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Residential building regulation

Boulevards of broken dreams

LAWYERS COMMENCING LEGAL ACTION TO ENFORCE CLIENTS' RIGHTS CAN FEEL LIKE THEY ARE CONFRONTED WITH AN IMPENETRABLE MAZE. A RAFT OF REGULATORY REFORMS PROPOSED OR IN TRAIN AT THE START OF 2024 OFFER A PATHWAY THROUGH THAT MAZE, BUT ONE WHICH REQUIRES CAREFUL NAVIGATION. BY MEGAN THORBURN, BRONWYN WEIR AND DR MATTHEW BELL



In May 2019 a couple signed a contract with a volume builder of homes. Four years later, that builder was the subject of news reports featuring angry owners left with nothing but a concrete slab to show for their investment,¹ and the couple were coming to the end of a lengthy tribunal process seeking compensation.² In the decision finding that “the extent of the faulty or unsatisfactory work by the [builder] is not acceptable”, Member Petrucci reproduced part of the applicants’ heartfelt submissions:

“We have worked hard and honestly, blood, sweat and tears to achieve this block of land and build our dream home for our family. Instead, the past five years have been the most traumatic years of our family’s lives, having to endure the emotional, mental and financial stress of this build with no fault of our own.”³

This situation occurred in Western Australia, but there have also been many high-profile builder collapses over the past couple of years in Victoria. Lawyers here would recognise the similar plight of many homeowners as well as the extent and frequency of the angst and confusion arising from residential building problems faced by lawyers and clients around the world.⁴

As lawyers, whether dealing with a residential construction problem for the first time or with many years’ experience, we can empathise with our clients in feeling that the regulatory system is an impenetrable maze of caselaw, statute, insurance and dispute resolution schemes, especially because each of these elements is constantly under review and many of the reviews can seem piecemeal. And, for lawyers who practise in more than one jurisdiction, this complexity is compounded because the statutory regime for residential construction is primarily state based (but with important federal overlays including the Building Code of Australia and Australian Consumer Law).

In this article, building on previous coverage in the *LJ*,⁵ we provide a brief overview of the current state of the reforms in Victoria within the broader national context of implementation of the landmark *Building Confidence* report undertaken in the wake of the Grenfell Tower tragedy in London.⁶ The reform program was significantly ramped up in late 2023, foreshadowing major changes which all lawyers practising in the area need to be aware of.

How a broken system was constructed

The *Building Act* 1993, which came into effect 30 years ago, introduced a new era of building regulation for Victoria. Key aspects included private building approval processes⁷ and a new performance-based building code (which commenced in 1996) providing building practitioners with authority and flexibility to foster innovation and creativity in design.

Under the now-outsourced statutory function, the appointed Relevant Building Surveyor (RBS) was required to attend the construction site only four times during construction.⁸ Ostensibly, their responsibility was limited to what they could reasonably see during the mandated inspections. It is similarly a shock to many homeowners (as well as many lawyers) that “an occupancy permit . . . is not evidence that the building or building work concerned complies with the [Building] Act or the building regulations”.⁹ This is still the situation today, resulting in a “light touch” certification scheme that relies heavily on self-certification (or no certification) by builders and tradespersons.

Also in the 1990s, Australia’s development industry underwent a transition from a largely “build and own” model to a “build

and sell” model. The use of “off-the-plan contracts” began to increase rapidly, supported by stamp duty savings and rapidly increasing property prices. Purchasers were only required to stake a 10 per cent deposit which was held in trust, developers could borrow on the basis of signed contracts, and banks were happy to lend based on this security.

After the September 11 attacks in 2001, the global insurance market took a dive, and insurers were no longer willing to offer builders warranty insurance for residential work. This led to the emergence of domestic building insurance (DBI) that only operated when a builder “Died, Disappeared or became Insolvent”. However, within 10 years, private insurers began to pull out of DBI also. In 2010, the Victorian Managed Insurance Authority (VMIA) stepped in to offer DBI, and it now services more than 85 per cent of the builders warranty market. VMIA’s capacity to provide this insurance remains stretched, with its operating deficit of \$115.4 million for the 2022-23 financial year attributed particularly to floods and the fall-out from the collapse of Porter Davis Homes.¹⁰

By the mid 2000s, local councils had all but stopped issuing permits. The industry had gravitated towards seeking permits from service-driven private certifiers, and councils were happy to avoid the risk associated with issuing permits. Building departments in local councils were rapidly shrinking as councils diverted more and more resources to the battlegrounds of the Victorian Civil and Administrative Tribunal’s (VCAT) planning lists.

Meanwhile, the Victorian government was eager to capitalise on the ever-increasing investment pool from superannuation and foreign buyers by establishing growth corridors for new domestic construction and transport corridors to infill urban areas with mid-density development. This helped encourage the growth of the “off-the-plan” apartment sector. To ensure the financial stability of the model, purchasers would be forced to settle having virtually no rights to delay or rescind contracts even if they were concerned about defects. They were assured that they could raise any defect issues after settlement.

Purchasers often find, however, that that assurance evaporates in the face of commercial reality. As apartment projects near completion and developers’ borrowings hit their peak, the pressure to complete projects is intense. These practices are often exacerbated by the “design and construct” procurement approach, under which the time and cost allocated to design development is squeezed, resulting in minimum documentation

SNAPSHOT

- Time is of the essence for regulatory reforms in Victoria in the wake of the building safety crisis – a significant concern given federal and state governments’ aspirations to drastically increase housing supply.
- The *Building Legislation Amendment Act 2023* came fully into force on 1 February 2024. Its reforms include a new building monitor, expansion of practitioner registration schemes and requirements for apartment building manuals.
- Victorian practitioners need to be aware of these reform programs, not just to keep clients informed, but to provide input to ensure that the regulatory scheme operates as effectively as possible.

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and maximum flexibility for the builder to substitute specified products and vary design in order to “value manage” the project. Even the most discerning RBS may find it difficult to do anything that would delay issuing occupancy permits.

After apartment sales settle, developers are free to wind up their special purpose vehicles, having no accountability to the apartment owners under the regulatory framework. On the face of it, consumers are protected as they enjoy statutory warranties and can sue the builder if there are defects.¹¹ In reality, the builder’s pockets are shallow compared to those of developers, and consumers may have assumed that they were protected by DBI. This is one of many misplaced assumptions which homeowners may make about the regulatory “safety net” as, under the relevant DBI Ministerial Order, warranty insurance is not mandatory for multi-dwelling buildings over three storeys.¹²

By the early 2010s, the number and complexity of cases in VCAT concerning high-rise apartment buildings was increasing significantly. The case about rectification of combustible cladding at the Lacrosse building following the 2014 fire provides a totemic example (and is an authority on what constitutes an apportionable claim in Victoria).¹³ To help manage the increase in disputes and to decrease VCAT’s caseload, Domestic Building Dispute Resolution Victoria (DBDRV) was introduced in 2017, but it is far from clear that the introduction of DBDRV has been a desirable addition to the regulatory scheme. VCAT reported an initial drop of about 30 per cent in new cases, but the decrease was short-lived with the overall drop in cases that year being only about 6 per cent. This was followed in 2018-19 with an almost 47 per cent rise in new cases. VCAT’s domestic building cases then went from approximately 1200 in 2017-18 to almost 1800 in 2018-19. Its case load worsened in 2020 when COVID-19 hit, and cases had to be adjourned. Meanwhile, Consumer Affairs Victoria said it received 11,070 complaints and inquiries in 2021-22 about domestic building issues, almost double the 2020-21 figure.¹⁴

In the wake of COVID-19, VCAT’s list faced a “perfect storm” of reduced capacity due to retirements of experienced Members and undermining of its jurisdiction via several important cases including *Krongold v Thurin*.¹⁵ In response, many domestic building disputes were transferred to other courts (and, indeed, Senior Member Kirton became a judge of the County Court) and the government has attempted retrospectively to shore up VCAT’s jurisdiction via Pt 10 of the *Justice Legislation Amendment Act 2023*.

National response to the building safety crisis

While this article has been concerned with Victorian reforms, reforms are taking place across Australia and internationally in response to the “building safety crisis” precipitated by the cladding-fuelled tragedy that occurred at Grenfell Tower in London in June 2017.

The *Building Confidence Report* (BCR), prepared by Peter Shergold and Bronwyn Weir, was commissioned in the wake of the Grenfell Tower fire and published in April 2018. It contained 24 recommendations to improve the effectiveness of compliance and enforcement systems in the building and construction industry. State Building Ministers accepted all of the report’s recommendations in principle and agreed to consider implementation of all of the endorsed responses to

the recommendations. Nearly six years later, as tracked by the Australian Construction Industry Foundation, progress has been made in that implementation across Australia’s nine relevant jurisdictions – six states, two territories, and federally – but there remains significant work to be done.¹⁶

The Centre for International Economics found in its report published in July 2021 that the cost to consumers from building defects relating to regulatory noncompliance is \$2.5 billion annually, with \$1.3 billion of that attributed to multi-storey apartment buildings. The report assessed the cost of implementation of the recommendations in the BCR, estimating that nationally consistent implementation of BCR recommendations would reduce the cost of building defects by approximately \$1.4 billion annually and offer time savings worth approximately \$375 million annually.¹⁷

Cladding rectification opening a Pandora’s box of building defects

The Victorian government’s approach to rectification of combustible façade cladding, a taskforce led by former premier Ted Baillieu and former deputy premier John Thwaites, involved a world-first \$600 million package in 2019 to be overseen by Cladding Safety Victoria (CSV). This program continues to rectify high risk cladding throughout the state, and the government has started to enforce its rights of subrogation to recover the costs of the work from responsible parties.¹⁸ However, defects are not limited to cladding. According to CSV’s research, around half of the apartment buildings funded for cladding remediation have serious non-cladding related defects, with balcony defects and water ingress the most prevalent.¹⁹

The question of whether cladding needs to be removed remains controversial: in response, on 21 September 2023, Ministerial Guideline (MG-15) and a Cladding Risk Mitigation Framework (CRMF) were published under s188(1)(c) of the *Building Act* to provide guidelines to municipal and private building surveyors, councils and owners to understand risk and how it is assessed and mitigated. The CRMF is intended to be used to provide a pathway for owners of apartment buildings with medium and low risk cladding to reduce those risks to an acceptable level and put the combustible cladding saga behind them.

Momentum for building regulatory reform increases

The Victorian government has recognised, consistent with the holistic approach advocated by the BCR, that cladding failures were but one symptom of the regulatory deficiencies. It established the Building Reform Expert Panel (Panel) in 2019 to undertake the Building System Review. The Panel’s Stage One Report, released in March 2023, proposed a reform package comprising 16 distinct recommendations aimed at strengthening regulatory oversight, enabling a risk-based approach to building approvals, increasing accountability and competency of practitioners in the system and enhancing consumer representation and advocacy.

The *Building Legislation Amendment Act 2023*, which came fully into force on 1 February 2024, has introduced a range of reforms arising from that Stage One Report including formalising the

role of the State Building Surveyor, establishing a Building Monitor and widening the range of building practitioners required to be registered. Sections 41A and 41B of the *Building Act* are a direct response to the BCR's call for better information about high-rise buildings, requiring applicants for an occupancy permit for certain classes of buildings to submit a draft building manual to the RBS.

On 28 November 2023, the Panel's Stage Two Report was released.²⁰ That same day, the Victorian government introduced a Bill to amend the procedures relating to DBI and announced a broad-ranging review of the *Domestic Building Contracts Act 1995* (DBCA).²¹ These measures are related, with six of the 14 recommendations from the Panel's Report calling for amendments to the DBCA and improvements to DBDRV.

Key aspects of the Stage Two Report's recommendations include:²²

- Increased accountability for developers of residential apartments through defining "developer" in relevant legislation, introducing a developer bond scheme, and requiring developers to engage an agent such as a superintendent, site architect, or clerk of works to be regularly on site. The recommendation for a bond scheme differs from the NSW scheme, in that the NSW scheme requires a 2 per cent bond (soon to be increased to 3 per cent) which is retained for up to two years, whereas the Panel has proposed that, subject to further consultation, the Victorian scheme should require a 5 per cent bond to be held for up to 10 years post construction.
- Extension of the DBCA's s8 warranties, enabling them to be claimed against developers as well as builders (which already exists in NSW and is proposed for introduction in the ACT).
- Introduction of a statutory duty of care (as was introduced in NSW in 2020).
- Further attempts to protect consumers of apartments through the establishment of an advisory committee to develop a staged introduction plan for mandatory, decennial liability insurance (DLI). DLI is available in Australia on a voluntary basis with reports of policies being issued for some apartment projects in NSW. Its introduction commenced following a report to the NSW Government by the Decennial Liability Insurance Ministerial Advisory Panel in August 2022. It appears the Panel is seeking to encourage a similar pathway for DLI to be offered in Victoria with a view to making it mandatory.
- That DBDRV may no longer be fit for purpose, noting that: its triaging processes are not well coordinated or clear; a high number of cases it receives are not suitable for conciliation; technical assessments are not used to their full potential; dispute resolution orders are infrequently used; and attempts to resolve disputes involving unregistered practitioners are often ineffective. Although the Panel says these issues arise from the DBCA itself no longer being fit for purpose, the Panel goes on to recommend immediate process improvements to address these issues.
- Better integration between agencies including the establishment of a single portal for consumers, enhanced information sharing and co-designing training and guidance materials. Notwithstanding these numerous recommendations for improvements to DBDRV, the Panel says that, over the longer term, the government should consider major reforms to

the institutional arrangements for building dispute resolution. It proposes that a new organisation would make the system simpler for consumers, combining DBDRV and the VCAT Building and Property List to form a separate and dedicated dispute resolution body.

The Panel has also turned its focus to post construction building maintenance and highlighted the government's investment in Building Information Modelling and Digital Twin technologies and its support of research into initiatives to reduce waste and increase recycling in the construction sector. This has led to four recommendations:

- strengthened essential safety measure (ESM) maintenance obligations through increased sanctions on owners where ESMs are not maintained; a new periodic (perhaps five-yearly) mandatory inspection to ensure ESMs remain fit for purpose; and mandating that owners implement changes or upgrades arising from the periodic inspection process.
- increasing competencies for owners corporation managers so they are more aware of ESM maintenance obligations and record-keeping requirements
- a new notification, design and inspection regime for complex hydraulic plumbing work
- ongoing support to incentivise the uptake of alternative building materials and align to the targets of the National Waste Action Plan.

While these proposals are being considered, the Building Legislation Amendment (Domestic Building Insurance New Offences) Bill 2023 has followed through on the government's commitment to crack down on builders who take deposits from owners but do not promptly take out warranty insurance. This widespread practice came to public attention in the wake of the collapse of Porter Davis in March 2023 which saw the state government having to step in to compensate owners left without insurance. The Bill creates two new offences with "tough" penalties for builders – approximately \$96,000 for individuals and \$480,000 for companies for an offence committed knowingly, and \$46,000 for an individual and \$230,000 for a corporation where the offence is committed under a standard of strict liability. Unlike other offences under the DBCA, the Victorian Building Authority is given powers to enforce these new offences.

The review of the DBCA is explicitly focused on consumer protection effectiveness and is supported by a Discussion Paper which asks for comments on all aspects of the DBCA including:²³

- definition of "domestic building work", including whether to extend to single trades
- monetary thresholds for Major Domestic Building (MDB) contracts, deposits and contents of MDB contracts
- whether MDB contract requirements should be extended to all contracts
- whether statutory warranties should be updated
- whether cost escalation clauses should be allowed below the current \$500,000 threshold
- whether fixed price default should be changed (re cost-plus, prime cost, provisional sums)
- whether progress payment stages are appropriate
- review of delay estimate and cooling off provisions
- whether the variations and termination provisions are appropriate.

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Security of payment reforms is also on the horizon

Hot on the heels of the Expert Panel's Stage Two Report, the Parliamentary Inquiry into Employers who Refuse to Pay their Subcontractors for Completed Works was finalised with the Report tabled in Parliament on 28 November 2023.

The Report makes several recommendations for reform of the Victorian *Building and Construction Industry Security of Payment Act 2003* (SOP Act), many of which are responsive to the Murray Review from 2018. These include to:²⁴

- abolish the (unique) Victorian "excluded amounts" regime, and the concept of "reference dates"
- amend the definition of "business day" to ensure that time stops running from 22 December to 10 January (which will bring much relief to those legal practitioners and adjudicators who have traditionally had their Christmas and New Year interrupted by adjudication claims)
- allow adjudicators to declare void notice-based time bars and other unfair terms
- extend time limits for making payment claims to six months, and impose time limits for making payments
- fall into line with most other jurisdictions by providing that reasons not included in a payment schedule cannot be included in an adjudication response
- allow the adjudicator discretion to extend determination delivery for up to 20 business days
- review the adjudication review mechanism
- give adjudicators expanded continuing professional development and civil liability protections
- require Authorised Nominating Authorities to disclose fee sharing arrangements with adjudicators and that adjudicator fees are to be included in adjudication certificates
- allow adjudication certificates to be filed as a judgment for debt.

The Report also includes a lengthy analysis of the pros and cons of, and attempts by other jurisdictions at, introducing a form of statutory trust. It concludes that Victoria should introduce retention trusts in the short term while undertaking further consultation with a view to introducing a cascading deemed statutory trust model as recommended by the Murray review (but not yet taken up by any other jurisdiction).

The Report stopped short of recommending the SOP Act be extended to residential building contracts but said that further consultation on this was warranted. This requires serious consideration given the risk that unsuspecting homeowners may be drawn into security of payment adjudications and that the DBCA already provides for its own, staged payment regime.

Where to from here?

If the Victorian regulatory mix was not already complicated enough, there is now the further overlay of its role in helping deliver on the federal government's *Housing Australia Future Fund Act 2023* (Cth). This Act establishes a \$10 billion Housing Australia Future Fund aimed at creating an ongoing pipeline of funding for social and affordable rental housing. The plan is to build an additional 1.2 million houses nationally within five years via a \$3 billion National Housing Infrastructure Facility, a \$3 billion New Homes Bonus and a \$500 million Housing Support Program.

In the face of the commitment of all Australian governments to fund a significant increase in the number of homes through new construction, we must ask: "at what cost?" The prevalence of defects in residential construction is unacceptably high. Indeed, if the indication from CSV's cladding rectification program, that half of Victoria's apartment buildings have non-cladding defects, plays out across the new housing stock,²⁵ we may find that 400,000 of Victoria's newly constructed 800,000 homes are defective. This will result in further increased litigation and untold community impacts as owners try to navigate the defect rectification quagmire.

As of early 2024, therefore, despite the road map for regulatory reform offered by the BCR in 2018 and the establishment of the Expert Panel in 2019, necessary reforms to strengthen regulatory controls remain elusive in Victoria. However, the Stage Two Report and associated reform proposals noted above bring a suite of suggestions forward for government which provide a pathway to extensive reforms and may be a signal that, in 2024, we will see – in Elvis's words – "a little less conversation, a little more action". ■

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2. *Chetty and Kulowall Construction Pty Ltd* [2023] WASAT 98, at [87]
3. Note 2 above, at [85]
4. Research into the extent of the problem of residential construction defects in Victoria, across Australia and abroad, is summarised in Britton, P and Bell, M, *Residential Construction Law* (Hart Publishing 2021) ch 2
5. Thorburn, M, "Under construction: Regulatory reform of the building industry in Victoria" (*LJL*, April 2022) p28; Thorburn, M, "Property law: building better consumer protection" (*LJL*, August 2023) p55
6. Shergold, P and Weir, B (2018), "Building Confidence: Improving the effectiveness of compliance and enforcement systems for the building and construction industry across Australia", Building Ministers Forum, https://www.industry.gov.au/sites/default/files/July%202018/document/pdf/building_ministers_forum_expert_assessment_-_building_confidence.pdf
7. *Building Act 1993*, pt 6. For the first time owners could choose to appoint a private building surveyor or their municipal building surveyor
8. *Building Regulations 2018*, reg 167 (now prescribing five mandatory stages by default)
9. *Building Act*, s46(2)
10. Victorian Managed Insurance Authority, *Annual Report 2022-23* (2023), p44
11. *Domestic Building Contracts Act 1995*, ss8, 9
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14. <https://www.abc.net.au/news/2023-06-30/building-construction-panel-wants-strict-rules-for-developers/102540004>
15. [2023] VSCA 191
16. ACIF, *A Cross-Jurisdictional Review of the Implementation of the Building Confidence Report* (November 2023)
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19. Cladding Safety Victoria, "Research Paper: Research Analysis on Issues and Risks Associated with Balcony Defects" (January 2023), p3; Cladding Safety Victoria, *Annual Report 2022-23*, p18
20. Expert Panel on Building Reform, *Building Reform: Paper 2* (2023), available via <https://www.vic.gov.au/better-regulation-reviews#building-system-review>
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22. Note 20 above: see summary at pp10-11
23. Note 21 above: see summary of consultation questions at pp19-21
24. Legislative Assembly Environment and Planning Committee, "Employers and Contractors who Refuse to Pay their Subcontractors for Completed Works" (November 2023), available via <https://www.parliament.vic.gov.au/get-involved/inquiries/Nonpaymentofsubcontractors/reports>; see summary of findings and recommendations at pp xxi-xxix
25. Note 19 above

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