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DEVELOPER BUILDING BONDS

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OVERVIEW

Due to changes in the *Strata Schemes Management Act 2015* (NSW) (**the SSMA**) and the *Strata Schemes Management Regulation 2016* (NSW) (**the SSMR**) which commenced on 1 January 2018, developers are now required to lodge a building bond with NSW Fair Trading on behalf of the Department of Finance, Services and Innovation (**the Secretary**), to the value of 2 percent of the contract value for works (**the Bond**).

The requirement for the lodgement of the Bond applies to residential or mixed use strata buildings, which are four or more storeys, and where contracts have been entered into, or where work commences, on or after 1 January 2018.

The purpose of the Bond is to secure funding for the payment of the cost of rectifying defective building work identified in a final report under the SSMA (up to the amount secured by the Bond).

According to the Second Reading Speech, the purpose of the amendments are to “*incentivise developers and builders to build well and to fix any problems early in the life of the building*”.¹








A Guide published by NSW Fair Trading sets out 7 key stages in the Bond process,² which are summarised in this eBook. A helpful timeline that sets out the stages is also annexed.



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¹ Page 8, Second Reading Speech
² <https://www.fairtrading.nsw.gov.au/housing-and-property/strata-building-bond-and-inspections-scheme>

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Stage 1 LODGEMENT OF THE BUILDING BOND

When is the Bond to be lodged?

Stage 1 requires the Bond to be lodged by the developer with NSW Fair Trading for residential and mixed use buildings which are four storeys or higher. Buildings up to three storeys are covered by Home Building Compensation Insurance.

For building contracts entered into on or after 1 January 2018, or where work commenced on or after this date, the Bond must be lodged on Fair Trading's online portal:

- at any time after building works commence; and
- before the issue of an occupation certificate for the Strata Scheme.

How is the Bond lodged?

To lodge the Bond:

1. The Developer must give the Secretary the Bond;¹
2. The Bond must be accompanied with:
 - (a) a lodgement form; and
 - (b) details of the strata plan number;²
3. The value of the Bond must be 2 percent of the contract price for the building works;³
4. The value of the Bond price is calculated:
 - (a) on the total price paid under all the applicable contracts for the building work as at the date of issue of the occupation certificate;⁴ or

- (b) where there is no written contract, on the basis of the cost contained in a report prepared by a quantity surveyor who is a member of the Australian Institute of Quantity Surveyors

What is the form of the Bond?

1. The Bond can be in the form of:
 - (a) a bank guarantee; or
 - (b) a bond; or
 - (c) another form of security as prescribed by the Regulations.⁵
2. The Bond can be issued by:
 - (a) an "authorised deposit-taking institution";⁶ or
 - (b) by a general insurer authorised to conduct new or renewal insurance business in Australia.⁷
3. A developer that fails to comply with the requirement to lodge the Bond may face a fine of **\$22,000.00**.⁸

1 Section 207(1) of the Strata Schemes Management Act 2015 (NSW) (the SSMA)
 2 Regulation 52 of the Strata Schemes Management Regulation 2016 (NSW) (the SSMR)
 3 Section 207(2) of the SSMA
 4 Regulation 50(1) of the SSMR
 5 Section 208 of the SSMA
 6 <https://www.apra.gov.au/register-authorized-deposit-taking-institutions>
 7 <https://www.apra.gov.au/register-general-insurance>
 8 Section 207(5) of the SSMA

Bond Lodgement

Establish account on online portal

To lodge the Bond, the developer must open an account on the “strata building bond and inspection scheme online portal” (**the Portal**) administered by Fair Trading,⁹ which can be completed at any time after the commencement of works.

Once the account has been created, documents can be uploaded to the Portal progressively as and when they become available.

Information required to be uploaded

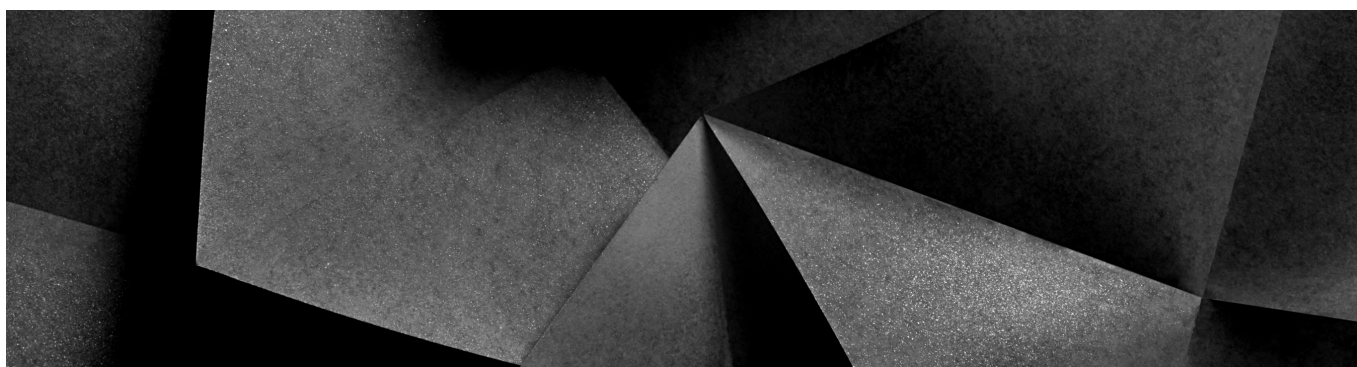
The developer is required to pay a lodgement fee of \$1,500.00¹⁰ and upload various documents and information to the Portal, which include:¹¹

- A Lodgement Form in the form approved by the Secretary;
- The Strata Plan number for the relevant Strata Scheme;
- The name and address for the Principal Certifying Authority for any building work to which the Bond relates;
- An address for service on the developer; and
- An address for service on the Owners Corporation for the Strata Scheme.

Additional Documents

Under the SSMR, documents required to be uploaded to the Portal could include the following:¹²

- any documents relevant to determine the contract price used to calculate the Bond amount;
- the building contract or contracts for the relevant work;
- specifications for the building work, and any variations;
- any written warranties relating to the building work;
- any schedule of non-conforming work relating to the building work;
- all ‘issued for construction’ and ‘as-built’ drawings and specifications relating to the building work;
- any schedule of approved samples relating to the building work;
- any development consent or other consents, approvals or certificates issued under the *Environmental Planning and Assessment Act 1979* (NSW) and relating to the building work;
- any alternative solutions and fire engineering reports, and the applicable assessment and approval by the Principal Certifying Authority, relating to the building work;
- any design certificates relating to the building work;
- any design certificates relating to the building work;
- Building Code of Australia compliance certificates by each subcontractor for any part of the building work carried out by the subcontractor; and



9 <http://reg.force.com/StrataBondDeveloper>
10 Schedule 4 of the SSMR
11 Regulation 52 of the SSMR
12 Ibid



- any inspection report obtained by the developer or builder relating to the building work.

This information and documentation is then considered by the Secretary. The Secretary will then either approve or reject the Bond.

If the Bond is **rejected**, further information and documentation may be required to be provided by the developer.

If the Bond is **accepted**, the developer is able to lodge the Bond.

Stage 2



APPOINT A BUILDING INSPECTOR

When must the building inspector be appointed?

Within **12 months** after the completion of the works, the developer must notify the Secretary and the Owners Corporation of the proposed independent building inspector (**Inspector**).

Completion of the works for Strata Schemes means the date of issue of an occupation certificate which authorises the occupation and use of the whole of the building.¹³

Criteria of the Inspector

The Inspector must meet the following criteria:

Member of certain association or bodies

1. The Inspector must be a member of a Strata Inspector Panel established by certain associations or bodies;¹⁴
2. Those bodies only include the following:
 - (a) the Housing Industry Association;
 - (b) the Master Builders Association of New South Wales;
 - (c) the Australian Institute of Building;
 - (d) the Australian Institute of Building Surveyors;
 - (e) the Australian Institute of Building Consultants;
 - (f) the institute of Building Consultants Inc;

- (g) Engineers Australia;
- (h) the Australian Institute of Architects; and
- (i) the Association of Accredited Certifiers.

No connection with developer

3. The developer **must not** appoint an Inspector if the Inspector was at any time in the **2 years** immediately prior to the appointment, "connected" with the developer ("connected" is given a wide meaning to include the Inspector being involved in any aspect of the construction of the relevant building work, including any design works);¹⁵

Duty of disclosure

4. The Inspector also has an obligation to disclose previous employment by the developer or a contractor of that developer, which occurred within the period of 2 years prior to the Inspector's appointment;¹⁷ and

Impartiality of the Inspector

5. The Inspector must act impartially in performing their functions as the building inspector and must not represent the interests of the developer.¹⁸

¹³ Section 190(2) of the SSMA and Section 3C(2)(a) of the Home Building Act 1989 (NSW)

¹⁴ Regulation 45 of the SSMR

¹⁵ Section 197(1) of the SSMA

¹⁶ Section 197(2) of the SSMA

¹⁷ Regulation 46 of the SSMR

¹⁸ Section 198(1) of the SSMA

Approval Required by the Owners Corporation

Once the Inspector has been selected by the developer, the details of the Inspector are uploaded to the Portal.

The Portal will then notify:

1. The Inspector of their proposed appointment; and
2. The Owners Corporation of the proposed appointment, along with any disclosures made by the developer in relation to the Inspector.

The Owners Corporation must agree to the appointment of an Inspector, prior to that Inspector being appointed.¹⁹

If the Owners Corporation approves the appointment through the Portal, the Inspector will be formally appointed as the building inspector.

Rejection of proposed Inspector or failure to appoint

Rejection by Owners Corporation

If the Owners Corporation rejects the Inspector, the same process is repeated until either:

1. The 12 month period expires; or

2. The Owners Corporation approves an Inspector, whichever occurs earlier.

If developer fails to appoint

If the developers fail to appoint an Inspector by the required time:

1. The developer must notify the Secretary through the Portal of this within 21 days after the 12 month period;²⁰ and
2. The Secretary will subsequently appoint the Inspector, which will be notified to the parties through the Portal.²¹

Owners Corporation to notify

The Owners Corporation must also notify the developer and Secretary of any approval or rejection of the appointment of the Inspector proposed by the developer within 14 days of the making of that decision.²²

Owners of a lot in a strata scheme can also object to the proposed appointment of the Inspector by the Secretary provided the Inspector has not carried out an interim inspection.²³

Who pays the Inspector's costs?

The developer is required to pay all costs associated with the Inspector, even if the Inspector is appointed by the Secretary.²⁴



19 Section 195(1) of the SSMA
 20 Section 194(1)(b) of the SSMA
 21 Section 196(1) of the SSMA
 22 Section 195(4) of the SSMA
 23 Section 196(2) of the SSMA
 24 Section 204(1) of the SSMA

Stage 3



INTERIM REPORT BY THE INSPECTOR

Timing and contents of Interim Report

Between 15 to 18 months after completion of the building works, the Inspector is required to provide an “interim” report (**Interim Report**), which must:

1. Be in the form approved by the Secretary;
2. Identify any defective building work; and
3. If reasonably practicable, identify the cause of that defective building work.

For the purposes of preparing the Interim Report and inspecting individual lots, the Inspector is required to give at least **14 days** written notice to the Owners Corporation and occupiers of lots of the Inspector's intention to enter any part of the Strata Scheme.²⁷

The Secretary has the power to vary the time in which the Interim Report is provided, if it is appropriate to do so in the circumstances (this can be by application of the developer, Owners Corporation, the Inspector or the Secretary).²⁸

Service of Interim Report on the parties

Within **14 days** after the Interim Report has been completed, the Inspector must provide a copy of the Interim Report to the:²⁹

1. Developer;
2. Owners Corporation;
3. Secretary; and
4. Builder responsible for any defective work identified in the report.

Within **14 days** after the Owners Corporation receives the Interim Report, the Owners Corporation must give the Interim Report to the individual lot owners concerned in the Scheme.³⁰

²⁴ Section 199(2)(a) of the SSMA and Regulation 47 of the SSMR

²⁵ Section 199(2)(b) of the SSMA

²⁶ Section 199(2)(c) of the SSMA

²⁷ Section 203(2) of the SSMA

²⁸ Section 212(1) of the SSMA

²⁹ Section 202(1) of the SSMA

³⁰ Section 202(2) of the SSMA

Stage 4



RECTIFICATION OF DEFECTS BY THE BUILDER

The builder responsible for the defective work as identified in the Interim Report is required to rectify those defects before the final inspection is carried out by the Inspector.³¹

For the purposes of arranging any inspections to individual lots for rectification works, the builder must give the Owners Corporation, the developer and individual lot owners at least **14 days** written notice prior to any proposed inspection being carried out.

The Secretary has the power to refuse a claim for the Bond by the Owners Corporation if the developer or builder is unreasonably refused access to the strata parcel.³²



31 Section 206(1) of the SSMA
32 Section 209(5) of the SSMA

Stage 5



FINAL REPORT BY THE INSPECTOR

Timing of Final Report

Between 21-24 months after completion of the building work, the developer must arrange for the Inspector to carry out a final inspection and provide a final report (**Final Report**), and notify the Secretary of the date for the final inspection.³³

If the original inspector is not available, the developer is required to notify the Secretary of that fact, no later than **14 days** of becoming aware.³⁴

In this case, the Secretary will then appoint the building inspector who will carry out the final inspection and prepare the Final Report,³⁵ which must be uploaded to the Portal between **21 to 24 months** after completion of the building work.³⁶

Contents of the Final Report

The Final Report must:³⁷

1. Be in the form approved by the Secretary;³⁸
2. Identify defective building work contained in the Interim Report which has not been rectified by the builder;
3. Identify any defective building work arising from rectification works carried out by the builder; and
4. Specify how the defective building work identified in the Final Report should be rectified.

What if a Final Report is not required?

If the Interim Report was prepared by the Inspector appointed by the developer and does not identify any defects, the developer may make an application to the Secretary for a determination that it is not required to arrange the Final Report.³⁹

The Secretary may on such an application:

1. Determine that a Final Report is not required;⁴⁰ and
2. Notify the Owners Corporation no later than 28 days after that decision is made.⁴¹

The Secretary may also make this determination if the Inspector that prepared the Interim Report was appointed by the Secretary, as long as the Interim Report did not identify any defects.⁴²

In the above case, the Bond will be released to the developer which is explained in further detail later in this eBook.

³³ Section 2001(1)(a) of the SSMA

³⁴ Section 200(1)(b) of the SSMA

³⁵ Section 200(2) of the SSMA

³⁶ Section 201(1) of the SSMA

³⁷ Section 201(2) of the SSMA

³⁸ Section 201(2)(a) of the SSMA and Regulation 48 of the SSMR

³⁹ Section 200(4) of the SSMA

⁴⁰ Section 200(4) of the SSMA

⁴¹ Section 200(5) of the SSMA

⁴² Section 200(3) of the SSMA



Stage 6

PAYMENT OF THE BOND

If there are no defects identified in the Final Report, the Bond is released in full to the developer through the issuer of the Bond.

Time in which the claim must be made

Any claim to the Bond must be made by the Owners Corporation within **14 days prior** to the expiry of the latest of the following dates:⁴³

1. 2 years after the date of completion of building works; or
2. 60 days after the Final Report is given by the Inspector to the Secretary.⁴⁴

Purposes for which the Bond can be used

Any part of the Bond (or the entirety of the Bond) may be claimed by the Owners Corporation or realised by the Secretary for the following:⁴⁵

1. To the Owners Corporation to meet costs for rectifying defective building work identified in the Final Report; or
2. To the Owners Corporation with the consent of the developer, if an application is made by the Secretary.

Amount of the Bond which can be used

The cost of rectification must be agreed between the developer and the Owners Corporation.

Absent any agreement, the Secretary will appoint a quantity surveyor to determine the cost to rectify defects, based on the defects identified in the Final Report.

The cost of such an appointment will be borne by the Owners Corporation and the Developer equally (which appears to be an attempt to incentivise the Owners Corporation to act reasonably as to the quantification of defects).

Use of the Bond once value of defects is determined

If the Secretary intends to make any payment out of the Bond, it must provide **14 days'** notice to the Owners Corporation and the developer, prior to the Bond being utilised.⁴⁶

43 Section 209(1) of the SSMA
44 Section 209(3) of the SSMA
45 Section 209(1) of the SSMA
46 Section 209(6) of the SSMA



The developer cannot impede the use of the Bond and in fact has positive obligations to assist the Secretary in that regard.⁴⁷

If the developer does not comply with its obligations to assist the Secretary, there is a maximum fine of **\$1,100.00**.⁴⁸

What happens if there is an overpayment to the Owners Corporation?

The Owners Corporation must repay any excess amounts to the developer and must also provide written notice to the developer that the defective works identified in the Final Report have been rectified.

If the Owners Corporation fail to comply with this requirement, it faces a maximum fine of **\$1,100.00**.⁴⁹

47 Section 209(4) of the SSMA

48 Ibid

49 Section 210(3) of the SSMA



Stage 7



COMPLETING THE PROCESS

The legislative changes are unclear in relation to what triggers the release of the remaining part of the Bond (if any) back to the developer.

It does, however, appear that the release of Bond back to the developer is triggered by the notification by the Owners Corporation that defects have been rectified (as it appears logical that if no further right to the Bond existed, it should be paid back to the developer).

Once the above notification has occurred, it is suggested that the developer notifies the Secretary through the Portal and requests for the balance of the Bond to be returned.

The legislative changes are also unclear in relation to the timing of this refund back to the developer.

REVIEWABLE DECISIONS

Types of decisions which can be reviewed

The following decisions are reviewable:⁵⁰

1. A decision to appoint an Inspector to provide a Final Report;
2. A determination that the developer is not required to arrange a Final Report;
3. A decision to vary the time period within which an Interim Report or Final Report (or any other action) is to be done; and
4. A decision that the whole or part of the Bond may be claimed for payment to an Owners Corporation, developer, or other person.

Any request for a review must be made within 14 days of the relevant decision.⁵¹

Who reviews the decision:

If the reviewer is not the Secretary, that reviewer must be approved by the Secretary⁵² and must be an individual who:⁵³

1. Was not substantially involved in the process of making the decision subject of the review;
2. Is a member of staff of the Department of Finance, Services and Innovation; and
3. Is suitably qualified to deal with the issues raised by the application.

⁵⁰ Section 213(3) of the SSMA and Regulation 56 of the SSMR

⁵¹ Regulation 56(3) of the SSMR

⁵² Section 213(5) of the SSMA

⁵³ Section 213(6) of the SSMA

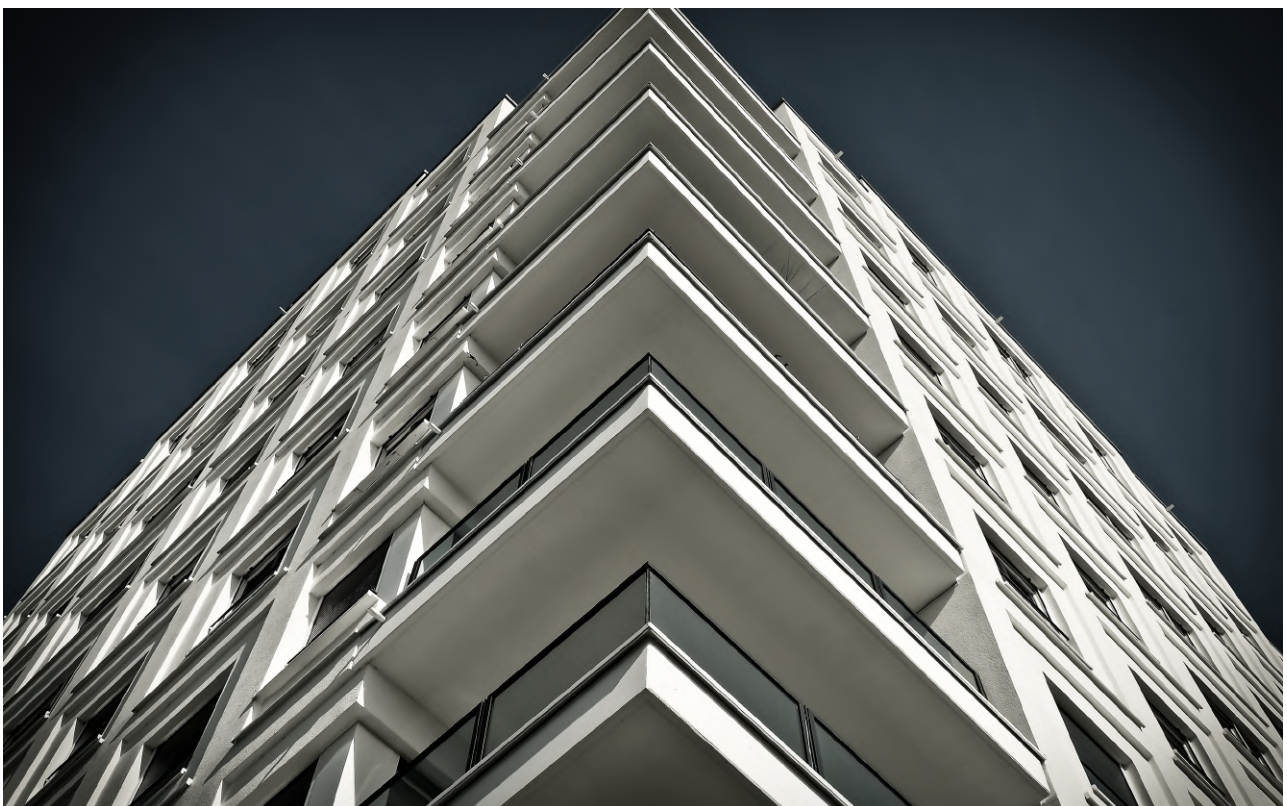
WHAT ARE THE IMPLICATIONS?

The Bond process will impact on contractual terms for all stakeholders involved in carrying out work on residential or mixed use construction projects, particularly in relation to the requirements for practical completion, the defects liability period and the release of security.

This is because both the developer and builder will attempt to shift their risk and obligations down the contracting chain to limit their exposure, which may mean for example longer defects liability periods and a later release of security.

The developer should also be aware that these amendments are in addition to the rights of an Owners Corporation pursuant to Part C of the *Home Building Act 1989* (NSW) (**the HBA**) which relates to statutory warranties.

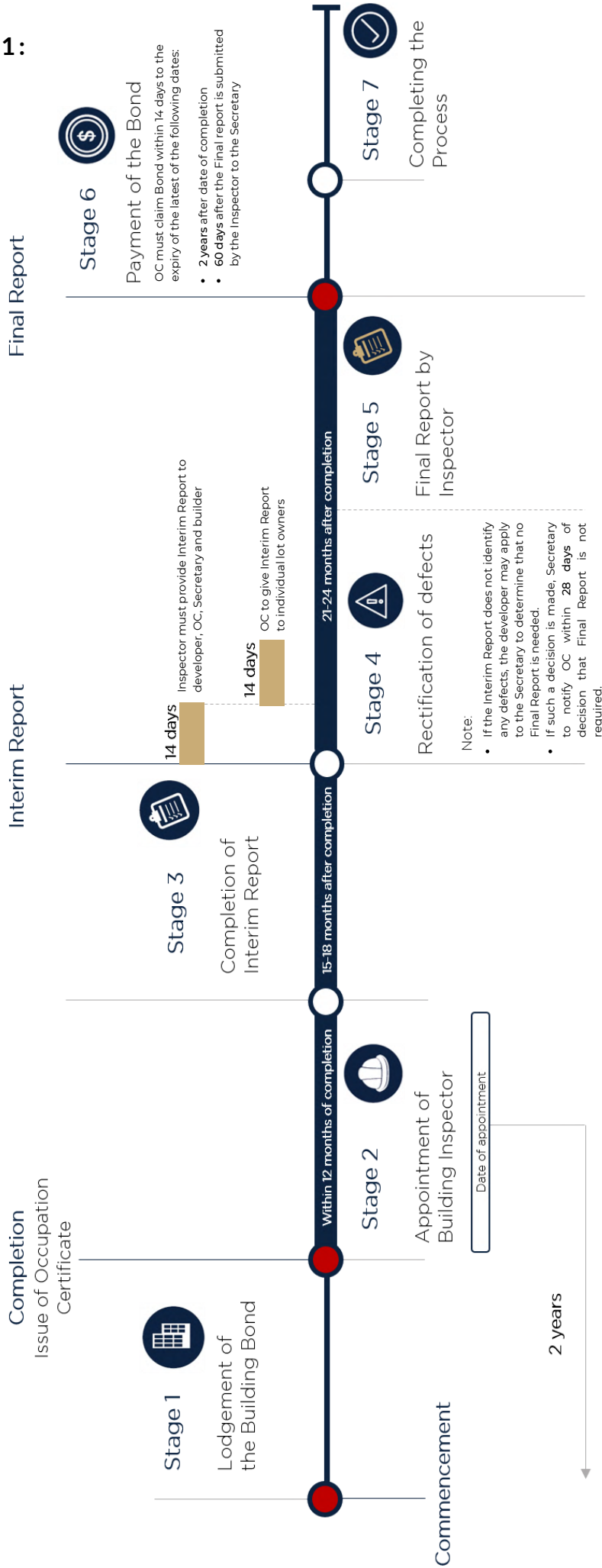
For example, if no defects are identified in the Interim Report, this does not mean that the developer is free from any claim, as the statutory warranty period contained within the HBA would still be applicable (2 years for non-major defects and 6 years for major defects) and it would be open to the Owners Corporation to take action in the appropriate forum.⁵⁴



DEVELOPER BOND TIMELINE

Appendix 1:

For contracts entered into on or after 1 January 2018, or if no contract, where work commences on or after that date



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