

### RECENT BUILDING REFORM IN NEW SOUTH WALES—WHO NEEDS INSURANCE WHEN YOU HAVE QUALITY?

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### INTRODUCTION

The first few months of 2004 have been very busy for New South Wales legislators as a raft of new reforms were introduced in response to various government inquiries and reports<sup>1</sup> with the intent of improving the building industry. These new legislative changes will have a major impact on how the industry:

- insures risks in residential developments,
- performs residential and other building works,
- contracts with other industry players; and
- certifies projects.

The *Home Building Amendment (Insurance Exemptions) Regulation 2003* (NSW) which amended the *Home Building Regulation 1997* (NSW) ('HB Regulation') introduced an exemption to the requirement for home warranty insurance for high-rise residential developments which took effect from 31 December 2003.

The *Environmental Planning and Assessment Amendment (Quality of Construction) Act 2003* amended the *Environmental Planning and Assessment Act 1979* ('EP&A Act') and is designed to improve the quality of buildings and to increase the accountability of the people who build and certify them.

The commencement of certain provisions of the *Home Building Legislation Amendment Act 2001* and the *Home Building Amendment (Contracts) Regulation 2003* introduced new formal requirements for residential building contracts and the regulation of building consultants which are now contained in the *Home Building Act 1989* (NSW) ('HB Act') and the HB Regulation. The purpose of these amendments is to regulate the capacity of industry players to vary and rescind residential building contracts and to

make provision in relation to consumer protection and liability.

This paper focuses on the effect of these new provisions on the building industry, in particular, the new requirements which must be complied with in order to legally contract for, build, occupy and sell developments.

### HOME WARRANTY INSURANCE: EXEMPTION FOR MULTI-STOREY RESIDENTIAL DEVELOPMENT

Contractors (or developers<sup>2</sup>) are not required to obtain home warranty insurance for residential building works which constitutes a 'multi-storey building', if construction commenced on or after 31 December 2003.

However, all residential building work commencing before 31 December 2003 remains subject to the requirements for home warranty insurance under the HB Act.

### What is a Multi-Storey Building?

'Multi-storey buildings' are buildings that have a rise in storeys of more than three as determined by the Building Code of Australia ('BCA'). The HB Regulation specifies that a storey does not include a storey which accommodates car parking.

However, under the BCA, a rise in storeys is calculated as the sum of the greatest number of storeys at any part of the external walls of the building and any storeys within the roof space:

(a) above the finished ground next to that part; or

(b) if part of the external wall is on the boundary of the allotment, above the natural ground level at the relevant part of the boundary.

A storey is not counted if:

(a) it is situated at the top of the building and contains only heating, ventilating or lift equipment, water tanks, or similar service units or equipment; or

(b) it is situated partly below the finished ground and the underside of the ceiling is not more than one metre above the average finished level of the ground at the external wall, or if the external wall is more than 12 metres long, the average for the 12 metre part where the ground is lowest.

A mezzanine is also regarded as a storey in certain circumstances.

In circumstances where there is doubt as to qualification of a multi-storey building, it is advisable to consult with a qualified engineer who is familiar with the BCA.

### **Exemptions Relating to Developers Under Contracts of Sale**

A developer<sup>3</sup> will be exempt from the requirement to give purchasers a certificate evidencing home warranty insurance for multi-storey residential buildings, for contracts of sale entered into after 31 December 2003.

Where residential building work on a development the subject of the contract of sale commenced prior to 31 December 2003, the developer will not be entitled to the exemption. We note here that residential building work will include any structural works for non-residential parts of a building which will eventually support or give access to the residential parts of the same building<sup>4</sup> and may also include fencing,<sup>5</sup> driveways<sup>6</sup> and arguably carparks.<sup>7</sup>

Where a developer entered into a contract of sale in relation to a multi-storey building before 31 December 2003, and the residential building work had not commenced prior to 31 December 2003, the developer is required to notify purchasers that they are exempt

from the home warranty insurance requirements of the HB Act and are no longer obliged to provide an insurance certificate.

If the developer fails to give notice to the purchaser that it is exempt from the requirements of the HB Act and from providing an insurance certificate, the developer will be in breach of the HB Regulation. While the developer will still technically be entitled to the exemption, there is a risk that the purchaser will still be entitled to rely on the express provisions of a contract of sale which allows it to rescind where no certificate is provided, in circumstances where this notice of exemption is not given. Therefore, it is in the developer's best interest to send this notice as soon as possible.

All other requirements of the HB Act will continue to apply to industry players who are exempt from home warranty insurance requirements, including the statutory warranties and the formal requirements for residential building contracts.

### **QUALITY IN CONSTRUCTION: AMENDMENTS TO THE ENVIRONMENTAL PLANNING AND ASSESSMENT LEGISLATION**

It is no coincidence that the introduction of the new requirements for 'quality in construction' coincided with the government's decision to exempt high-rise residential development from the requirement for home warranty insurance. Only time will tell whether the impetus for 'quality in construction' will fill the void left by the absence of insurance cover.

### **Critical Stage Inspections (CSI)**

#### **CSI for high-rise residential buildings**

It became a mandatory requirement on 1 January 2004 for CSI to be performed during the construction of high-rise residential

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buildings.<sup>8</sup> Where a high-rise residential building was already under construction at 1 January 2004, the requirement to perform CSI only applied if the principal certifying authority ('PCA') for the project had not been appointed at that date.

CSI must be undertaken on the development site at the following stages:

- (i) at the commencement of building work;<sup>9</sup>
- (ii) prior to covering of waterproofing in any wet areas, for a minimum of 10 per cent of rooms with wet areas within a building;
- (iii) prior to covering any stormwater drainage connections; and
- (iv) after the building work has been completed and prior to any occupation certificate being issued in relation to the building.

#### **CSI for other classes of buildings**

On and from 1 July 2004, the requirement to perform CSI will apply to the construction of all other classes of buildings.<sup>10</sup>

#### **CSI required for occupation certificates**

The PCA must be satisfied that CSI (and any other inspections required by the PCA) have been carried out before the PCA issues an occupation certificate or subdivision certificate for the building or work.

If one or more of the CSI or any other inspections required by the PCA are not performed, the PCA will not be able to issue an occupation certificate for the building and the building will not be able to be legally used and occupied. If work that requires a CSI is covered up before the inspection is able to take place, then the contractor will be required to uncover the work so that the required inspection can take place.

#### **Who may conduct CSI**

Only a PCA or other certifying authority will be able to conduct

CSI. Aside from the final CSI, the inspections may be carried out by another certifying authority with the PCA's agreement. Structural engineers may only undertake additional inspections aside from CSI. PCAs will be able to obtain Part 4A compliance certificates and other documentary evidence from suitably qualified people, but it will not be permissible for such certificates or documents to be issued in lieu of the PCA or another certifying authority undertaking the CSI.

The PCA is therefore responsible for overseeing the construction phase of a development and as such is said to be more of a 'quality manager' rather than a 'Building Code of Australia specialist'.

#### **New Preconditions to Performing Building Work**

New preconditions to performing building work apply to all developments where a development consent had been granted prior to 1 January 2004, but work had not commenced, and to all new developments. The following must now be in place before the erection of a building may commence:

- (i) a construction certificate must have been issued (unless the landowner holds a complying development certificate, or in the case of subdivision work, a development consent for the work has been issued);
- (ii) the PCA has been appointed for the project;
- (iii) the PCA has notified the consent authority and the council of the PCA's appointment (at least 2 days prior to work commencing);
- (iv) the PCA has notified the landowner of the CSI and other inspections that are required (at least two days prior to work commencing);
- (v) the landowner has appointed a principal contractor (the

contractor), who must hold a contractor licence if residential building work is being performed;

(vi) the landowner has notified the PCA of the appointment of the contractor; and

(vii) the landowner has notified the contractor of the CSI and other inspections required in respect of the building work.

If building work commences before such preconditions are met, a maximum penalty of \$33,000 may be imposed.

#### **Landowner Must Appoint PCA**

From 1 March 2004, a PCA must be appointed by the landowner (unless the contractor is also the owner of the land in question).

Given that the contractor is often contractually bound to obtain the Part 4A compliance certificates on behalf of the landowner under the building contract, the PCA is usually engaged by (or novated to) the contractor.

Under the new scheme, contractors will no longer be able to have a direct contractual relationship with the PCA. In the absence of direct control, a contractor will have no real recourse against a PCA if they commit an act or omission other than to make a complaint under the EP&A Act.

#### **New Requirements for Occupation Certificates**

In order to issue an occupation certificate, a PCA must be satisfied of the following:

- (a) all CSI and other inspections have been carried out;
- (b) any preconditions to the issue of the certificate specified in the development consent or complying development certificate have been met; and
- (c) as previously required:
  - a development consent or complying development

certificate is in force for the building;

- a construction certificate has been issued (unless the building is the subject of complying development certificate);
- the building is suitable for occupation or use in accordance with its Building Code of Australia classification; and
- any applicable requirements of the *Environmental Planning and Assessment Regulation 2000* ('EP&A Regulation') have been met, for example, a fire safety certificate is required for most buildings.

### **PCAs May Not Certify Their Own Designs**

PCAs and accredited certifiers cannot certify their own designs. However, an accredited certifier (other than a PCA) may issue a compliance certificate to certify that building work has been completed in accordance with the plans and specifications that they prepared.

### **NEW FORMAL REQUIREMENTS FOR RESIDENTIAL BUILDING CONTRACTS**

From 16 February 2004, new mandatory clauses were required in contracts for residential building work, including statements concerning cooling-off periods which may be utilised by the person engaging a contractor and a prescribed checklist. Exemptions to these new requirements will apply in certain circumstances.

### **Plans and Specifications Clause**

This mandatory clause which must be included in residential building contracts provides that plans and specifications, and variations to such, will form part of the residential building contract.

More significantly, however, any variation to the plans and specifications for work to be done

under the contract will be required to be signed in writing by both parties. This will have the effect that developers will not be able to unilaterally direct variations to plans and specifications without the written agreement of the contractor.

### **Quality of Construction Clause**

This mandatory clause which must be included in residential building contracts provides that work done under the contract will comply with the BCA, relevant codes, standards and specifications and the conditions of any relevant development consent or complying development certificate.

The clause also provides that the contractor's liability may be limited under the contract for a failure to comply with the quality of construction clause if:

- (i) the design or specification is prepared by or on behalf of the developer; or
- (ii) the design or specification is required by the developer, despite the contractor advising the developer in writing that the design or specification contravenes the clause.

### **Checklist**

A five point mandatory checklist must be inserted into residential building contracts, which includes thirteen questions which are posed towards the developer engaging the contractor. Point 2 states that the developer should not sign the contract unless the developer has read and understood the clauses, notes and explanations contained in the document.

However, the requirement for this checklist does not take into consideration the recent exemption provided to multi-storey residential development as follows:

- (i) Point 4 provides that the contractor must provide the landowner with a certificate of home warranty insurance (for work

over \$12,000) before the commencement of work and before demanding or receiving payment; and

- (ii) Questions 12 and 13 provide that the contractor must have a policy of home warranty insurance and must give the landowner a document explaining the operation of the Act, including the operation of sections dealing with insurance disputes.

We understand that the Department of Fair Trading is considering correcting this anomaly with a further amendment in due course which will exempt residential building contracts to construct multi-storey buildings from the requirement for the checklist. For the time being, however, this checklist will be required to be included unless it falls within one of the exemptions.

### **Exemption from Inserting New Clauses**

Parties to residential building contracts will not have to insert the plans and specification clause or the quality of construction clause if the relevant building contract is one of the following:

- (i) a building contract which was already in force at 16 February 2004;
- (ii) is not a contract for the performance of residential building work;
- (iii) is a subcontract to the head contract for residential building work;
- (iv) is made between a speculative licensed contractor and a licensed trade contractor;
- (v) is for the doing of specialist work that is not also residential building work; or
- (vi) is for a contract price not exceeding \$1,000.

The checklist is not required if the relevant building contract is one of the following:

(i) a building contract which was already in force at 16 February 2004;

(ii) is not a contract for the performance of residential building work;

(iii) is a subcontract to the head contract for residential building work;

(iv) is between a building consultant and a contractor;

(v) where the building consultancy work that is the subject of the contract must be performed within two working days after entering into the contract; or

(vi) is entered into with a building consultant by a solicitor or a licensed conveyancer on behalf of the landowner.

## **BUILDING CONSULTANTS SUBJECT TO REGULATION**

On 1 January 2004, building consultants became subject to regulation under the HB Act. The new provisions apply to 'building consultancy work', which includes any work involved in, or involved in coordinating or supervising the pre-purchase visual inspection of a dwelling. Pest inspections, inspections of specialist work or other building consultancy work are excluded from the definition. Like contractors who perform residential building work, building consultants must obtain a licence in order to perform building consultancy work and their contracts of engagement must comply with certain formal requirements.

## **EFFECT OF AMENDMENTS ON THE BUILDING INDUSTRY**

### **Contractors**

Contractors must ensure that the preconditions to qualification are satisfied before relying on the exemption for home warranty insurance to ensure that:

- they are not subject to penalties,

- they are entitled to recover payment for their work; and

- they do not breach any relevant obligations under the residential building contract.

As previously stated, the new prohibition on contractors from appointing a PCA will have a major impact on industry practice. In order to ensure that a contractor can progress the works without delay and so that the landowner does not incur any extra costs for the delay, it would be prudent that the landowner's contract with the PCA include a requirement that the PCA cooperate with the contractor and should perform its duties of inspection with due expedition and without delay. Further, another certifying authority may be appointed by the contractor to perform CSI, other than the last CSI, with the consent of the landowner's PCA, thereby minimising the risk that the project can be delayed by a third party over which the contractor has no control.

### **Landowners**

Ideally a landowner should ensure that the new responsibilities and risks introduced by the latest amendments are allocated appropriately under the relevant building contract. Landowners should be diligent in checking that the new pre-conditions to commencing building work have each been allocated and met, and that they are allocated to the party best able to perform the precondition. It would also be prudent for the landowner's building contract to specifically require the contractor to coordinate its works with the PCA to ensure that the CSI are performed in accordance with the EP&A Act. The consequences of breaching the CSI requirements, at the extreme, may leave the landowner with a development that cannot be legally occupied.

Landowners who are developers must ensure that the preconditions to qualification for exemption from the home warranty insurance provisions of the HB Act are satisfied before relying on the exemption. Serious consequences may arise if a landowner mistakenly considers themselves exempt from giving purchasers an insurance certificate evidencing home warranty insurance. For example, contracts of sale of units in the development may be voidable by purchasers before completion, leaving landowners with a project which is not viable or cannot be financed.

### **PCAs**

The amendments to the EP&A Act have substantially increased the responsibility of PCAs. There are new powers of the Director-General to investigate and audit the work and activities of PCAs and the penalties against PCAs for unsatisfactory professional conduct have increased. It is now an offence to improperly influence a PCA or for a PCA to seek or accept a benefit on the basis that the PCA will act other than impartially. The maximum penalty for this offence is \$1.1 million or imprisonment for two years, or both.

In that regard, PCAs may become more diligent whilst undertaking their obligations and it is likely that the costs to engage PCAs will increase as a consequence of their increased responsibilities and the new requirements for CSI. PCAs may be reluctant to issue certificates and pass inspections as readily as they did previously, as the risks of breaching the EP&A Act have multiplied. There is currently no time limit in which the PCA must perform its duties in relation to CSI, so if PCAs are more cautious while performing their certification duties, this may have an adverse effect on a contractor's construction programs. At the extreme, it could also increase the likelihood that

PCAs will require modifications or demolition of works to ensure that EP&A Act and development consent requirements are satisfied.

This will impact on project costs.

### **Building Consultants**

Building consultants who perform 'building consultancy work' for the purposes of the HB Act must now become licensed and comply with the formal contract requirements.

### **CONCLUSION**

Whether or not quality in construction can be achieved by the introduction of, among other things, the requirement CSI during construction, is a matter for speculation. What is certain, however, is that the amendments made to the Environmental Planning and Assessment legislation will have wider impact on the building industry than first envisaged, as it has introduced further risks to various forms of development which must be dealt with by landowners. These reforms will have a significant impact on landowners, developers, contractors and PCAs.

owned by the developer.

4. HB Regulation 5(c).
5. HB Regulation 5(m).
6. HB Regulation 5(j).
7. HB Regulation 5(c) and (e).
8. A high-rise residential building is a Class 2 building, that is a building containing two or more sole occupancy units each being separate dwellings. Class 3 and 4 buildings were also subject to this new requirement from 1 January 2004.
9. 'Building work' means any physical activity which starts in connection with the erection of a building.
10. Section 162A EP&A Regulation.

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### **REFERENCES**

1. Joint Select Committee on the Quality of Buildings (Campbell Committee Inquiry) and the NSW Home Warranty Insurance Inquiry (Grellman Inquiry).
2. Developers are able to arrange home warranty insurance under clause 41 of the HB Regulation, as they may be considered a 'beneficiary' under the policy.
3. A developer is a person on whose behalf work is done in connection with (a) an existing or proposed dwelling in a building or residential development where 4 or more of the such dwellings are or will be owned by the developer, or (b) a proposed retirement village or accommodation specially designed for the disabled where all of the residential units are or will be