THE INDEPENDENT VOICE OF STRATA OWNERS

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HBA Review Team
Building & Construction Policy
Better Regulation Division | Department of Customer Service

Dear Angus and Team

Home Building Act Review 2021

Introduction

1. In NSW, urban consolidation has been a goal of successive Governments resulting in a rapid expansion of the residential strata sector. The emphasis on increasingly tall and more complex apartment buildings to house a growing population demands that only the most suitably qualified professionals are permitted to undertake this work. However failures in the regulatory system and in the construction industry have led to systemic defects in high rise apartment buildings. The protection of consumers through the delivery of high quality, sustainable homes is of paramount public importance.

   The Owners Corporation Network of Australia Limited (OCN) is the independent peak consumer body representing residential strata and community title owners and residents. As such, OCN is uniquely positioned to understand the impact that the legislative framework has on day-to-day machinations and community living.

General comments

2. The OCN's comments on the *Home Building Act 1989 (NSW)* (**HBA**) review Concept Paper (**Paper**) are set out below.

3. The 'Historical Reviews and Events' diagram at section 1.2 of the Paper overlooks some critical events in reducing accountability and liability for defects that have led to the current predicament for consumers of residential construction in NSW, in particular apartment owners.

4. There has never been an attempt by any NSW government to use its licencing powers to control whether building contractors have the experience or knowledge or financial stability needed to be a trustworthy builder of a strata plan. However, the underwriting requirements of private home warranty insurers did limit who could carry out such construction up until the introduction of the multi-storey exemption in December 2003. Since then, home warranty insurance has not been required to build over 3 storeys. No NSW government has attempted to replace the filter of insurer underwriting requirements with any measure designed to prevent contractors from building strata plans above 3 storeys if they do not have the experience, knowledge, skill or financial stability to be trusted to undertake such a venture.

5. That lack of licencing control and the ability for both developers and builders since December 2003 to build over 3 storeys through $2 companies has led to the current widespread failure of strata plan construction in NSW. Until 2020, the regulatory response to the increase in litigation due to defects has been to seek to reduce litigation by further reducing consumer rights so that they have less to litigate instead of addressing the causes of defects. That has over time simply encouraged and emboldened the spread of the cultural failure within the strata construction industry that had led to the current position.

6. Quite simply, the greed of the unscrupulous, and the need for others to commercially compete with industry participants who do not care whether they leave consumers with defects, has destroyed the industry's standards and reputation, and left a long and ever increasing trail of devastated consumers.

7. The reforms introduced in 2020 are just the first of many steps needed to restore consumer (and insurer) confidence in the NSW construction industry. The 2020 reforms are generally positive in how they seek to implement those steps. However, there are still major flaws in how those reforms address what they attempt to address as noted in OCN's recent submission to the upper house inquiry into the regulation of building standards. That is in addition to undertaking many other reforms needed and getting those further reforms right.

OCN's comments on the issues that the Paper focuses upon

Expanding the scope of the HBA

8. The OCN supports the HBA becoming a Building Act to both increase its scope and dramatically simplify the current provisions on what it applies to and what it does not. Despite OCN being the only consumer voice at the recent HBA review focus group consultations, it was telling that there was virtually universal support for that approach to regulating the whole of the construction industry in NSW.

9. There was literally only one reservation with such a change expressed during the focus group consultation, which was attended by a large number and range of industry representatives. The reservation raised by a lobby group for developers was with legislated defect warranties interfering with the ability of sophisticated industry participants to determine contractual liability regimes for themselves.

10. The OCN respects that large, sophisticated corporations can protect themselves in contractual negotiations. However, when neither party to a contract will be the end user of the construction, the parties to the contract cannot be relied upon to put aside their own interests and decide what the extent of their defect liabilities, if any, to the end user will be in a manner that is fair to the end user. Allowing that is not conducive to defect free construction.

11. Under such a scenario, the builder is happy to provide a lower price in return for not being 'on the hook' to the end user for defects. The developer is very happy to pay less for the build in exchange for allowing the builder to have very little, if any, liability to the end user for defects. The builder can then make up its discount in price (and then some) by 'cutting corners' during the build safe in the knowledge that it will not be liable for the defects that result.

12. The OCN submits that the basic defect protections of the HBA warranties should also be available to all end users of all classes of construction except end users that are a contracting or land owning developer.

The 'major defect' definition

13. The change from a 7 year warranty for all defects to 2 and 6 year warranties for 'non-structural' and 'structural' defects via the 2011 amendment act sought to reduce litigation costs for builder and developers by reducing consumer rights. As most defects do not become noticeable to owners within 2 years of completion, it served to make builders and developers less accountable for defects which encouraged those already taking insufficient care during construction to take less care. It also resulted in:

    (a) Owners corporations starting to take active steps to identify as many defects as they could within 2 years;

    (b) Owners corporations not having time to try to work through defect issues with builders and developers before having to commence proceedings (within 2 years of completion);

    (c) The focus of defect issues between owners corporations and builders and developers in many instances going away from what is needed to fix the defects to liability arguments over whether each defect is within the structural defect definition;

    (d) For defect litigation that was commenced, the litigation was more complex and more expensive due to the 'lawyers' picnic' of liability arguments over the structural defect definition.

14. The 2014 amendment act then further reduced consumer rights by narrowing the structural defect definition while changing the terminology to 'major defect'. That further accentuated the effects of the 2011 amendment act noted in the previous paragraph. Thus, in addition to letting $2 companies and licenced but incompetent builders run rampant in strata construction, the regulatory regime had the effect of:

    (a) Forcing owners corporations to incur costs to identify defects as early as possible;

    (b) Forcing owners corporations to then protect themselves as best they can by litigating immediately rather than having the opportunity to work through defect issues with a builder or developer (where there is one prepared to not ignore defect issues);

    (c) Making defect litigation more expensive, complex and lengthy and more focused on which defects builder and developers are liable for (due to legal arguments on how definitions should apply) than repair of defect outcomes.

15. As will be very obvious from the above, the OCN agrees that the 'major defect' definition is not fit for purpose. The effects referred to above which have contributed to defects becoming more prevalent

than ever and consumer confidence becoming less than ever, should be addressed by returning to one warranty period of at least six years for all defects.

16. If that is not to be done, the major defect definition should at least be changed to reflect the 'serious defect' definition in the RAB Act with the definitions in both the HBA and the RAB Act amended to also include any defect that causes a risk to safety. The OCN submits that there could be no reasonable basis for not ensuring that the regulatory regime allow consumers a 6 year period to identify and pursue any defect that causes a risk to safety. Nor should the powers of the regulator fall short of being able to take steps to address any defect that causes a risk to safety.

The developer definition

17. The OCN supports aligning the definition of developer in the HBA to the definition of developer used by the RAB Act.

18. That is needed to minimise developers avoiding liability for defects via contract structuring techniques. Further, the 'Note' under section 3A(1A) of the HBA says [bold added for emphasis]:

> *This makes the owner of the land a developer even if the work is actually done on behalf of another person (for example, on behalf of a party to a joint venture agreement with the owner for the development of the land).* ***The other person on whose behalf the work is actually done is also a developer in relation to the work.***

19. That clearly indicates that the key effect of the HBA now adopting the RAB Act definition for a developer was what was previously intended for the HBA but not achieved due to drafting oversight. That already existing intention to make the party that contracts with a builder a developer in addition to the 'land owning' developer is defeated by the current drafting of section 3A.[1]

20. The OCN also submits that the HBA should be 'future proofed' on this issue by adding to section 18G to allow the Court to overrule the effect of any contract structuring approach intended to avoid responsibility for defects.

Section 18G and developers

21. A further reform needed in relation to the obligations of developers under the HBA is to amend section 18F to ensure that developers cannot rely upon the design related defences intended for arms' length builders only in section 18F by 'gaming' the current wording of section 18F. To avoid the potential for such perverse outcomes, section 18F must be amended to ensure that neither a developer, nor a contractor related to a developer, can rely upon a section 18F defence.

The scope of licencing

[1] The Court cannot use such a Note to overcome the drafting of section 3A requiring circumstances where a party would be an owner of at least 4 dwellings before it is relevantly considered a 'developer'.

22. There was universal support at the recent HBA review focus group consultations that current licencing requirements (including who must be licenced) should not be reduced. There was also at least widespread support for expanding licence requirements to parts of the construction industry that currently do not need to be licenced. The OCN strongly supports both of those positions.

23. The Paper queries which licence types should require a competency assessment. A regulator issuing a licence to someone to carry out a particular business activity is sending a message to consumers of that business activity that the regulator considers that person to have met the minimum competence requirements for that activity. It should be uncontroversial that no residential building works licence should be issued without a competency assessment. The competency requirements applying for each type of licence should be different to reflect the minimum competence requirements for the particular activity to be licenced.

24. The OCN's experience with owner-builder licenced construction is limited due to the restrictions upon what owner-builders can build. However, the OCN understands that consumers are often 'guided' into obtaining an owner-builder permit by contractors who would otherwise not be permitted to contract with them for an amount over $20,000. That is not conducive to the prevention of defects.

<u>A licence to build above 3 storeys (which avoids any home warranty insurance underwriting controls)</u>

25. The Paper says at section 3.3.3 that:

> *Under the HBA, only builders and tradespeople who are properly trained and have the relevant experience are licenced.*

26. The OCN strongly disagrees. The requirements to obtain a residential building works licence as a builder in NSW are 'entry level' requirements only. They reflect no more than a minimum that should be expected for someone to be allowed to carry out a small and simple construction job. However, the current regulatory regime licences someone with such basic entry level requirements to build a 4 level strata plan or a high rise building or anything in-between without having to meet any other requirements.

27. Consumer confidence will not be restored until that absurd position is properly addressed. The government's recent response of requiring that a residential building work licence holder have 5 years practical experience for the licence holder to be a head contractor for a building above three storeys (including a high rise) is manifestly inadequate. This is an ongoing significant failure in improving building standards and consumer protection.

28. A starting point for licence requirements that would assist in restoring consumer confidence would be a licencing regime that does not allow a builder to build above 3 storeys unless:

    (a) The builder, or its nominated licenced supervisor, has been licenced (ie: not just ambiguously having "relevant experience") as a builder and/or a nominated licenced supervisor of a builder, for at least 10 years; and

(b) The builder achieves, and maintains from year to year, at least a 2.5 star rating under an iCIRT detailed assessment (or a prescribed equivalent rating under another rating tool).

29. Such an approach would by itself prevent a very significant proportion of the defects currently being experienced. It can also be cost neutral for the government as it would be appropriate for the applicants for such a licence to cover the cost of an iCIRT detailed assessment as part of their fee to apply for a licence.

30. If a contractor cannot achieve such a rating, they cannot be trusted to, and should not be allowed to, build over 3 storeys in NSW. It is inappropriate to provide them with a licence that allows them to do that. It is also inappropriate to later seek to victim blame consumers for defects, particularly those who have struggled to enter the housing market, by later saying it is your fault that you bought a unit from an untrustworthy builder or developer.

Other HBA licencing changes needed

31. Each person should only be allowed one residential building works licence number for life. That includes the one licence number being the licence number that applies for all companies that person is a nominated supervisor for at any time.

32. There should be a presumption against a person being able to build through more than one company at once or being able to build through a new company within 7 years of having a licence through a previous company. That is needed to assist in curbing the multiple licenced $2 company practices of a number of builders.

33. A licensing system for all developers of residential apartment buildings above 3 storeys is needed. If the government is going to allow the widespread practice of developers using *"single purpose vehicles"* as the land owning entity liable for defects (which become $2 companies shortly after completion when the units are all sold and the profits distributed elsewhere) to continue, there must be a requirement for a licenced parent company or director who is responsible for the single purpose vehicle's defect liabilities. Achieving and maintaining at least a 2.5 star rating under an iCIRT detailed assessment (or a prescribed equivalent rating under another rating tool) should also be a prerequisite for such a developer licence.

34. Reform is needed to ensure that the nominated licenced supervisor of a company building a strata plan is actually supervising the construction. There are nominated supervisors that are supposedly supervising numerous large projects at once and also supervisors that rarely attend any site at all. A positive obligation to supervise all construction should be legislated together with sensible limits on the extent of what one person can be permitted to simultaneously supervise. There should also be penalties for breaching such requirements.

Contracting requirements

35. The OCN says that the current appropriate balance for all contracts with consumers is:

(a) For work where the reasonable market cost of the labour and materials involved including GST exceeds $2,000, the HBA applying and the short form contract requirements applying;

(b) For work where the reasonable market cost of the labour and materials involved including GST exceeds $50,000, the long form contract requirements applying.

36. There should be a requirement that all residential building work subcontracts, where the reasonable market cost of the labour and materials involved including GST exceeds $2,000, be in writing with the short form contract requirements being the minimal requirements.

37. There should also be a provision for both contracts with consumers and subcontracts that prevents avoidance of those requirements by use of multiple contracts for the same project or by variations to an existing contract with a small scope.

38. Homeowners often pay deposits above the cap as they are not aware of the deposit cap or the contractor tells them they have to if they want the work done.

39. The maximum deposit should be 5% of the contract price subject to the following exceptions:

(a) Any HBCF premium is not included within the 5% cap, but the payment of an amount paid to a contractor attributable to HBCF premium must be paid to the insurer as soon as practicable, and the failure to pass such payment onto the insurer is a criminal offence punishable by jail;

(b) An amount needed to order materials that should be ordered in advance of the physical work commencing is not included within the 5% cap but the payment of such an amount must be paid to the relevant supplier/s as soon as practicable and the failure to pass such payment to a relevant supplier is a criminal offence punishable by jail.

<u>Enforcement powers</u>

40. The OCN considers that, putting aside the provisions intended to prevent phoenix company type behaviour which are flawed, the current enforcement powers in the HBA, are generally appropriate. The real problem is that the regulator does not use them as often as it should which the OCN understands to be primarily a resourcing issue.

<u>Rectification orders</u>

41. It would be sensible for the rectification order powers available under the RAB Act to also be available under the HBA irrespective of whether they are eventually available under just one or several Acts.

42. Notwithstanding that, there are currently some serious flaws in the RAB Act rectification order procedures that the OCN considers to be anti-consumer.

43. An owners corporation is the party most affected by a flawed building work rectification order. If an order requires or permits the carrying out of work that will not be a proper long term repair or will cause adverse amenity or aesthetic issues, the owners are stuck with the consequences and funding a

remedy for those consequences. Owners also face criminal prosecution if they do not provide access for repairs. That allows the legislation to be used to intimidate owners into providing access into their homes for inadequately specified repair work or contractors that they have no faith in for good reason.

44. Despite those aspects and the reality that those carrying out the functions and powers provided by the Act will not ever be infallible, owners corporations (unlike developers) cannot appeal building work rectification orders. Further, many repair orders are and will be modified by negotiation between Fair Trading and Developers to settle litigation brought by Developers appealing orders. Despite being the most affected party, an owners corporation has no say in such settlements and cannot challenge the revised repair orders that result.

45. The concerning nature of the above is illustrated by a rectification order recently being issued requiring the carrying out of a scope provided to Fair Trading by a developer without the owners corporation being provided with the scope or any opportunity to comment upon the adequacy of the scope, and the regulator bizarrely refusing the owners corporation's request to now provide the owners corporation with a copy of the repair scope referred to in the order. The OCN hopes that this is a 'teething issue' matter as such flaws in the fairness of the processes under the regulator's new powers, and how they are applied, invite further public scandal, instead of restoring consumer confidence.

Other HBA reforms needed

46. The provisions at section 38 of the DBP Act in relation to deemed economic loss applying to the duty of care required by the DBP Act should be immediately incorporated retrospectively in the HBA. The OCN is aware that a number of builders and developers, including quite shockingly a government agency, are seeking to defend owners corporation claims under the HBA for common property defects on the basis that it is the individual lot owners, not an owners corporation, that suffers loss in relation to common property defects.

47. The HBA should be amended to make it clear that subcontractors are responsible to consumers for the adequacy of their work under the HBA (by minor revisions to sections 18B(2), 18C and 18D(1A) to clarify that intention).

48. The HBA definition of *"owner"* should be amended so that leasehold strata schemes are no longer left without rights under the HBA for defects (see *The Owners – Strata Plan No 91322 v Trustees of the Roman Catholic Church for the Archdiocese of Sydney [2019] NSWCA 89*).

Yours sincerely

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