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Unsafe as houses

Owner-builders and conveyancing

Failure to check that prospective owner-builder vendors have complied with their legal obligations can have severe repercussions for conveyancing practitioners. By Russell Cocks

Purchasers of new homes are consumers and recent governments (particularly in Victoria) have been dedicated to consumer protection. Thus the law has had some degree of protection for buyers of new homes for close to a quarter of a century. While this is of no particular importance to those involved in conveyancing, the enforcement of the requirements and subsequent add-ons have made owner-builder obligations relevant to the conveyancing process and a good understanding of the requirements is necessary.

Consumer protection scheme

In its simplest form, this consumer protection regime requires a builder of a new home to give the owner a policy of insurance protecting the owner from structural defects for six and a half years and from non-structural defects for two years. This regime does not involve conveyancing practitioners and, so long as the owner remains the owner for six and a half years, we have no interest. But if the property is sold within that period, the new owner is entitled to the benefit of the insurance and the representative of the purchaser is expected to ascertain details of the policy and pass them on to the purchaser.

However, there is a widely held belief that the vendor in such circumstances has a legal obligation to facilitate the transfer of the policy to the purchaser. This is not correct. The vendor has no obligation to disclose the existence of builder's warranty insurance, no obligation to respond to requisitions about its existence and no obligation to facilitate its transfer. Some vendors, as a matter of marketing or courtesy, may disclose such insurance, may respond to inquiries and may leave the policy on the kitchen bench when they vacate, but they have no legal obligation to do so.

ILLUSTRATION PAT CAMPBELL

One of the early extensions to the consumer protection scheme was to apply it not only to construction of a new home by a builder, but also to renovations or extensions of homes undertaken by builders. Building warranty insurance is now required to be provided by a builder in relation to any domestic building work performed by a builder for an owner in excess of $12,000. Again, this is not relevant to the conveyancing process if the owner retains ownership for more than six and a half years, but is relevant to a purchaser who buys the property within that time.

Various penalties are imposed on builders who breach these requirements and owners who sign building contracts that do not comply with these and other consumer protection obligations may avoid those contracts. But this is of little relevance to the conveyancer. What is of significance in the conveyancing context is the next extension to the scheme.

Most new homes and many renovations and extensions are built by builders. However, some new homes (approximately 10 per cent) and many renovations and extensions (approximately 30 per cent) are undertaken by owner-builders – people who own the land (or home) and build a new home (or extension or renovation) on their land. While the owner-builder remains the owner of the new home (or renovation) the government has no interest. But if the owner-builder seeks to sell the property within six years and six months, the government has decided that they too should provide insurance to the purchaser. Thus a domestic owner-builder who proposes to sell a property that they built or renovated in the last six years and six months is required to take certain steps before entering into a sale.

One further extension of the scheme took place in the mid-1990s. The Victorian government was also concerned about purchasers of properties built by owner-builders that were not domestic properties, including commercial properties such as lock-up shops and small factories. The government does not impose an insurance requirement if such properties are sold, but does require such owner-builders to warn prospective purchasers of any defects in such properties by requiring the owner-builder to append a condition report to any proposed contract of sale if the property is sold within 10 years of construction.

Thus s137B of the *Building Act* 1993 (Vic) establishes a regime requiring prospective owner-builder vendors to undertake certain steps prior to entering into a contract for the sale of land and prescribes consequences for lack of compliance. It is here that the regime is of most significance to the conveyancing process as the government chose to give the scheme teeth by making any contract of sale that an owner-builder enters into in breach of those obligations voidable at the option of the purchaser and including a disclosure obligation which, if breached, also makes the contract voidable. Given that the conveyancing process is predicated on the enforceability of contracts, any possible exception to that principle is of great significance to those involved in conveyancing. It exposes a vendor's representative to an allegation of negligence if the obligations are not explained and a purchaser's representative to such an allegation if compliance is not checked.

Disclosure obligation

Before considering the obligations themselves, which fall into three categories, it is first necessary to understand the disclosure obligation. As mentioned above, a vendor of real estate has no obligation to disclose the existence of the builder's warranty insurance. However, an owner-builder seeking to sell real estate is obliged to disclose the existence of required owner-builder warranty insurance in the vendor statement required by s32 of the *Sale of Land Act*.

Thus, the crucial question is: when will an owner-builder be required to insure?

This is set out in ss137B of the *Building Act* 1993 (Vic):

- ***a person who constructs a building***
  This is not limited to owner-builders – it includes all persons, including registered builders. It is not limited to construction, as "construct" is defined in sub-s7 to include build, alter and extend. It therefore applies to owner-builder constructors and owner-builder renovators. It is not limited to domestic buildings, so it extends to owner-builders of commercial premises, as well as owner-builders of domestic premises.
- ***must not enter into a contract to sell the building***
  This is concerned with the sale of the building after construction by the person who constructed it. It therefore covers not only owner-builders, but also builder-owners, being registered builders who also own the land being sold rather than having simply constructed the property for the owner of the land.
- ***within the prescribed period*** **(discussed below)** ***unless required insurance is obtained***
  Section 135 allows the Minister to require certain persons to have insurance. The current Ministerial Order, effective from 1 July 2003, requires owner-builders of major domestic work (more than $12,000) to obtain insurance if they propose to sell the property. This requirement therefore applies to domestic owner-builder constructors and domestic owner-builder renovators for works over $12,000. It does not apply to owner-builders of commercial premises. If an owner-builder undertakes work on the property in identifiable stages, it may be that insurance will only be required if any one of the stages exceeds $12,000 in value. The Ministerial Order requires insurance if "the value of that building work exceeded $12,000 at the time the work was carried out". It may be argued that it is irrelevant that the value of all of the work done exceeds $12,000 if no single stage exceeds $12,000.
- ***in the case of a person other than a registered building practitioner a condition report is obtained***
  (applies to an owner-builder, but not a registered builder-owner)
- ***warranties are included in the contract (sale of home only)***
  (This is limited to the sale of a home and does not apply to commercial premises. The warranties are set out in s137C.)

It is important to understand that these are three separate and distinct obligations. Sometimes all three apply, sometimes two and sometimes just one. Applying these principles to the various categories, the requirements are:

1. Domestic builder-owner constructor (registered builder)
- no condition report required
- must have insurance (full construction – assume more than $12,000)
- warranties

2. Domestic builder-owner renovator (registered builder)
- no condition report required
- must have insurance (if more than $12,000)
- warranties

3. Domestic owner-builder constructor (not registered builder)
- condition report
- insurance (full construction – assume more than $12,000)
- warranties

4. Domestic owner-builder renovator (not registered builder)
- condition report
- insurance (if more than $12,000)
- warranties

5. Commercial owner-builder (constructor or renovator) (not registered builder)
- condition report only

Prescribed period

There is some uncertainty in relation to the prescribed period. The *Building Act* appears to lead to one conclusion and the Ministerial Order to another. It is doubtful that a Ministerial Order can take precedence over an Act, but the insurers appear to be following the Ministerial Order line, so for the sake of practicalities it seems best to adopt that view.

The insurance that is "required" by the Ministerial Order must now be obtained to cover:
- structural defects for a period of six years after completion of the works; and
- non-structural defects for two years after completion.

This change has been achieved without amendment to the *Building Act* simply by specifying a lesser insurance requirement within the Ministerial Order. As only that insurance is required, that is the only insurance that owner-builders are able to buy.

A domestic owner-builder who proposes to sell a property that they built or renovated in the last six years and six months is required to take certain steps before entering into a sale.

No permit obtained

An owner-builder would be unlikely to construct a building without obtaining a building permit, but it is common for owner-builders to undertake improvement work without obtaining a permit – indeed, much of this work does not require a permit. Such work clearly falls within the definition of "construct", but were owner-builder obligations intended to arise if a permit was not obtained?

I understand that the intention of the legislation drafters was that the obligations should extend to non-permit work. However, the obligations were drafted on the assumption that a building permit would be obtained, as the "prescribed period" was based on certificates that could only be issued if a building permit had been obtained. Indeed, the Minister's second reading speech referred to obligations arising when building permits were obtained. Thus it may be argued that the owner-builder obligations do not arise in relation to construction work that was undertaken without a permit.

However, an owner-builder wishing to be certain of a sale would be wise to comply. Not many vendors can afford to take the risk that a purchaser will seek to avoid a contract for any reason, let alone one that can be avoided. However, if the vendor gives written instructions to sell without complying with the legislation, it is not for conveyancing practitioners to dispute their clients' decisions.

Restrictions on owner-builders obtaining permits

The first Ministerial Order (1996) included restrictions on owner-builders obtaining permits, but then the restrictions were removed and in recent years owner-builders have been able to obtain building permits on an unrestricted basis. The *Building (Amendment) Act* 2004 (Vic), which came into effect in October 2004 has reintroduced the restrictions.

Owner-builders must obtain a "certificate of consent" from the Building Control Commission before being granted a permit in respect of works costing more than $12,000. More than one certificate may be issued in respect of the same property, but no owner-builder can obtain a certificate in respect of more than one property in any three-year period.

This is designed to eliminate "professional" owner-builders who are really unregistered builders.

Contracts conditional on obtaining insurance

The Ministerial Order that came into effect on 1 December 1998 allowed an owner-builder who was obliged to obtain insurance under s137B to enter into a contract of sale conditionally on obtaining insurance. No money, including a deposit, could be payable under that contract until the policy was issued. Only insurance could be delayed, not the report or warranties.

However, this provision has not been included in subsequent Ministerial Orders. Therefore owner-builders cannot sell subject to obtaining insurance.

Liability of mortgagees and subsequent owners

The previous regime extended owner-builder duties to two other categories:

- subsequent owners, being people who purchased from owner-builders; and
- mortgagees of owner-builders.

However, the *Building Act* does not do so. Nevertheless, the Ministerial Order does seek to extend the owner-builder obligations to executors and mortgagees of owner-builders. There is no attempt to extend it to subsequent owners.

Pre-selling homes under construction

Many homes are built by builders for owners. The building contract will comply with various requirements (particularly

a 5 per cent deposit and five-day cooling off period) and will include details of the builder's warranty insurance. Sometimes a builder may enter into a building contract with a person who is the owner of the land, but is having the property constructed as part of a commercial enterprise for re-sale rather than to live in. Such owners may be referred to as "developers". When the home is complete, the developer may sell it to a purchaser pursuant to a normal contract for the sale of real estate and the purchaser will take the benefit of the building warranty insurance that flowed out of the prior building contract.

The developer may wish to sell the land and building prior to completion of construction. This is particularly common in large scale apartment developments where the land itself is the subject of a plan of subdivision that is proceeding towards registration in tandem with construction of the apartments pursuant to the building contract between the developer and the builder. The sale will be conditional on completion of construction and registration of the plan. Such arrangements are known as "off-the-plan" sales.

The important fact in these arrangements is that there are two separate contracts – one between the builder and the owner/developer and one between the developer and the end-purchaser. This is important as all the building obligations are quarantined into the building contract, which must therefore comply with the *Domestic Building Contracts Act* 1995 (Vic) (5 per cent deposit, five-day cooling off period). The contract of sale of land therefore has no building obligations and thus no need to comply with these requirements.

Mirvac v Philp[1]

Philp wanted to avoid an off-the-plan contract. He could do so if he could establish that the contract of sale was a building contract, as that contract (as a normal contract for the sale of land) had a 10 per cent deposit and three-day cooling off period. The Victorian Civil and Administrative Tribunal and the Victorian Supreme Court accepted the argument that as Mirvac had "arranged" for the property to be built, it was therefore a builder. It followed that the land contract was therefore a building contract and thus voidable. This aberration, which meant that there were in fact two building contracts relating to the property, was cured by the *Domestic Building Contracts (Amendment) Act* in May 2004 that confirmed that a contract for the sale of land would not be a building contract if it made reference to a building contract for the construction of the building between the developer and the builder that was, or would come into, existence. This re-established the status quo.

Owner-builders cannot pre-sell

A developer can pre-sell as the land contract does not include any building obligations – these are quarantined in the building contract. A registered builder can also pre-sell, provided that a separate building contract is used to quarantine the building obligations.

However, an owner-builder cannot pre-sell as there is only one contract – the contract of sale between the owner-builder and the purchaser. There is no separate building contract as, by definition, there is no separate builder. Even if owner-builders were to seek to structure the contract of sale to comply with the requirements of the *Domestic Building Contracts Act* (5 per cent deposit and five-day cooling off period), they could not comply with two other requirements:

- the contract must include a condition report; and
- insurance must be in place prior to the contract.

By definition, the condition report cannot be completed until the building works are complete and an owner-builder cannot obtain insurance without a condition report.

Therefore an owner-builder is unable to pre-sell (not that this will stop them from trying).

Conclusion

A large portion of the time taken to conduct a residential conveyancing file is devoted to understanding the extent, if any, of the building warranty insurance applicable to the property. A clear understanding of the legislative requirements underpinning these issues is necessary if pitfalls are to be avoided in this area. ●

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1. 2004 VSC 301.