

The Honourable Mick De Brenni MP
Minister for Energy, Renewables and Hydrogen
Minister for Public Works and Procurement
Queensland Home Warranty Scheme Review
Building Policy
Public Works Division
Department of Energy and Public Works

Dear Minister,

SCA (Qld) are pleased to make a submission to the Queensland Home Warranty Scheme Review (the Scheme). We are pleased to have contributed to the Discussion Paper as released and commend the depth of detail it provides to ensure this important reform is implemented to the best possible standard.

Introduction

There were over 500,000 lots in more than 50,000 community title schemes across Queensland at the end of 2021. Over 11% of households live in apartments across our state¹ and SCA (Qld) estimates 1.2 million Queenslanders live, work and play in strata title properties across the State. This is a significant portion of our state population and a figure which will continue to grow.

SCA (Qld) is the peak association supporting Queensland's strata sector. We understand the sector from a broad array of viewpoints owing to our diverse membership. SCA (Qld) represents body corporate managers, community titles schemes with committee members acting as nominees, lot owners as individuals, and service providers to the strata industry including specialist insurers, painting suppliers, energy suppliers, solicitors, accountants, water and plumbing providers, banks, elevator maintenance professionals, cleaning providers, surveyors, valuers, glaziers, IT providers and pool servicing and maintenance providers.

As an organisation we have a particular interest in Review Theme 6 "A Modern and Responsive Scheme". We are members of the sub-committee on the Ministerial Construction Council regarding this reform and are interested primarily in the extension of some form of statutory coverage for consumers for building defects above three storeys. SCA (Qld) will provide feedback with respect of the questions asked by the discussion paper around this theme in order.

1. Is there a need for increased consumer protection for apartment buildings exceeding three storeys?

SCA (Qld) firmly believes there is a need for consumer protection to owners of lots in buildings above three storeys. The most comprehensive study done into the topic of building defects in Australia in multi-owned (strata or body corporate) was undertaken by Griffith and Deakin Universities. Titled "An examination of building defects in residential multi-owned properties"² (the Report or Deakin Defects Report) and authored by academics Dr. Nicole Johnston and Assoc Prof. Sacha Reid, the Deakin Defects Report outlines the serious problems facing building standards in this section of the built environment.

¹ Hazel Easthope, Sian Thompson and Alistair Sisson, Australasian Strata Insights 2020, City Futures Research Centre, UNSW, Accessed at <https://cityfutures.be.unsw.edu.au/research/projects/2020-australasian-strata-insights/>

² Johnston, Nicole and Reid, Sacha 2019, An examination of building defects in residential multi-owned properties, Deakin University, [Melbourne, Vic.].

Whilst there is no uniform definition of a defect in academia or industry, recent works have tended to reference the following definition published by David Watt:

“a failing or shortcoming in the function, performance, statutory or user requirements of a building, and might manifest itself within the structure, fabric, services or other facilities of the affected building.”³

It is important to understand the magnitude of this problem that is building defects in strata properties. The Deakin Defects Report examined 212 building audit reports from New South Wales, Victoria and Queensland and found over 3000 line item defects.⁴ 85% of buildings analysed had at least one defect and the average number of line item defects was 14. The Deakin Defects Report⁵ defined the following core “construction systems” in a high-rise building to inform their analysis also:

- Building Fabric and Cladding
- Electrical, Lighting and Data
- Fire Protection
- Hydraulics
- In Motion Equipment
- Mechanical and Ventilation
- Roof and Rainwater Disposal
- Safety
- Structural
- Utility Supply
- Waterproofing
- Non-essential Services
- Access and Egress

The Deakin Defects Report also found that on average, almost six “construction systems” were affected by defects in each building. This data is concerning to anyone who has bought or is considering purchasing in a strata property.

The Deakin Building Report identifies two basic reasons for defects. These are design issues and defects arising in the construction phase.

Research cited⁶ by the Deakin Defects Report into this topic noted that organisational factors were perhaps the key factor driving defects in this type of construction work. Specifically, the following quote cited in the Deakin Defects Report perhaps best summarises the issues causing defects.

“ Such factors include: instability in the client organisation (key people often change), client’s project control (day to day plans often change), late visits to site and people changing their minds, time pressure, composition of the project organisation (those who had worked together before did better), cost pressure (lowest bid wins strategy), support to the site organisation (lack of support), and motivation (lack of activities aimed at motivating)⁷. “

None of these factors are likely to have an immediate and industry wide remedy. If anything, prevailing economic and population pressures in the state of Queensland indicate they are potentially going to be exacerbated in the construction industry in coming years. Despite these pressures causing issues within construction companies and sites, it is consumers who feel the effects.

³ David Watt, Building pathology: principles and practice (Blackwell Publishing, 2nd ed, 2007) 96.

⁴ Johnston, Nicole and Reid, Sacha 2019, An examination of building defects in residential multi-owned properties, Deakin University, [Melbourne, Vic.].

⁵ Australian Building Management Accreditation (ABMA), ABMA Building Management Code (2018) Queensland Edition.

⁶ Monika Jingmond and Robert Agren, ‘Unravelling causes of defects in construction’ (2015)

⁷ Jonathan Drane, ‘Building Defects: How can they be avoided? – a builder’s perspective’, paper presented at the Strata and Community Title in Australia for the 21st Century 2015 Conference, Gold Coast, Australia.

Strata owners often have close to their entire net worth invested into their property. It is unacceptable to leave them without appropriate insurance coverage, particularly in the present environment. Several construction companies in Queensland, due to a variety of market factors have recently entered into liquidation.⁸ As an organisation we have received anecdotal feedback that many apartment buildings constructed recently by some of these builders are already facing issues given the QBCC will not issue a direction to rectify what can be serious defects through no fault of their own. This is unjust and unfair. Given the recent turmoil in the construction industry and the abovementioned statistics, this is likely going to be a growing problem.

Without appropriate consumer protections, the only option for an affected strata community is expensive, time consuming and stressful litigation. Funding litigation can be an issue for schemes, particularly those with a small number of residences. At present, a body corporate attempting to “sue” a builder or developer has the legal issue of proportionate liability, a lack of sophistication when compared with the builder or developer in terms of resourcing and of course the potential winding up of a given defendant. All these factors mean the current framework is manifestly inadequate in protecting the rights of consumers.

Consumers have protection from defective goods and services through most sectors of the economy. Most professions mandate professional indemnity insurance and the Australian Consumer Law⁹ protects everyday people from defective goods. There is no such recourse for what is often a person’s biggest purchase - a property in a new development which is over three storeys. Apartments are increasingly the only option for many members of the Queensland community and to leave what often amounts to a huge portion of their net worth and substantial time, effort and emotional energy without coverage is unacceptable. This needs to change. It needs to be understood that homes are an important source of stability and community for people, one that cannot necessarily be quantified. This should warrant appropriate consideration by policy makers.

Building defects cause emotional and personal strain which cannot be quantified but is no doubt real. This is not simply speculation, the New South Wales Legislative Council Regulation of Building standards, building quality and buildings disputes Report¹⁰ (henceforth “NSW Report”) received submissions from owners regarding the emotional, personal and of course financial toll of building defects.

Submissions to the NSW report included the following excerpts relating to personal hardship faced by owners in affected strata schemes- these are just some of a plethora of examples:

“I am now out of pocket over \$550,000 (paid for by way of a mortgage) and I am still not living in my home due to major building defects, gross negligence and unreasonable delay on the builders’ part... This whole situation has left me with medically-diagnosed severe depression.”¹¹

“I will start by stating that words and numbers on a page cannot adequately convey the human pain and suffering caused, firstly by the handful of individuals responsible for this sorry affair but also the environment within which they were allowed to operate.”¹²

⁸ <https://www.9news.com.au/national/condev-probuild-privium-more-major-australian-construction-companies-will-fail-2022-insolvency-expert-predicts/907d2e0b-4e56-4040-93e0-14295e8c5383>

⁹ *Competition and Consumer Act 2010*

¹⁰ <https://www.parliament.nsw.gov.au/lcdocs/inquiries/2540/PAC%20-%20Regulation%20of%20building%20standards%20quality%20disputes%20-%20Final%20report%20-%20Report%20no%206.pdf>

¹¹ Submission 60, Name suppressed, p 1. (NSW Report)

¹² Submission 141, Name suppressed, p 1. (NSW Report)

“Besides the financial cost, there is also a real hard to measure negative impact on time, health, relationships and ultimately quality of life in the past 8 years for all concerned.”¹³

Given the above, the socially responsible policy is to increase consumer protection, so that experiences like this don't become widespread in Queensland. Information from the Deakin Building Report indicates that there is little variation between the rates of building defects in Queensland and New South Wales in the context of multi-owned dwellings.¹⁴ Without added consumer protection, this is a real possibility.

It is important to note the economic consequences of a lack of building defect insurance at a macro level. Consumer confidence in the New South Wales high rise apartment sector was significantly dampened by high profile instances of building defects. Valuers estimated the Opal Towers incident to have diminished values across the New South Wales high rise apartment sector by 16 per cent.¹⁵ Markets rely heavily on sentiment for consumers. There is little to suggest a similar high profile incident of high rise building defects in Queensland wouldn't diminish confidence in a similar fashion. By guaranteeing insurance coverage, Queensland will prevent itself from such a market crash.

It is virtually impossible to argue that the costs of premiums will approach 16 per cent of asset value even if the introduction of insurance cover is the only reform made. This means purchasers will likely be better off by having guarantees as to the construction of their building. Confidence in the Queensland Building sector should take priority. On a “net” basis owners will potentially be better off for paying a premium and having confidence in their asset and its resale value. A 16% or similar loss in asset value would leave consumers broadly in a significantly worse position with reference to their “balance sheet” than if they simply paid an insurance premium. It only took two buildings across the enormous New South Wales market to cause what is a very large loss in values across the entire market.

All of the above factors indicate the serious need for expanded consumer protection. SCA (Qld) will support any and all mechanisms which enhance confidence in the high-rise building sector. We are open to any policy levers which can enhance confidence in the sector.

If Government is to maintain or strengthen its overarching planning policy favouring strata development, it is important reforms reflect this with respect of construction. Carving out an increasing share of Queenslanders from protection for their largest asset is contrary to the overarching goals of the Scheme.

2. **Should any increased consumer protection cover only structural issues, or should all residential construction work including subsequent renovations be covered?**

SCA (Qld) believes that consumer protection cover should be extended primarily to cover structural issues for new builds. Subsequent renovations would be the responsibility of either the body corporate or the relevant owner/owners. SCA (Qld) believes that the vast majority of problems are in new builds and often can be apparent upon appropriate expert inspection within the first 12 or 24 months following completion.

SCA (Qld) believes that the actions of the original owner often are the substantive cause of the most major issues. SCA (Qld) therefore believes expansion of consumer protection should in the first instance be focused on original construction and specifically structural issues created during the time of the control of the original owner. Any expansion to include subsequent renovation work should be a step following on from enhancing protections for structural defects in new builds.

¹³ Submission 51, Name suppressed, p 4 (NSW Report)

¹⁴ Deakin Defects Report, p 21

¹⁵ <https://www.abc.net.au/news/2019-01-21/opal-tower-effect-to-hit-sydney-apartment-prices/10727268>

We note that subsequent renovation work can be negotiated to have appropriate insurance with respect of building contracts. We believe, as a priority, that ensuring new builds are covered should be the focus and a “first step.”

3. Do you think expanded Scheme Cover is an effective option?

SCA (Qld) believes any and all methods of expanding consumer protection in this space need to be considered. SCA (Qld) believes the Scheme has significant positives to help consumers, most particularly its “first resort” nature. In other states, pursuit of the building contractor through civil litigation or otherwise adds expense, often borne by the claimant owner which significantly reduces the amount of money available for rectification.

The Scheme as it stands is an effective option to ensure coverage. Given it is both mandatory and run on a not for profit basis, risk can be effectively spread through expansion of the Scheme. The QBCC also has the benefit of having licensing oversight. This gives them understanding of trends with respect of construction issues and allows them to amend their premiums and activities accordingly. The ability to share information in this fashion makes the regulator ideally placed in this regard.

This makes Scheme extension a matter of appropriate analysis being conducted by the QBCC around premium levels, and adjustment accordingly should claims exceed the estimated cost. Given the mandatory nature of the Scheme, risk will be spread across the sector. Whilst there may be arguments made by the construction industry to the contrary, the mandatory nature of the Scheme may help keep premiums reasonably affordable.

The Scheme’s first resort nature and its not for profit basis mean it is well positioned as an instrument to protect consumers. The QBCC as a one stop shop for regulation of the building and construction industry will be helpful if Scheme coverage is extended. We believe with appropriate resourcing and a commitment from the Government to ensure adequate funding there is no reason extension of the Scheme as it stands is unworkable as a solution.

SCA (Qld) believes that all measures must be taken to ensure that consumers in high rise buildings have trust and confidence in their home. SCA (Qld) notes that based on housing targets in the South-East Queensland Regional Plan¹⁶ it is likely that most new dwellings in this region will be over three storeys. To leave these Queenslanders out of the Scheme would reduce its scope quite significantly. This is contrary to the high policy considerations which inform the existence of the Scheme.

4. Would you be willing to pay a higher premium to receive insurance cover?

SCA (Qld) acknowledges that for a variety of reasons premiums on a high rise building will likely be substantially higher per dollar value of work than a detached house, duplex or other “low rise” building. At present, based on the data available in the discussion paper, the Scheme is sustainable. SCA (Qld) understands that the risk will be greater for taller buildings and present premium rates may need to be increased. We note a key review theme is more flexible and affordable premiums. This means it may be in line with the principles set out by the review that high rise consumers pay a premium separate to that of low rise consumers.

We acknowledge that there will likely be an overall increase in premium; however, we would view the resultant restoration in confidence in the sector as being worth the cost. The financial implications for Mascot Towers, where the builder has gone into liquidation have been severe. Owners face a loss of 70-80% of the purchase price, ongoing legal and strata fees and in many instances bankruptcy.¹⁷ Whilst it may not always make sense for an individual to take out an insurance for a particular event, on a macro scale, large rates of non-insurance can be catastrophic.

¹⁶ <https://dsdmipprd.blob.core.windows.net/general/shapingseq.pdf>

¹⁷ <https://www.sbs.com.au/language/english/owners-in-last-ditch-attempt-to-recoup-losses-two-years-after-mascot-towers-evacuation>

We believe the need to pay for insurance will over time encourage standards to be higher. This, coupled with other reforms we will refer to later in this submission mean that over the long-term premiums are likely to be able to be controlled.

In the medium and long term, any increase in premium - whether it is charged to high rise construction or is spread across the entire sector - confidence in building is worth the price. The mandatory nature of the Scheme means any premium increases can be equitably distributed.

It is also important to note last financial year, roughly 19% of Queensland State Government revenue was from transfer duty.¹⁸ The bulk of this was from property transactions and amounts to billions of dollars. Strata owners also paid almost \$40 million in taxes last financial year on their insurance premiums.¹⁹ It would be fair and reasonable to reinvest a portion of these revenues in ensuring confidence in building for strata owners.

Queensland had significant financial windfall from interstate migration and an increased value of property transactions over the course of the COVID-19 pandemic. This trend is set to continue.²⁰ We note the abovementioned costs to values in Sydney. Similar falls in the Queensland market to those brought about by Mascot and Opal Towers in New South Wales would have a disastrous effect on state revenues. We therefore urge the State Government to view any investment from them as an investment in securing revenue from property taxation and would suggest this approach is protective of their interest. Given new build strata will likely make up a huge portion of development in Queensland in coming decades, this is a no brainer and any cost to Government in underwriting the expansion of the Scheme will likely pay for itself in the long run.

5. Alternative measures

a. Government bond Scheme:

SCA (Qld) believes that the idea of a Government bond Scheme is one worth exploring. It must be rigorous and backed by independent assessment of building defects. There should be sufficient safeguards in any regime to ensure the inspections are thorough and independent of the developer.

SCA (Qld) believes a bond Scheme would need to be accompanied by a mandatory inspection regime in at specific intervals, ideally 12 and 24 months after practical completion by a structural engineer. SCA (Qld) believes most structural defects will be found by an appropriately qualified engineer carrying out a thorough onsite inspection at these landmarks post construction. The Bond should be a percentage of construction cost sufficient to cover significant remediation works and released in stages as approvals around structural fit for purpose are given through these mandatory inspections. We believe that any bond Scheme must operate with a view of 'consumer first,' and if necessary, be punitive upon developers.

b. Decennial Liability Insurance

SCA (Qld) believes a mandatory decennial liability has the potential to be an effective remedy for the current building crisis in high rises. Decennial liability insurance is a product which has many benefits and would restore long term confidence in the sector also. SCA (Qld) believes for the avoidance of doubt that the strict liability in the French system, where there is no obligation to prove fault should be applied to original owners if this type of insurance is introduced to Queensland.

¹⁸ https://budget.qld.gov.au/files/BP2_4_Revenue.pdf

¹⁹ Johnston, N., Lee, A., Mishra, S., Powell, K., Bowler-Smith, M and Zutshi, A. (2021) A data-driven holistic understanding of strata insurance in Australia and New Zealand. Deakin University

²⁰ https://population.gov.au/sites/population.gov.au/files/2021-12/population_statement_2021.pdf

The French civil code introduced the concept of decennial liability at its inception for construction work.²¹ This means that if significant structural defects in a building manifest themselves in the first ten years of a building life cycle, the builder is obliged by law to rectify.

Obviously, buildings built in the 1800's lacked the complexity and technicality of those built today. Decennial liability insurance came about as buildings became more complex in the 20th century- as the issue of bankruptcies or other inability by builders to rectify became an issue regarding more complex buildings. Decennial liability insurance in France is designed with the overarching goal of confidence in the building sector.

Under the French system, the ten year period for major defects, damage or partial or total collapse begins on the date of construction works and protection by this liability period is transferred to any subsequent owner.²² This means any defects which manifest in the first ten years of a building life cycle must be rectified. If there is no capacity for the contractor to rectify, the insurance is used to fund works. Government strictly regulates premiums and there is no allowable limit on cover by law.

This type of system has operated very successfully around the world including in many former French colonies.²⁰ In France, premiums are generally 0.8% to 2% of construction cost.²⁰ In France, it is a criminal offence not to take out this type of insurance for a construction contractor. Government strictly regulates premiums and there is no allowable limit on cover by law. If a defect is identified and the construction contractor is still available, they are obligated to rectify.

The decennial liability product as it applies in France would work in the Queensland context quite well. Given Queensland has a government monopoly on this type of insurance, issues which have been barriers to this type of product in other jurisdictions such as underwriting and reinsurance should not be as much of a factor.

Decennial liability should be easy to implement in Queensland given the monopoly on administration and licensing the QBCC has. SCA (Qld) firmly believe that a first resort, mandatory decennial liability scheme, if implemented, will ensure significantly improved building standards, confidence in the property market and will be affordable. It is important to note that in the United Kingdom, decennial insurance premiums have come down over time after their introduction²¹. This indicates that over time, the prospect of liability improves building quality, culture and overarching confidence. There is nothing to suggest this would not be the experience in Queensland.

6. **Should we also be looking at other ways to make sure that risk is appropriately managed, such as licensing additional parties involved in work on residential high-rise buildings, such as developers?**

SCA (Qld) firmly believes that there needs to be appropriate regulation of developers.

At present, any person can theoretically be a developer. There is no regulation on this, any person or other entity that can borrow or raise sufficient capital to buy a site and lodge a development application can be a developer. For the definition of a developer, or associate of a developer, we would encourage the Department to copy the well tested and effective definition used in the *Electoral Act 1992*²³ to restrict electoral donations to such persons. These provisions have been effective in defining and capturing developers for the policy intent of that Act and should be extended across the board with respect of any proposed controls or requirements on developers to help enhance building standards

²¹ <https://ferrer.law/blog/construction/decennial-liability-and-decennial-liability-insurance-the-only-road-to-the-promised-land-for-the-new-south-wales-building-crisis>

²² https://constructionlegal.com.au/wp-content/uploads/2020/03/jrippon_bcl_v35_pt5.pdf

²³ s273

Any such person ought to have a requirement to be a fit and proper person to be in control of a project. There needs to be capacity, particularly for Councils, to potentially be able to refuse development applications made by a developer who has failed to rectify defects on a previous project. There should be ongoing requirements and rating system placed on developers. SCA (Qld) believes that factors to be considered include:

- Outstanding payment of contractors;
- Failure to rectify defects on a previous project;
- Failure to have appropriate insurances ; and
- Any other matter which goes to the concept of fit and proper status - this list is not to be exhaustive.

A starting point would be factors considered by the QBCC regarding builders with respect of the demerits system being applied in a similar fashion to “developers”.

SCA (Qld) believes where a developer has failed to provide appropriate recourse or rectification on a project or if they do not meet standards of behaviour expected, a remedy could be to have a blanket refusal for further development approvals by them or related entities. If the conduct was particularly egregious this could even extend to stopping construction on in progress projects. These measures would provide a powerful economic incentive for appropriate conduct.

Similarly SCA (Qld) believes there needs to be greater oversight of building certifiers. Feedback from members of SCA (Qld) involved in these issues is that the Government should take stronger action to ensure that commercial interests and other pressures do not prevent building certifiers from acting in the public interest.

Building certifiers, particularly private certifiers, face practical and commercial pressures to provide client advice that may conflict with their compliance and enforcement roles as independent checking professionals – the concerns are:

- conflicts of interest
- disengagement of building certifiers
- confusion over the building certifier role
- the standard of building certifier work
- enforcement action.

SCA (Qld) believes appropriate oversight of these factors, particularly relationships with developers need to be addressed. This could include independent certification administered by the QBCC for buildings over three storeys, or requirements to use multiple private certifiers on a given project. Regardless, SCA (Qld) believes that there must be significant changes to the status quo.

7. **Mixed use buildings?**

SCA (Qld) supports inclusion of the residential aspects of schemes like this. Buildings with a mixed use should provide insurance cover to residents, particularly for structural defects. Given it is more likely that sophisticated investors or indeed the original owner may be responsible for the commercial precinct within the building, they should have costs excluded. That said, it is possible that defects will affect a whole building, therefore, in this instance, a focus should be placed on ensuring that rectification does occur. In instances where insurance is to be used, it should only be paid out to residential property owners.

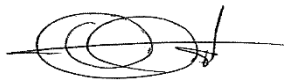
Conclusion

At this point in the discussion around the extension of the Scheme SCA (Qld) is happy to work cohesively with Government and stakeholders regardless of the direction of the discussion. What SCA (Qld) can affirm is that we support:

- An extension of some form of statutory insurance coverage for building defects above three storeys;
- Appropriate regulation of developers; and
- Appropriate regulation of building certifiers.

In substance, SCA (Qld) has a firm position that an extension of coverage above 3 storeys is critical to ensure that the deleterious effects the New South Wales apartment market and specifically owners in Mascot and Opal Towers suffered are not repeated in Queensland. SCA (Qld) believes that the unique framework in Queensland, where a government monopoly and a strong, one stop shop building regulator in the form of the QBCC exists means Queensland is uniquely placed to solve these problems.

SCA (Qld) therefore urges the Government to focus on ensuring that confidence is guaranteed in the high rise building sector. State taxation revenues and planning policy require this confidence to be successful in the long term. This is in the interests of all players within the sector, particularly in the coming decades.



Kristi Kinast
President SCA (Qld)