



BEST PRACTICE GUIDE

BUILDING DEFECTS: WHO PAYS?

A MAJOR MANAGEMENT ISSUE OF ALL STRATA OWNERS

In 2012, a major study by the University of New South Wales found that 85% of strata owners had to address costly building defects. Since then the problem seems to have grown even worse, with some notorious major developments and a state-wide fire safety issue with external cladding materials.

Building defects are an ever-present risk. Building defects are not always apparent. Very often they are latent, and only become a problem years after the construction work.

It is essential that all strata owners manage this risk by understanding the potential avenues for recovering such costs, and the pro-active management steps necessary to protect any such rights.

HOME BUILDING ACT 1989 BUILDER AND DEVELOPER LIABILITY

The main means by which the NSW State Government seeks to protect the owners of residential property from the defective building work is the Home Building Act 1989. Under this Act all contracts to perform building work contain

warranties, whether those warranties are written into the building contracts or not.

For example, there is a warranty that the building work will be done with due care and skill in accordance with the plans and specifications set out in the contract. Both the Builder and the Developer are held liable for any breach of these warranties.

Under the Act, the benefit of the warranties are passed onto subsequent owners of the property, such as owners under a strata scheme. These warranties provide the most common and straightforward avenue by which strata owners may get someone else to pay the rectification costs. However, there are potential pitfalls and problems:

- Depending on the date of the building contract, and the type of building defect involved, the warranties only apply for variously two, six or seven years from the date the building work was completed. Beyond these limitation periods owners lose their recovery rights under the Home Building Act.
- If the defect can be proven (usually by expert evidence) then historically it is difficult for a builder or developer to defend a claim. The most notable defence is if the defect arises from a design fault, which the builder drew attention to. (See the sub heading below on the Design



and Building Practitioners Act 2020).

- If the Builder/Developer does not address the rectification of defects within the relevant warranty period then the owners will need to commence legal proceedings if they want to preserve their rights of recovery.
- If the sum in dispute is less than \$500,000, then claims under the Home Building Act will be dealt with by the NSW Civil and Administrative Tribunal. The Tribunal's preferred remedy in the case of building defects, is to make an order that the Builder rectify the defects, rather than to award money damages to the owners.
- In any legal proceedings there is always the risk that even if successful owners will not be able to recover compensation because the builder and developer have become insolvent. Unfortunately this is all too common in the construction industry.

HOME OWNERS WARRANTY INSURER

Because of the prevalence of builder and developer insolvencies, building contracts for residential building work are required to include Home Owners Warranty Insurance. This insurance is intended to cover the owners for the cost of rectifying defects.

Where claims are made against a builder and developer, it is important to also notify the insurer of the claim. Insurance may be denied where notifications are made out of time. There have been various Home Owners Warranty insurers and schemes over the years. At present insurance is provided by a government instrumentality, icare, which provides a maximum cover per dwelling of e.g:

- \$300,000, if issued before 1 February 2012
- \$340,000 for all other policies

STRATA SCHEMES OF FOUR OR MORE STOREYS

Home Owners Warranty Insurance is not required with respect to strata scheme buildings of four or more storeys.

This exception has caused much hardship to strata owners

in the past. However, as of 1 January 2018, a 'Strata Building Bond and Inspection Scheme' applies, which creates a fund owners may be able to access if necessary.

The Scheme is governed by the Strata Schemes Management Act, and required developers to lodge a bond equivalent to 2% of the cost of the building work with NSW Fair Trading.

In order to recover the bond the developer must obtain a defect reports from an approved consultant within 15 to 18 months, and another within 21 to 24 months. The bond can then be used to meet the cost of rectifying defects.

This is a tightly regulated scheme, with time limits. Owners to whom the scheme applies must inform themselves to ensure the preservation of any recovery rights.

DESIGN AND BUILDING PRACTITIONERS ACT 2020 ANYONE INVOLVED IN THE CONSTRUCTION PROCESS

The Design and Building Practitioners Act 2020 (NSW) opens up the potential for negligence claims that have previously been restricted by case law. It essentially means that anyone involved in the construction of the owners' property owes the owners a duty of care to avoid causing those owners economic loss because of building defects.

The duty of care is not limited to those involved in the building work, but also those involved in the design, manufacture of products or project management and supervision.

In many instances the construction professionals involved will have professional indemnity insurance, providing owners with a greater degree of comfort that successful claims will be paid.

The limitation period is six years from the date on which the defect (or defects) first became apparent or should reasonably have been apparent. In many instances this may provide owners with an alternative if for some reason they are unable to pursue a breach of warranty claim under the Home Building Act. Interestingly, the duty of care has been made retrospective, so applies to defects discovered after 2014, and

perhaps later.

As a general rule claims in relation to building defects will be better pursued under the Home Building Act, which provides a more straightforward route to recovery. Claims under the Design and Building Practitioners Act 2020 (NSW) will have more complex evidentiary requirements, and may raise as yet untested legal issues in interpreting the new legislation.

The Design and Building Practitioners Act 2020 (NSW), expressly excludes certifiers from the duty of care. This is a serious omission, and if relevant owners may still wish to consider whether they should pursue a negligence action against a certifier at common law.

THE OWNERS PAY!

Because of the legal duties imposed on Owners Corporations they will rarely avoid the cost of rectifying building defects to the common property. Unfortunately the various legal and insurance avenues available do not provide strata owners with a complete safety net. All too often owners lose recovery rights by failing to take required actions within the required time periods.

These actions include:

- Obtaining early legal advice as to the date on which the building work was completed (the rules will vary depending on the date of the building contract), and recording and diarising the dates on which the warranty periods will expire.
- Establishing whether there is Home Owners Warranty Insurance, and if so the identity of the relevant insurer. Alternatively, establishing whether the 'Strata Building Bond and Inspection Scheme' applies, and if so obtaining confirmation from NSW Fair Trading that the developer has lodged the required bond, and diarising the dates for building reports, and then acting on those building reports.
- If the 'Strata Building Bond and Inspection Scheme', does not apply, the owners should obtain their own building report well before the expiry of the warranty periods. This will vary depending on the circumstances of each building, but six months before the expiry of the warranty periods is generally a good guide.
- Keep of record of building defects reported by lot owners. If urgent repair is required keep a detailed record of the defect and related repairs, including photographs.
- Provide the builder and developer with any building defects report well before the expiry of the warranty periods, and demand a response as to how the builder and developer will rectify these defects within the warranty period.
- If the owners are not satisfied that the builder and developer have not rectified defects prior to the expiry of a warranty period, and if the costs involved are significant, then the owners should commence legal proceedings before the relevant warranty period expires. Failure to do so may cause recovery rights to be lost. This does not prevent any claim from being settled amicably – on the contrary. (There is some suggestion that rather than commence legal proceedings, warranty rights can be preserved by a deed. That is questionable – such a deed has yet to pass the test before a court or tribunal.)
- If in doubt seek expert legal advice.



CONTENT PROVIDED BY BANNERMANS LAWYERS

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