summary of the changes to consumer protection arrangements affecting apartment owners since the 1970s until very recently. It also includes international examples of the application of decennial liability insurance arrangements which appear to be operating successfully elsewhere to protect vulnerable buyers of new apartments in multi-story buildings.

OCN is still exploring these schemes. However, given the apparent success in other countries we considered this as something worthy of consideration by **the Committee**. This will be discussed briefly in Section 1 of this submission.

The following brief comments are provided on the other matters raised in the terms of reference.

#### ***Private certifiers***

The terms of reference also seek input on the vital role of the private certifier where well reported conflict of interest issues need to be addressed. We have no doubt this will be a focus area in many submissions and OCN does not believe it can add too much more on this matter in the body of this submission. Nevertheless, OCN's response to the **Stronger Foundations paper** in **Annexure B** deals with this on page 5. As explained there, care needs to be taken not to overstate their role and capacity to overcome deep systemic problems.

#### ***Flammable cladding***

Flammable cladding is a major issue for many apartment owners. It is also a high-profile example of the wider malaise in the construction industry. Through no fault of their own affected apartment owners find themselves living in unsafe buildings with an urgent need to raise funds to rectify the situation. Their building insurance premiums have increased and in some cases the market values of their properties have plummeted. Many investor owners are unable to let properties.

The key issue here is to find the best way to provide timely and meaningful assistance to affected owners. Without it there will be no prospect of restoring consumer confidence in the industry in the immediate term and the risks of a major incident involving risks to life persist longer than they should. Section 1 of this submission deals with the need for immediate funding support to address this and other defect related issues currently facing many apartment owners.

## Section 1 - The Adequacy of Consumer Protections of Owners and Purchasers of New Apartments

This section of the submission focuses on the following aspect of the Committee's terms of reference:

*“the adequacy of consumer protections for owners and purchasers of new apartments/dwellings, and limitations on building insurance and compensation schemes, including:*

- (i) the extent of insurance coverage and limitations of existing statutory protections*
- (ii) the effectiveness and integrity of insurance provisions under the Home Building Act 1989*
- (iii) liability for defects in apartment buildings,”*

Effective informed consumer choice in any marketplace is the best discipline that can be imposed on suppliers to meet consumer needs. This is not the case in the market for new apartments, although, collectively, apartment buyers are becoming extremely wary as public confidence in the industry declines.

To address this, developers, builders and other participants in the delivery of new apartment buildings need to be made more directly accountable to apartment owners for building quality.

This section:

1. Explains why new apartment buyers are particularly vulnerable consumers
2. Examines each of existing consumer protections and proposes improvements needed to improve accountability of the building industry to its customers
3. Proposes improved information to consumers to assist them in making more informed apartment purchases
4. Explains the need for a substantive immediate assistance package for the most impacted apartment owners

### ***The problem of vulnerable consumers***

New apartment owners are a particularly vulnerable group of consumers and cannot exert an effective influence over the build quality of new apartments.

The reasons for this are numerous including the following:

1. Apartment buyers have no real information about the technical and financial capability of the developers and builders delivering their apartment complex and tend to focus on benefits featured in sales promotion material.
2. Apartment buyers are generally new to apartment living and are poorly equipped to manage the following key aspects of their situation:
  - a. Meeting their responsibilities as a participant in a new owners corporation.
  - b. Exercising the limited collective consumer rights they do have.
  - c. The complex lengthy legal and technical process sometimes needed to achieve a successful warranty claim against builders for defective work

3. Apartment buyers have no direct influence over the process for delivering their buildings:
  - a. They are not directly represented during the design and construction process in the same way as commercial or Government clients
  - b. There is no real risk to the developer of losing repeat business as a result of poor quality in the same way they face when dealing with major corporate and Government clients
4. The handover process from developers to apartment owners can be easily exploited by developers and builders to avoid meeting defect warranty obligations. For example:
  - a. It takes time for the ownership responsibilities to pass effectively from the developer to the apartment owners as new owners progressively occupy a building.
  - b. The developers, builders, and their appointed strata managers, have immense knowledge and experience advantages over new owners during this process.

Without informed consumer choice driving building quality, effective consumer protection arrangements are essential, particularly when the consequences for the consumer are potentially life changing.

#### ***Existing consumer protections and required improvements***

Arrangements impacting on consumer protection for new apartment owners include:

1. Statutory warranties in the Home Building Act
2. Homeowner warranty insurance and NSW construction bond scheme
3. 'Special purpose' vehicles ('\$2' companies) used to limit company liability to consumers
4. Duty of care owed by building practitioners to apartment owners
5. The potential role for decennial insurance schemes in NSW
6. Improving the information to prospective purchasers about the purchase decision

Each of these arrangements is briefly considered in turn noting the current inadequacies and potential improvements. More detail on many of these matters can also be found in the submission to Government provided in **Annexure B**.

#### ***Statutory warranties***

Statutory warranties for most construction defects under the Home Building Act have been wound back from seven to two years by legislative action in 2012. The exception is for less than clearly defined 'major defects' such as structural failures where the warranty period is six years. Even the starting point for these periods, the project completion date, is somewhat ill defined with the individual circumstances being relevant in court decisions.

Furthermore, the effectiveness of these existing warranties has also been wound back by a series of court decisions regarding the deliberate arrangements by construction industry participants to avoid warranty obligations. Further details of this important issue are set out further in the submission provided in **Annexure B**.

The current NSW statutory warranties are broadly in line with those in other Australian jurisdictions. This may well be used as a pretext for no change in NSW. Unfortunately, that simply leaves vulnerable consumers exposed to current exploitation practices and provides no driver for the construction industry to lift its game. The two year period is particularly problematic as many

serious defects that may not be classified as major are hidden from sight at project completion and can take more than two years to reveal themselves.

Accordingly, the following changes to the Home Building Act should be considered:

1. Extending the length of the current warranty periods
2. Clarifying the definition of a major defect covered by the longer warranty period
3. Rectifying the dilution of current warranties by a series of court decisions.

This latter initiative is very important and needed to re-establish the intended application of those warranties.

Warranty obligations can be reinstated quickly with changes to the Home Building Act. Proposed changes to address watering down by court decisions are set out within **Annexure B**. There is a compelling case for these changes to be retrospective as well as immediately assisting apartment owners currently dealing with defect issues.

The Home Building Act should also include an anti-avoidance provision to ensure developers seeking to avoid their liabilities (in these ways) comply with the legislation, and provide the courts with the ability to deal with such proactively.

#### *Home owner warranty insurance and the construction bond scheme*

Statutory warranties are meaningless without a company of substance standing behind them. All too often the companies involved are special purpose vehicles lacking the financial capability to back the warranties and are wound up before the full extent of a legitimate claim can be met.

In 2003 the crucial backstop for this, compulsory home owner warranty insurance, ceased to be required for apartment buildings over three levels. From that time the risks of default on statutory warranties fell on the unsuspecting new apartment owners. Put another way new apartment owners now wear the risks so high that insurers were not prepared to carry them.

The insurance companies in this scheme had also applied a level of discipline on building companies by requiring certain financial and technical capabilities to be met before they would be covered by the insurance needed to participate in this market. That discipline still operates with reasonable effect in home building for dwellings below three levels.

This vital form of consumer protection and discipline on construction of apartment buildings over three levels is now missing. In its place the Government has, in recent times, established the development bond scheme.

This bond scheme applies to all construction contracts entered into after 1 January 2018. It requires developers to lodge a bond valued at 2% of the construction contract price with the Government. A building inspector, independent of the developer, is appointed to inspect and report on the building construction. The builder must attend to any defects identified. A final inspection is carried out at the end of the two year period after construction is completed. Any defects not attended to get paid for out of the bond with any residual balance being paid back to the builder.

An obvious issue with this scheme is the very short time available to identify defects and difficulties in identifying construction defects which are not able to be identified by inspection. This includes the most common of important and costly defects, waterproofing and fire containment devices. The 2% of construction cost is also too low with rectification costs as high as 10% of the contract cost not



uncommon. Such a scheme would have been useless protection for the owners of Opal Tower if the builder was not financially strong enough to survive claims against the statutory warranties.

Clearly, if this scheme is to be retained then the size of the bond and length of time for defects to be identified should be significantly increased.

Indeed, the 2% bond would probably be more usefully spent on the establishment of decennial insurance arrangements similar to those proposed below and explained more fully in **Annexure D**.

#### *Addressing the use of “special purpose vehicle” (\$2) companies to avoid liability*

One of the biggest challenges for holding builders and developers accountable for defects, where they do not have insurance, is that they are usually “\$2 companies” or “special purpose vehicles” that become insolvent soon after projects are finished. These arrangements also serve to limit liability for defect costs to companies which have little or no assets to meet a court judgement. Victoria has recently flagged changing the law in an attempt to ensure such companies are held liable for cladding defects in that state (<https://www.afr.com/real-estate/commercial/victoria-to-commit-funding-for-cladding-fix-20190625-p5210z>).

It is worth contrasting how contractors requiring Home Building Company Finance (HBCF) cover for work involving houses or “low rise” strata schemes compare with those constructing high rise strata schemes. The former are subjected to stringent financial checks and solvency criteria, and scrutiny of their claims histories, to maintain their “eligibility” for HBCF cover. Those that build high rise are not. A “cowboy” builder wishing to be subject to less scrutiny is almost encouraged to build only high-rise units, where their poor conduct will have even more serious effects.

As a result, a new class or category of builder/contractor and developer licences should be introduced to build high rise strata schemes currently not requiring HBCF. To maintain that licence a builder, contractor or developer should be required to be subject to the same HBCF eligibility criteria. This would be a relatively simple and low cost scheme, as it would only involve expanding the current eligibility criteria assessment scheme already in place, and any extra costs of same should be borne by charges to be assessed and/or increased licence fees.

#### *Duty of care*

The introduction of a statutory general duty of care is necessary to fill a gap in common law duty of care left by the High Court in 2014. It is laudable that the Government has recently accepted this legal reform. The statutory duty of care creates a positive duty that will help drive cultural change and discipline in the industry. Furthermore, it is not tied to prescriptive defects but will have a general application promoting shared responsibility. OCN notes that the statutory duty of care has been also been endorsed by the Victorian Cladding Taskforce in both its interim and final reports, which also puts forward the benefits of a duty of care from a regulator’s perspective.

A statutory duty of care is consistent with shared responsibility and it complements but does not replace other regulatory requirements. It would add to the incentives for all parties involved in the construction of building, including architects, designers, building surveyors, water proofers, fire engineers and builders to take reasonable, practicable safety measures.

In our view, the statutory duty of care must be provided with retrospective effect to provide additional consumer protection for those strata schemes already dealing with defects. This is a

justified approach given that the statutory codification of the duty is a confirmation and clarification of the law that was presumed to exist until the High Court put it in doubt in 2014.

*Reform of NSW building regulation to provide for decennial liability and insurance*

It is always instructive to look at how other countries deal with the risks that building construction defects risks impose on residential owners in apartment style buildings. **Annexure D** includes a research paper entitled “*Decennial Liability Insurance - the solution to the Strata Living Crisis in New South Wales*” by construction lawyer Jessica Rippon that does just that.

After examining the development of arrangements in NSW over many decades the paper confirms the need for substantive reform of the consumer protections for NSW apartment owners. It proposes a vital role for “decennial liability insurance” in NSW to cover “major” defects in multi-storey buildings. It further notes that, subject to other regulatory changes, it could be offered and managed by the private sector.

The term ‘decennial’ arises from the fact that in many countries liability and associated insurance exists for the most major building defects for 10 years.

The paper takes a holistic approach to improving building regulations, liability, and insurance in NSW to accommodate decennial insurance. This includes:

1. Changes to the Statutory warranty periods under the HBA
2. Changes to the insurance requirements in the HBA
3. Introducing the concept of joint responsibility
4. Changes to the EPA Act

Given that such arrangements are in place in other countries and given the potential for this package of recommendations to significantly improve the consumer protection afforded NSW’s new apartment buyers, OCN commends the analysis, findings, and recommendations in this paper to the inquiry for further consideration.

As the author concludes the proposed set of arrangements provide “*the necessary protection needed for those living in strata title developments while at the same time protects contractors from facing bankruptcy when major damage in a high-rise development is discovered. From a policy perspective, decennial liability insurance also offers cost savings in the form of less litigation and increased efficiency through owner’s insurance and subrogation suits, relieving the pressure off our court system.*”

***Providing better information to new apartment buyers***

There are least two important aspects to providing the information needed by new apartment owners.

Most importantly useful information about the financial capability and past performance of companies developing and building residential apartment complexes is not available easily to prospective apartment owners. To address this a public register should be established by the regulator overseeing the licencing regime containing the basic information about each company and individual used as the basis for issuing a licence.

This information would be an invaluable addition to property searches by prospective buyers and could play a vital role in companies building brands associated with good performance to help promote their projects.

The other useful information for a new apartment owner is a clear summary of the rights and obligations that come with strata title. This information package should set out clearly the potential for building defects and the processes available to deal with them should they arise. A signed declaration by the purchaser that they have read and understood such a document could be a precondition to entering into a contract for sale.

### ***The vital importance of immediate consumer support funding***

Confidence in NSW apartment building construction standards has fallen dramatically as the nature and extent of the defect crisis has become apparent. Potential new apartment buyers are now very wary as they watch people confronting extended periods out of their homes and potential bankruptcy because of building defects.

Most of the recommended measures for addressing root causes will take years to remedy the issues driving lost confidence. Immediate temporary actions are needed in the meantime to restore consumer confidence. The Victorian Government has recognised this by proposing funding packages to assist apartment owners affected by flammable cladding on their buildings.

Similarly, the NSW government needs to step in and provide long term (10 to 20 years, noting current strata finance provides 1- 7 years loans), no or low interest rate loans to help owners get their buildings fixed (for defects generally, not just cladding).

Strata schemes not dealing with cladding would need to meet certain parameters, to avoid the funding being sought for minor defects (which can vary depending on the size of a strata, and the cost involved) or what amounts to refurbishment works. Reputable and vetted consultants and remedial builders need to be involved in that process. This will provide confidence to consumers that this problem is going to be fixed, while the government also fixes the system in the medium to long term to make sure this never happens again.

NSW should also introduce a grant fund to assist strata schemes facing the costs of repairing cladding defects. Like Victoria that fund should draw monies from fees paid by developers, for example based on a per lot basis on the registration of a strata scheme (required prior to registration).

Such loans or funds should not draw funds from strata schemes or lot owners, which would be punishing the very people the schemes are intended to assist. The burden should fall most heavily on those drawing the greatest profit from the property development process or contributing most to causing the problems. This is also consistent with the accountability for the problems, which clearly lies with the industry, and helps provide incentives for improvements by the industry over time.

Government funding is justified morally too, noting that the apartment owners paid stamp duty on their original purchases based on the full market price for a new and functional home. The apartment owners most entitled to help now have seen this value reduced, sometimes very significantly, as a result of identified building defects.

Duty on residential property transactions delivers close to \$6 billion per annum to State Government revenues and the stamp duty payable on a \$1 million apartment is \$40,449. This is very much in line

with the typical costs per owner to repair common building defects and well below the costs to owners in the most extreme situations when apartments become unliveable and unsalable.

***Summary - consumer protection of new apartment owners needs major reform***

Section 1 of this submission has established a clear mismatch between the inherent vulnerability of new apartment owners as consumers of the building construction industry. This is a central cause of poor building quality because consumer choice is ineffective in directly shaping supplier responses. Furthermore, the costs of the poor quality construction are not transmitted to those responsible.

To address this statutory warranties need to be improved, builders and developers need to be subject to much more stringent licencing conditions, and reform of the insurance arrangements in the industry are required. This needs to be implemented as soon as possible. In the meantime, an emergency support package is required to assist apartment owners who are, or will be, significantly impacted by the defective construction already being undertaken.

## Section 2 - The current status and degree of implementation of reports into the building industry

This section of the submission focuses on the following aspect of the Committee’s terms of reference:

*“the current status and degree of implementation of recommendations of reports into the building industry including the Lambert report 2016, the Shergold/Weir report 2018 and the Opal Tower investigation final report 2019”*

While there have been dozens of reviews and reports stretching back to at least 2002 (the Campbell Report<sup>3</sup>) on building regulation the most current reports are the Lambert report<sup>4</sup>, released in 2016 and the **Shergold-Weir** report<sup>5</sup> to the National Building Ministers Forum released in February 2018. Unfortunately, action to date in response appears patchy and not demonstrably effective.

More recently the signs are encouraging.

1. The Premier has publicly stated that there is a need to re-regulate the industry
2. The Minister for Better Regulation and Innovation has acknowledged the depth of the problem including the need for culture change in the construction industry
3. Relevant Ministers before and after the March NSW election have stated their intentions to implement key recommendations of the **Shergold-Weir** report, as well as committing to establishing a form of statutory duty of care to be owed by construction participants to apartment owners.
4. Stakeholder consultation has commenced on the implementation of the Government’s commitments (OCN’s formal response to the Government’s **Better Foundations discussion paper** can be found in **Annexure B** to this submission)
5. The Government is currently providing direct financial support to the residents displaced from Mascot Towers

Despite this, the challenges are indeed immense, and it is entirely appropriate for this Inquiry to focus on the need for evidence of the required reforms being delivered in a reasonable time frame.

Based on the matters addressed in the Government’s recent **Better Foundations discussion paper** OCN is yet to be convinced that this will be the case. To provide assurance that reform is being progressed as needed requires:

1. Strong customer focused measures of ultimate success.
2. Greater transparency of the actual implementation of **Shergold-Weir** recommendations.
3. Establishment of proper processes within Government for achieving reform.
4. Immediate assistance for affected apartment owners pending the outcomes of reforms.

To assist the Inquiry each of these points is considered further below.

---

<sup>3</sup> “Report on Inquiry into the Quality of Buildings, Joint Select Committee on the Quality of Buildings, Parliament NSW, Legislative Assembly.” [Sydney, NSW] Chair: David Campbell, July 2002

<sup>4</sup> M. Lambert, Independent Review of the Building Professionals Act 2005, 2016

<sup>5</sup> P. Shergold, B.Weir, “Improving the effectiveness of compliance and enforcement systems for the building and construction industry across Australia” February 2018

### ***Measuring successful outcomes in customer focused terms***

No reform package can succeed without clearly defining what success looks like and being able to meaningfully measure progress to that outcome. Furthermore, this must include measuring progress in terms that matter to consumers, in this case new apartment owners.

These requirements are yet to be clearly established in the building reform process.

Owners of new apartments are the customers that have been most let down by the building construction industry. For them successful reform is being able to buy a new home at a reasonable price knowing that:

- It is safe to live in and defect free
- When defects are present these are attended to promptly and properly at no cost to them
- When defects are so serious the apartment is not fit for purpose, they get their money back

Apartment buyers do not wish to participate in a buyers' lottery where the losers have their hard-earned finances and aspirations decimated.

**Shergold- Weir** characterises successful reform as re-establishing confidence in the building construction industry without directly linking this to new apartment owners as the customers.

Many construction industry participants will continue to argue that re-regulation will slow the delivery of much needed new homes and increase their price. Experience to date suggests that this view of customer needs, together with de-regulation, has resulted in billions of dollars of extra defect costs loaded unevenly on new apartment owners. Much of this extra cost arises because avoiding defects during construction is much cheaper than attending to them after completion.

Any attempt to measure the success of building reforms must include a strong focus on consumer outcomes and this, in turn, must include the true cost of defects in new apartments and the failure to meet building (including safety) standards.

### ***Improving transparency of reform implementation***

The Government has stated its intention to implement the **Shergold-Weir** reforms. Delivering all 24 recommendations is a major undertaking and the scope of work associated with each recommendation open to some interpretation. This makes monitoring and reporting of progress a challenge.

To address this more transparency on the Government's specific intentions would be helpful to all stakeholders. While stakeholder consultation has commenced this should be developed to include detailed public reporting setting out the Government's intentions for each and every recommendation in the **Shergold-Weir** report.

Such reporting would assist with ongoing stakeholder input, enable monitoring of progress over time, and provide confidence in the Government's commitment and ability to execute reforms.

### *Establishing proper arrangements within Government for achieving reform*

In its response to the Government's **Building Stronger Foundations discussion paper** OCN addressed arrangements within Government needed for the successful delivery of the required reform over time. These included:

1. Ensuring the proposed Building Commissioner had the capability, resources, independence, and authority to drive and implement reforms.
2. Establishing arrangements for the longer term development and implementation of building industry reform program with stakeholder input that sufficiently prioritises consumers.
3. Reforming oversight of the housing sector (including apartments) by establishing new senior "Minister for Housing, Strata and Building Quality".

### *An effective Building Commissioner*

The Government is moving to establish a building commissioner role with a focus on the industry. A key test of the Government's commitment to the reform process will be the additional funding allocated to that role, the relevant capability of the appointee, and the authority and political support provided to the role. The OCN welcomes the public statements of the Premier, that the office holder will have additional resources and that this position and the reforms will not have to be funded from existing budget of the relevant Department.

### *Longer term arrangements for reform*

Another indicator of the Government's commitment will be the way it deals with ongoing development of industry reform needs. The 'interim package' proposed in the Government's **Building Stronger Foundations discussion paper** is not the end of the story. It is an important starting point, but it does not address many of the known causes of building defects as set out in **Annexure B**. As **Shergold-Weir** noted implementation of their recommendations involves up to three years or more.

Establishing a Building Commission with functions and resources to deal with longer term implementation, monitoring, enforcement, and development of industry reforms would show that this need is understood. The need for a properly qualified and experienced person to review the **Shergold-Weir** report and the current problems with the home building industry could be incorporated into the Commission. This person's functions, wherever appointed, should extend to liaising with stakeholders, including consumer groups such as OCN, and the industry as required.

This person could also be appointed sooner and commence making recommendations as to a program of legislative reform to make changes that are required, which the government can then take steps to enact. Whether that is to the Home Building Act, Environmental Planning & Assessment Act, or any other parts of the various overlapping legislation that governs the industry and sits between government portfolios, this person should be empowered to take a "whole of government" and holistic approach. Doing this would provide the focus and program necessary to enable all aspects of the required reform package to be identified and enacted.

A key benefit of setting up these arrangements is to ensure that the implementation of **Shergold – Weir** recommendations includes addressing the real causes of problems as well as giving stakeholders the confidence that it does.

*New Ministerial oversight of the housing sector*

With the rapid growth in apartment living and its increasing relative importance as a housing option there is a case for more fundamental reform of Government responsibilities for this sector. To this end OCN proposes the establishment of a new senior ministerial portfolio of “Minister for Housing, Strata and Building Quality”, with responsibility for housing policy, building quality regulation and strata housing policy and services.

*Providing immediate assistance for affected apartment owners*

As set out in Section 1 of this submission there is a compelling argument for the establishment of assistance packages for apartment owners who are the unwitting victims of widespread defects in new apartment buildings. Not only is this important to restore consumer confidence but the Government’s approach to this issue is a measure of how seriously it sees this problem as well as its understanding of where accountability lies. The prompt establishment of meaningful, well targeted apartment owner assistance arrangements would provide a very strong signal of the Government’s determination to restore consumer confidence in the new apartment market.



### Section 3 - Strata committees and building defects

This section of the submission focuses on the following aspect of the Committee's terms of reference:

*"The role of strata committees in responding to building defects discovered in common property, including the protections offered for all strata owners in disputes that impact on only a minority of strata owners."*

It is inevitable that disputes arise in strata schemes given the inherent need to balance the rights of individual apartment owners with the extensive shared responsibilities within each strata community. In the most extreme situations the impact on the people involved can be very damaging both personally and financially. Disputes involving building defects in common property affecting individual apartment owners are among the most intractable and these can test available dispute resolution processes to the limit.

However, there are options for reducing and better managing disputation in these situations.

In new buildings defects are a major source of tension and conflict between individual apartment owners and strata committees. It follows that by reducing the presence of these defects and improving the consumer protection afforded new apartment owners a key source of conflict is significantly reduced. Initiatives to do this have been dealt with earlier in this submission.

In addition, initiatives in the following key areas should also be considered:

1. Providing an independent professional support service for committees in new buildings.
2. Elevating strata title policy development and strata scheme regulation and support services within Government.
3. Providing more accessible training and support for strata committee members.

Indeed, achieving these initiatives may be best served by fundamentally refocusing residential strata policy development and regulation within Government. Such wider restructuring is consistent with the increasing importance of strata title in meeting the housing needs of a growing population.

The remainder of this submission briefly describes the role of strata committees and their reliance on key support services. It then addresses each of the above three areas for proposed improvement in more detail.

#### ***The role of strata committees and their support services***

Strata committees are crucial to the successful management of a residential apartment building strata scheme and the assets owned by the scheme. They:

- Represent the Owners Corporation, the entity that manages the strata scheme and its common property assets, on many key decisions.
- Are democratically elected at Annual General Meetings of apartment owners.
- Are required to operate within the requirements of the Strata Schemes Management Act 2015 and associated regulations, as well as being bound by resolutions by the Owners Corporations at General Meetings of the lot owners.

The level of professional assistance committees can call upon depends on the size and nature of the apartment complex, which varies widely. Larger schemes can, and do, call on professional strata

management and building management companies to provide assistance. In smaller schemes, particularly those with less than fifty apartments, much more of the direct day to day management of the building falls on the strata committees.

The quality and capability of strata committees also varies significantly from one strata scheme to another. Similarly, the quality and capability of professional support services, such as strata managers and building managers varies. The accreditation requirements for these service providers are frequently opaque or insufficient. Rapid growth in the residential strata industry has opened the way for inexperienced companies and staff to enter the market.

Management of major building defects is a particular challenge for even the most experienced and capable strata committees.

The combination of an inexperienced committee supported by inexperienced or under qualified service providers dealing with major building defects inevitably leads to sometimes intractable disputes with individual apartment owners.

### ***Providing an independent professional support service for owners and committees in new buildings***

The challenges facing strata committees in new buildings with major defects go beyond those faced by strata committees in more established buildings. With this in mind there is a case for providing significant additional independent expert support and training for apartment owners and their committees as soon as occupation commences. ‘Independent’ means independent of the developer, builder and strata manager appointed by the developer.

To understand the need for this it is helpful to explain the situation facing new owners when they move into their apartments in a new building.

The set up process in a new building is based on the inherent assumption that the level of defects is modest which, all too often is not the case. As a result, the ongoing levies imposed on lot owners commence at a level required to accommodate ongoing maintenance and future age-related repairs and asset replacements among other matters. As such, the opening balance in an owners corporation bank accounts is usually very low and certainly not sufficient to cover major defects.

The first two years following building occupation are critical to the ability of apartment owners to have defects addressed. Defects not identified and pursued in this period will not be covered by the 2% bond or the critical 2 year statutory warranty provided by the builder for the majority of defects.

Unfortunately, it is during this period that strata committees are being established and finding their way through a complex set of obligations. They are ripe for exploitation by unscrupulous developers, their builder and their appointed strata manager.

The role of the strata manager during this period is also worth noting. Many strata management companies grow their business by working with developers to help manage the handover to new apartment owners. Developers are a vital source of new business for strata management companies and these companies need to walk a delicate line between serving the developer and serving their ultimate potential clients, the new apartment building owners. In the worst cases developers, builders and strata managers can and do ‘manage’ novice committees out of fully pursuing their rights during the critical period to have major defects identified and rectified.

Pursuing a major claim for defect rectification against a resistant builder to meet warranty obligations can be expensive and time-consuming placing stress on relationships between individual apartment owners and their committee. The absence of funds at this stage of proceedings means that special levies on apartment owners or high interest strata loans need to be established adding more scope for conflict.

As time wears on the owners are faced with pressure to attend to defects before a claim is concluded. The lot owners want the impacts on their day to day living addressed and the Strata Schemes Management Act 2015 requires building owners to fix common property defects. Building insurance premiums start to rise and insured event exemptions come into play if defects are not attended to adding to the extra levies imposed on apartment owners.

If a claim is settled, then rectification work follows. Apartment owners, particularly those people who are elected to the strata committee, are now faced with the complex management process associated with a major building rectification project. Work scopes and specifications need to be established, tenders invited, and contracts established with successful tenderers.

Even after rectification gets underway the potential for conflict continues. Either the apartment owners need to be moved out while work gets underway or they need to be worked around. There is noise, dust and safety risks to be managed as occupants share their homes with a construction site. Tenants demand reductions from their landlords and landlords complain to the strata committee.

Finally, there is the processing of release of retention monies to the rectification builder and handover of work records to be managed. After that the building warranty periods begin again for the work that has been undertaken.

The case for an expert advice and support services independent of developer, builder, and developer appointed strata manager, to help new owners through this process is compelling. It fills the expertise gap typical of new apartment owners and addresses any issues of conflict of interest the usual parties. Importantly, it provides confidence and education for willing new committee members and other interested apartment owners.

### ***Elevating strata title policy development and regulation within Government***

At some point the responsibility for building defects and their rectification will fully rest with the apartment owners. The developer and builder will no longer be involved due to the expiry of warranty periods or the dissolving of their special purpose business entities.

In these situations, the disputation over defects between committees and owners is more direct. Sources of conflict include:

1. Failure of the owners corporation to act promptly to rectify a common property defect affecting a particular apartment owner or owners. The ongoing impact on that owner is a major issue for them but not always fully appreciated by the other apartment owners involved in organising and funding repairs.
2. Failure of the owners corporation to set the level of ongoing levies on apartment owners high enough to build up funds for age related rectification. This results in funding shortfalls when rectification becomes urgent. Disputes arise over the raising of funds, particularly when significant one-off special levies or series of special levies are imposed. Apartment

owners on fixed incomes and/or servicing large ongoing mortgage payments find these levies particularly onerous.

3. General mismanagement of the actual rectification work can also lead to difficulties for individual owners. This includes failed rectification efforts, further time delays, and the associated ongoing impact on living conditions.
4. The expectations of individual apartment owners in relation to the time taken for defect rectification and its cost can be unrealistic.

The role, attitude and capability of the strata manager can be very important too. Lot owners can have particular difficulty if the strata manager is too compliant with the requirements of poorly performing strata committee or if they are not knowledgeable enough to provide good advice to the parties involved.

The existing options available to apartment owners for resolving these matters can be expensive, uncertain and demanding if they cannot be resolved directly with the current strata committee. These include:

1. Gaining support from other owners to address the issues of concern and getting this formally endorsed for action at general meetings of the owners corporation.
2. Gaining support from other owners for a change of strata committee members at an Annual General Meeting of the owners corporation.
3. Seeking intervention from Fair Trading.
4. Seeking formal mediation with the owners corporation.
5. Seeking a determination from NCAT.
6. Seeking the appointment of a compulsory manager by NCAT for the strata scheme to resolve issues.

Options 1 and 2 may not be feasible for a range of reasons depending on the circumstances. The value of option 3 depends on the capacity and scope of Fair Trading's role in these matters and the nature of the dispute. Based on the data option 4 has proven successful in a significant proportion of disputes. However, a large minority of situations progress to option 5.

Options 5 and 6 can result in problems of their own. It is not unheard of for strata committees to fail to implement a decision by NCAT either fully or in the time frame required. There have been complaints too about compulsory managers appointed by NCAT mismanaging a strata scheme once appointed. The remedies for both these situations can be very expensive, time consuming and uncertain.

In general, there is scope for improving regulatory oversight and enforcement of strata law to ensure that committees and strata managers are doing their jobs properly.

The resourcing and charters of Fair Trading and NCAT need to be reviewed are unlikely to have kept pace with the rapid growth in strata living and the escalation of disputes associated with the management of building defects. This would provide for additional critical services such as a strata scheme audits, strata law enforcement, training and support for strata committees similar to that set out in **Annexure C**.

Indeed, given the growth in and vital importance of apartment living the case for setting up a specialist strata department or commissioner reporting directly to a senior Minister is compelling.

***Providing more accessible training and support for strata committee members***

A vital element in managing disputes over building defects and other issues is a properly motivated competent strata committee. As already discussed, this is not always the case for a range of reasons, including the unique and detailed nature of strata law and the complexity associated with many management functions including management of building maintenance and rectification.

To address this OCN submitted a proposal to the NSW Government to establish a training and support function for strata committees funded via a very small levy on each apartment owner in NSW. The scope of this service could be extended to include independent expert support for owners in new buildings. It could also be incorporated into the responsibilities of a new strata commissioner function reporting to a senior Minister.

The original proposal is provided to Government is attached in **Annexure C** for consideration as part of this inquiry.

**ANNEXURE A - TERMS OF REFERENCE****Inquiry into the regulation of building standards, building quality and building disputes**

1. That the Public Accountability Committee inquire into and report on the regulation of building standards, building quality and building disputes by government agencies in New South Wales, including:
  - (a) the role of private certification in protecting building standards, including:
    - (i) conflicts of interest
    - (ii) effectiveness of inspections
    - (iii) accountability of private certifiers
    - (iv) alternatives to private certifiers,
  - (b) the adequacy of consumer protections for owners and purchasers of new apartments/dwellings, and limitations on building insurance and compensation schemes, including:
    - (iv) the extent of insurance coverage and limitations of existing statutory protections
    - (v) the effectiveness and integrity of insurance provisions under the Home Building Act 1989
    - (vi) liability for defects in apartment buildings,
  - (c) the role of strata committees in responding to building defects discovered in common property, including the protections offered for all strata owners in disputes that impact on only a minority of strata owners,
  - (d) case studies related to flammable cladding on NSW buildings and the defects discovered in Mascot Towers and the Opal Tower,
  - (e) the current status and degree of implementation of recommendations of reports into the building industry including the Lambert report 2016, the Shergold/Weir report 2018 and the Opal Tower investigation final report 2019, and
  - (f) any other related matter.
2. That the committee table an interim report as soon as practical and its final report by 14 February 2020.

**ANNEXURE B – OCN RESPONSE TO THE GOVERNMENT’S “BUILDING STRONGER  
FOUNDATIONS” DISCUSSION PAPER**

**ANNEXURE C – SUBMISSION TO GOVERNMENT FOR A PACKAGE TO SUPPORT STRATA  
COMMITTEES AND GOVERNMENT RESPONSE**



**ANNEXURE D – DECENNIAL INSURANCE RESEARCH PAPER**