

# **Housing Regulation in Victoria**

## **Building Better Outcomes**

**Final Report October 2005**



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# About the Victorian Competition and Efficiency Commission

The Victorian Competition and Efficiency Commission is the Victorian Government's principal body advising on business regulation reform and identifying opportunities for improving Victoria's competitive position.

The Commission has three core functions:

- reviewing regulatory impact statements and advising on the economic impact of significant new legislation
- undertaking inquiries into matters referred to it by the Victorian Government
- improving the awareness of, and compliance with, competitive neutrality.

For further information on the Victorian Competition and Efficiency Commission, visit our website at: [www.vcec.vic.gov.au](http://www.vcec.vic.gov.au).





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17 October 2005

The Hon. John Brumby, MP  
Treasurer  
Level 4, 1 Treasury Place  
East Melbourne VIC 3002

Dear Treasurer

**Inquiry into regulation of the housing construction sector and related issues**

In accordance with the terms of reference received by the Commission on 10 November 2004, we have pleasure in submitting to you the Commission's final report on *Housing regulation in Victoria: building better outcomes*.

Yours sincerely

Three handwritten signatures in black ink, corresponding to the names listed below.

Graham Evans AO  
Chair

Robert Kerr  
Presiding Commissioner

Alice Williams  
Commissioner

## Terms of Reference

### VCEC Inquiry into Regulation of the Housing Construction Sector and Related Issues

I, John Brumby MP, Treasurer, pursuant to section 4 of the *State Owned Enterprises (State Body—Victorian Competition and Efficiency Commission) Order (‘the Order’)*, hereby direct the Victorian Competition and Efficiency Commission (‘the Commission’) to conduct an inquiry into regulation of the housing construction sector in Victoria.

#### Background

Housing construction is a major sector of the Victorian economy. It creates income and jobs, and is a key driver of economic activity in several other industries.

In recent years, the issues of housing affordability, property taxes, workplace relations in the construction sector and national building regulatory reform have been examined in various Commonwealth reviews.

There has been less focus in these and other studies on state-based regulations affecting the housing construction sector. It is therefore timely to undertake a systematic and comprehensive review of Victorian regulation of the housing construction sector, to ensure that the sector meets important community needs in the most efficient and effective manner.

#### Scope of the inquiry

The Commission is to inquire into and report on:

1. the competition and other impacts of Victorian regulations affecting housing construction in the State, including, but not limited to, the approval, design, building and maintenance of housing;
2. the benefits and costs, duration and impact on competition of permits, licences and fees issued by Victorian regulatory bodies for housing construction and related practitioners;
3. opportunities to improve regulations in the sector;
4. ways to improve the processes for developing, administering and enforcing regulations in the sector;
5. current arrangements and opportunities to improve the existing development contributions system; and
6. the appropriateness of performance indicators for regulatory bodies in the Victorian housing construction sector.

Taxation arrangements, land development issues (such as land supply, zoning and infrastructure service provision), industrial relations and native vegetation management are outside the scope of this inquiry.

The Commission should take into account any substantive studies or developments undertaken in Victoria and elsewhere—including by the Commonwealth and other States, and international best practice—that may help it provide advice on this Reference.

### **Inquiry process**

In undertaking this inquiry, the Commission is to have regard to the objectives and operating principles of the Commission, as set out in section 3 of the Order. The Commission must also conduct the inquiry in accordance with section 4 of the Order.

The Commission is to consult with key interest groups and affected parties, and may hold public hearings. The Commission should also draw on the knowledge and expertise of relevant Victorian Government departments and agencies.

The Commission is to release an issues paper by 24 December 2004, which seeks submissions from interested parties on the key issues to be examined in the inquiry. The Commission is to produce a draft report by 30 June 2005, outlining recommendations for the purpose of consultation. A final report is to be provided to the Treasurer by 30 September 2005.

**JOHN BRUMBY MP**

**Treasurer**

10 November 2004

Please note:

The Treasurer amended the reporting date for the final report to 17 October 2005 to allow adequate time for further consultation with interested parties on the draft report.





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## Abbreviations

ABCB	Australian Building Codes Board
ACCC	Australian Competition and Consumer Commission
AMCA	Air Conditioning and Mechanical Contractors' Association
APRA	Australian Prudential Regulation Authority
ARBV	Architects Registration Board of Victoria
BAB	Building Appeals Board
BACV	Building Advice and Conciliation Victoria
BCA	Building Code of Australia
BIA	business impact assessment
BAB	Building Appeals Board
BPB	Building Practitioners Board
BRAC	Building Regulations Advisory Committee
CAV	Consumer Affairs Victoria
HIA	Housing Industry Association
MAV	Municipal Association of Victoria
MBAV	Master Builders Association of Victoria
OCEI	Office of the Chief Electrical Inspector
OECD	Organisation for Economic Cooperation and Development
PIAC	Plumbing Industry Advisory Council
PIC	Plumbing Industry Commission
RAIA	Royal Australian Institute of Architects
RIS	regulatory impact statement
VCAT	Victorian Civil and Administrative Tribunal
VCEC	Victorian Competition and Efficiency Commission

## Key messages

- This is a timely inquiry because good housing construction regulation is important for consumers, and the core regulatory framework is a decade old. Moreover, a large housing sector and many builders (small and large) mean regulatory efficiency is all the more important.
- The case for regulation rests on health, safety and sustainability considerations, in a sector where consumers are generally not well informed and housing is a major financial commitment. But regulation should not come at excessive cost.
- Current regulatory arrangements work reasonably well, although hard data on regulatory outcomes are surprisingly incomplete:
  - Regulatory costs have been rising and industry participants consider them excessive.
  - Regulatory costs contribute at least 4 per cent to new house construction cost, with significant variation across different types of house.
- The key elements of the regulatory architecture should be maintained—namely:
  - a Building Act and Regulations based on the (national) Building Code of Australia and its standards
  - independent statutory regulators for building and plumbing, with Consumer Affairs Victoria overseeing consumers’ contractual interests and (together with the Victorian Civil and Administrative Tribunal) handling disputes
  - building permits and practitioner registration, with consumers supported by current limited (last resort) builders warranty insurance.
- But the regulatory framework and its implementation can be improved to accord with good regulatory principles and to reduce compliance costs, to the benefit of consumers and the industry:
  - More information should be provided to both builders and consumers at least cost about how the regulations work and about the level of protection they are afforded.
  - Objectives and statutory functions can be simplified and reporting of outcomes can be improved. The Building Act currently sets out 10 loosely arranged objectives and 50 functions across five statutory bodies.
  - Increased flexibility in regulatory instruments is possible—for example, least cost pursuit of energy efficiency goals.
  - Improvements in registration, enforcement and mandatory warranty insurance are needed.
  - Some institutional links and allocation of tasks can be better arranged.
  - Costs imposed by local government need attention.
- These changes will improve a familiar environment:
  - Regulatory costs should be reduced without compromising regulatory benefits, with an attainable goal of a \$1500 reduction for a majority of new homes.
  - Moreover, the future growth in the costs of regulation should be contained, as better cost–benefit scrutiny is applied.
- The new development contributions system is soundly based, but its implementation by local councils requires independent audit scrutiny.

# Overview

## Introduction

The affordability, safety and quality of housing are vital elements in the standard of living of all Victorians. Housing has a profound effect on the quality of everyday life and is the largest single purchase most people ever make. Moreover, the size of the housing construction sector in the Victorian economy means its efficiency is important to overall resource use and economic welfare. That efficiency, together with the sector's capability to meet consumer and community needs, is affected by regulation.

In the past decade, the price of housing increased faster than incomes and housing affordability decreased for first homebuyers. Industry organisations claim that regulation in Victoria contributes unnecessarily to higher house prices, by imposing substantial costs on housing construction. Regulation can also impose indirect costs if prescriptive regulation stifles innovation in new products or processes that can improve quality or reduce costs over time.

In recent years, national reviews have examined regulation in the housing construction sector, but there has not been a detailed, state based study in Victoria. The core legislation governing Victoria's housing construction sector is now more than 10 years old, and the associated Building Regulations are due to be revisited under 'sunsetting' requirements. A review of regulation of this sector is, therefore, timely.

In this report, the Victorian Competition and Efficiency Commission concludes that the regulatory 'architecture' surrounding housing regulation in Victoria—while complicated and not easy for a typical homeowner to understand—is internally consistent and appears to have served Victorians reasonably well (although hard data to support a firm conclusion on regulatory outcomes are incomplete and need to be improved). Nevertheless, there is considerable scope for improvement, and the Commission has developed 47 recommendations to achieve this (listed at the end of this overview). These recommendations would preserve the essential health, safety and sustainability features of current regulation and lead to a less complicated, more focused, more effective and more consumer friendly regulatory environment. The regulatory objectives would be defined more precisely and the regulators' functions would better align with these objectives. Regulators would be instructed on how they are expected to operate, and improved performance reporting would enhance the transparency and accountability of their operations.

The Commission has interpreted ‘housing construction’ to embrace all residential construction—for example, both low-rise dwellings and apartments. However, while the housing construction sector is under reference, the regulation affecting it frequently applies more generally. For this reason, some of the Commission’s findings and recommendations have implications broader than the sector under review. In addition, any institutional changes will need to account for regulators’ responsibilities beyond the housing construction sector. The government will need to take this into account in addressing the Commission’s recommendations.

The Commission expects that its recommendations would reduce the cost of regulation over time. It should be a reasonable goal to reduce regulatory costs by, say, at least \$1500 for the majority of new houses, without compromising regulatory benefits. Further, improved information for consumers would support some reduction in regulation and allow consumers to pursue savings where they value them most. In the longer term, the recommendations would help to improve the quality of regulation, with new requirements only being introduced when they yield net benefits to the Victorian community.

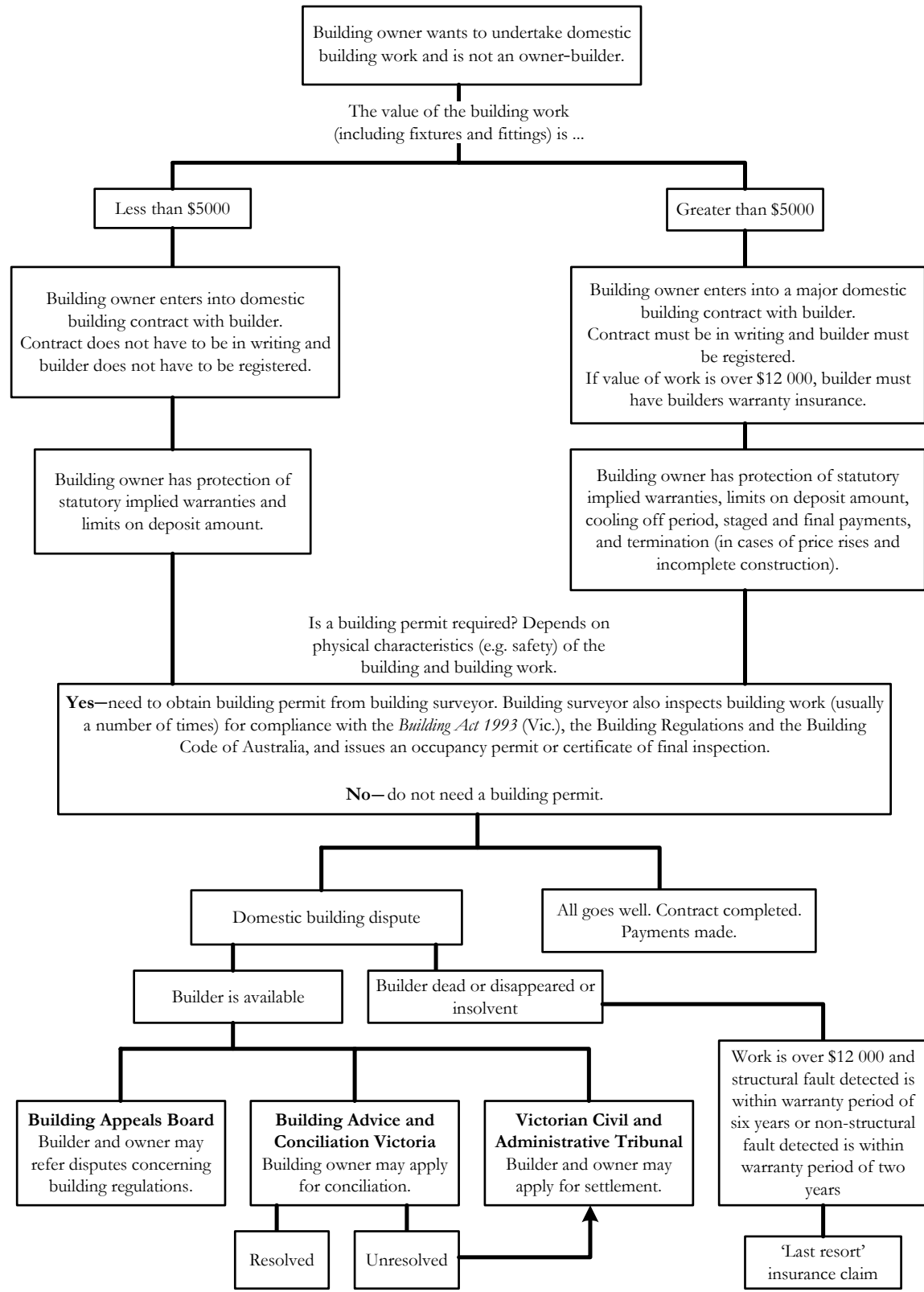
## **The regulatory framework hierarchy**

Regulation of the building process in Victoria is embodied in three main instruments: the Building Code of Australia (the minimum requirements for building practices and for aspects of building performance); state legislation, Regulations and variations to the Building Code of Australia; and local government laws. Although it has commented on local government regulation, the Commission has concentrated on core building regulation established by state legislation. While other legislation and Regulations affect housing construction in the state, the most important are the *Building Act 1993* (Vic.), the *Building Regulations 1994* (Vic.) and the *Domestic Building Contracts Act 1995* (Vic.). Figure 1 illustrates the main steps in Victoria’s regulatory process that will be triggered when a building owner wants to undertake domestic building work that is not exempt from regulation and when the owner is not an owner–builder.

The Domestic Building Contracts Act provides that the contract into which a building owner enters with a builder includes implied warranties (such as that the work will be carried out in a proper and workmanlike manner) to protect the owner. (There are exemptions—for example, for work carried out by a single trade, such as painting). In addition, the Act imposes limits on the amount of deposit and progress payments payable by the owner. Further, if the contract is for \$5000 or less, the builder does not have to be registered and the contract may be unwritten. If the contract is for more than \$5000, it is referred to as a major domestic building contract. The contract must then be in writing and the builder must be registered.

Figure 1

## Regulation of the building process



In addition to the implied statutory warranties, the owner has other protections, such as a cooling off period during which the contract may be cancelled. Further, if the value of the contract is more than \$12 000, the builder must have builders warranty insurance. This insurance protects against the consequences of structural defects in building work for six years, but only if the builder has died or disappeared or become insolvent.

Under the Building Act, domestic building work that is not exempt can be undertaken legally only if a building surveyor issues a permit. (Building work may be exempt if it does not affect the structure or safety of a building.) In most cases, the building surveyor will need to be satisfied that the builder (unless an owner-builder) is registered by the Building Practitioners Board and has domestic builders warranty insurance. The building surveyor collects levies to fund the regulatory process, inspects the building work several times during construction and issues an occupancy permit or certificate of final inspection when the work is completed.

The Domestic Building Contracts Act and, to a limited extent, the Building Act provide procedures for resolving domestic building disputes without resorting to courts and incurring the expense, uncertainty and delay that may result from court proceedings (figure 1).

## **The regulatory arrangements**

Figure 1 is a simplified description of part of the regulatory framework (the full framework is too complicated to explain in a diagram). Other aspects of the framework include:

- the multiple objectives of the Building Act, of which key elements are undefined
- the 12 other Acts (administered by five ministers) that the Commission has identified as having an impact on housing construction
- the group of organisations that administer the Building Act—the Building Commission, the Building Practitioners Board, the Building Advisory Council, the Building Regulations Advisory Committee, the Building Appeals Board, the Plumbing Industry Commission and the Plumbing Industry Advisory Council—and that have 50 statutory functions among them
- more than 1000 standards called up by the Building Code of Australia
- Consumer Affairs Victoria administering the Domestic Building Contracts Act

- the role of local governments in administering important parts of the regulatory framework and sometimes superimposing their own requirements
- the seven ways in which the Commission has identified that new regulatory obligations can be imposed, often without adequate public scrutiny.

Simplifying these regulatory arrangements would improve the effectiveness of the whole framework.

## **The case for regulation**

### **Benefits**

The case for industry-specific regulation in this sector relies on two features of housing construction:

- (1) Consumers generally do not know enough to protect their interests, owing to information imbalances between the parties engaged in housing construction.
- (2) Costs and benefits of housing construction affect people other than the direct consumer and builder (spillover effects)—for example, costs arising from adverse environmental impacts.

Benefits come from correcting for these features.

### **Information imbalances**

While consumers will generally seek goods and services with the price–quality–risk combination they want, their ability to do so is compromised when it is prohibitively expensive for them to become well informed about building processes. Further, many aspects of the building are hidden by the time a house is completed. In these circumstances, the consumer is unlikely to be fully informed about the quality and safety of the built product, both during construction and after completion.

For purchasers of residential buildings, this problem is more significant because many will be infrequent buyers with little knowledge of the construction process. Moreover, the potential costs arising from uninformed choice are significant, given the large dollar sums at risk. The Housing Industry Association (HIA) commented that:

Homeowners tend to enter into home building infrequently (possibly only once or twice in their entire life) and accordingly are unlikely to be knowledgeable about how to ascertain whether a builder is capable of delivering a quality end product. (sub. 58, p. 11)

The presence of information imbalances between consumers and suppliers is, however, not a conclusive argument for regulation. It is possible to conceive of a housing construction sector with no specific regulation. Consumers would attend to their own best interests, seeking expert assistance if they wished (for example, from an architect). They would have contractual remedies against poor building performance. They could include Building Code of Australia standards in their building contract. They could seek builders by reputation, endorsed either commercially or by industry associations. And they could insure against adverse events.

Some market delivered alternatives already exist:

- Appropriately qualified experts (for example, architects and building inspectors) supply information and expertise that consumers may lack.
- Contractual remedies or insurance may provide redress where the standard of house construction is inadequate.
- Industry associations may provide a credible system for rating building practitioners, helping to address the inherent difficulty consumers may have in determining a builder's record in delivering a quality product.

The fundamental problem, however, is that consumers are still unlikely to know what they don't know and, therefore, may be unaware of the information deficiencies they need to address. The Department of Sustainability and Environment noted that this aspect of market failure:

... forms a substantial element of the justification for a regime of detailed technical standards to govern construction activity, as well as a regime of inspections and approvals before, during and at the completion of construction. (sub. 84, p. 5)

## **Spillovers**

The presence of spillover costs or benefits may also provide a reason for government regulation because the contractual relationship between builder and client may not capture wider costs and benefits. If significant costs or benefits associated with house construction are incurred by parties other than those involved in that transaction (that is, beyond the consumer/homeowner and the builder), then market driven outcomes are likely to be unsatisfactory from a community perspective. If the owner of a house does not bear the environmental costs of using a particular building material, for example, then their choice of product is unlikely to deliver an environmental outcome consistent with what is best for the community.



Similarly, where a homeowner does not receive the full benefits associated with a particular type of construction, the incentive to build in a way that is best for the community is diminished. This argument has been put forward to support regulation requiring 5 Star energy efficiency ratings for new houses. Proponents of such regulation suggest that home buyers will not consider fully the broader community benefits from the lower greenhouse gas emissions of more energy efficient houses and, consequently, will underinvest in energy efficiency.

## **Regulation costs**

Regulation imposes administrative costs, compliance costs (for example, builders may need to change design and construction methods to meet regulatory requirements) and efficiency costs (for example, the effect of regulation on competition and innovation). The Building Commission estimated that state and local government regulation adds 5 per cent to the cost of a ‘case study’ house (with a further 3 per cent for more complicated cases). As a cross-check on this (and various industry cost estimates), the Victorian Competition and Efficiency Commission collected information from 32 building practitioners to develop its own indicative estimates of compliance costs. The results varied substantially across building practitioners, from 2 per cent of project cost to almost 20 per cent. While the surveyed practitioners held different views on the incremental cost attributable to regulation, they generally agreed that four areas of regulation (5 Star energy efficiency, scaffolding requirements, termite protection and builders warranty insurance) impose the highest compliance costs; they disagreed, however, about the size of these costs. Moreover, the cost estimates vary according to the type of house—for example, the cost of scaffolding required by regulation is higher for double-storey houses than single-storey houses—and siting and location—for example, the costs of some regulations are higher in regional areas than metropolitan Victoria.

Based on both sets of estimates, and given that no attempt has been made to estimate the efficiency costs of regulation, it seems reasonable to infer that the selected regulations impose a cost equal to at least 4 per cent of the value of housing construction in Victoria. With the value of housing construction in Victoria exceeding \$10 billion, the estimate of 4 per cent suggests that regulation affecting housing construction cost more than \$400 million in 2004. While this is a conservative estimate of the total cost of housing construction regulation, the extent to which it represents the incremental cost of regulation is unclear. Some activities required by regulation might be undertaken even if there were no regulation. Based on the evidence provided, however, the Commission considers that the estimate is unlikely to overstate the incremental costs. The estimate is based on the lower bound of inquiry participants’ estimates and is conservative compared with other attempts to measure some or all of the regulatory costs.

## Characteristics of a good regulatory framework

Good regulation will generate benefits larger than its costs. Some inquiry participants criticised the Commission's draft report for not quantifying the benefits of regulation and comparing these with its estimated costs. However, even less information is available about the benefits of regulating housing construction than about the costs, so the Commission could not develop its own estimates. Rather, the inquiry has focused on whether appropriate processes are in place to encourage regulation in the future that will yield net benefits.

The central issue is whether the regulatory intervention and the way in which it is implemented (including its costs) lead to outcomes that are superior to what would occur without intervention and other feasible alternatives. This is more likely to occur if the regulatory framework exhibits the following features:

- Regulation should be understandable and introduced only after proper consultation.
- Regulatory effort should be the minimum necessary given the scale of the problem (and generally should not restrict competition).
- Regulation should not be unduly prescriptive.
- Regulation should be consistent with other laws and regulation.
- Regulation should be enforceable.
- There should be pressures for continual improvement.
- Regulators should be accountable.<sup>1</sup>

Because regulation generates costs as well as benefits, governments should regulate only where necessary, where the benefits of doing so exceed the associated costs, and where the approach chosen is designed to yield higher net benefits to the community than would derive from other feasible options.

## Inquiry participants' views

Inquiry participants raised many issues about aspects of the regulatory framework, including energy and water efficiency, disability access, local government regulation, the operation of the registration system, builders warranty insurance and the extent to which homeowners understand the regulatory arrangements. Some were critical of the current regulatory framework.

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<sup>1</sup> These factors are consistent with those required by the *Victorian guide to regulation* (State Government of Victoria 2005b).

The HIA commented, taking into account the range of regulation (including planning, environmental and occupational health and safety regulation), that:

Housing construction in Victoria is subject to arguably one of the most regulated environments in the world. (sub. 58, p. 10)

The Master Builders Association of Victoria suggested that:

... the reach and breadth of regulation has gathered pace in recent years, to the point where builders are impeded from constructing houses in a sensible time frame. (sub. 49, p. 26)

Other inquiry participants commented about the bodies that administer the regulatory arrangements. The Property Council argued that the regulatory bodies in Victoria, such as the Building Commission and the Plumbing Industry Commission, work in an efficient and open manner (sub. 69, p. 4). The Municipal Association of Victoria commented that the four bodies<sup>2</sup> associated with the Building Commission are independent of each other and that councils have not raised significant concerns about the operation of these bodies (sub. 64, p. 2). The Australian Institute of Building Surveyors argued that ‘it is not uncommon for advice from the relevant bodies and the Building Commission to be conflicting and/or ambiguous’, although it ‘is satisfied in principle as an industry body, with the performance of the Commission’ and considered that the appeals process run by the Building Appeals Board is successful (sub. 41, pp. 6, 12, 14).

The City of Boroondara commented on a number of the regulatory bodies, suggesting that:

- from the average building practitioner’s perspective, there is little known about the BAC [Building Advisory Council], its roles, activities or responsibilities...
- the perception of the BRAC [Building Regulations Advisory Committee] is that there are too many self-interested parties involved...
- the BAB [Building Appeals Board] provides a cost-effective and timely service to the industry...
- not enough resources are being given to the BPB [Building Practitioners Board] to properly administer the registration system and to ensure practitioners are carrying out their responsibilities properly (sub. 66, pp. 3–4).

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<sup>2</sup> The four bodies are the Building Practitioners Board, the Building Advisory Council, the Building Regulations Advisory Committee and the Building Appeals Board.

## **Assessing the regulatory framework**

Some regulation of housing construction is justified, particularly on health, safety and sustainability grounds, where consumers, given their lack of information, are most at risk. The hierarchical regulatory relationship among the Building Code of Australia, Victorian legislation and local laws provides a mechanism for benefiting from national consistency while allowing reasonable local variation. Victoria's framework is internally consistent, and its components operate broadly as part of an integrated system. Enforcing minimum building standards helps to ensure buildings have desirable safety characteristics, and provisions in the Building Code of Australia give Victorians access to savings from national consistency. Conforming to these provisions also limits the adverse impacts of prescriptive regulation on innovation.

The building permit system (with exemptions) supports the regulatory system. A registration system for builders and plumbers makes it more likely that they will work according to the required standards. Insurance provides a limited backstop for consumers if a builder is not available to meet contractual commitments to fix defects. Dispute resolution assistance is also available. Further, the reform that allows inspections by private as well as council building surveyors, to ensure compliance with minimum standards, has been a success. Regulatory bodies too are needed to ensure the government's objectives are achieved, and a statutory base for regulation (administered by an independent body) should be capable of providing greater predictability and accountability in this large and complex industry.

The Commission does, however, perceive considerable scope for improving four related areas. First, modifications to the key components of the regulatory framework would streamline regulation and, if accompanied by improved information, make it more effective and accessible to homeowners and building practitioners. Second, the regulators' focus on the objectives set by the government should be sharpened and their accountability increased. Third, cooperation among regulators with complementary roles needs to be encouraged. Fourth, the implementation of new regulation can be improved.

## **Modifications to key components of the regulatory framework**

### **Building permits**

Building permits are one of the key regulatory instruments. Exemptions from the requirement to have a building permit thus influence the coverage of the regulatory framework and are one of its most important features. New Building Regulations come into place in 2006, and the Department of Sustainability and

Environment noted that the conditions for granting exemptions will be a significant issue for the accompanying regulatory impact statement (RIS). This RIS should consider the most appropriate options for making exemptions from building permits and the process through which these exemptions are administered (recommendation 6.1). If, as seems possible, there will be little information to quantify the costs and benefits of the options, the exemptions and effectiveness with which the options are administered should be periodically reviewed after the Regulations are re-made. Such monitoring needs to account for the permit system being part of an integrated regulatory system, with the other principal parts being practitioners' registration and insurance. Adjustments in the permit system may affect these other areas of regulation.

Building permits invoke a requirement for inspections of building work. The role of these inspections may be misunderstood, such as when a consumer incorrectly believes that inspections cover all the work specified in the contract with the builder (rather than minimum building standards). Consumers who have this misunderstanding may pay insufficient attention to monitoring builders and building surveyors. Regulatory intervention could be 'lighter' where consumers understand their role. Steps should thus be taken to ensure consumers are adequately informed—before the point of application for a building permit—about the role and limitations of the regulatory system in protecting their interests. Consumer information can promote choice and limit the need for more intrusive and costly forms of regulation. The consumer should be made aware of the regulation affecting the outcome of their project, including their right to choose a building surveyor (who is working in their interest) and the limits of building practitioners' insurance cover (recommendations 6.7 and 7.1).

### **Housing design and construction—5 Star energy requirements and accessibility for people with a disability**

Some new regulatory issues in housing design have the potential to yield benefits but will introduce significant costs. The most important design issues are the introduction of 5 Star energy requirements and pressures to improve building accessibility for people with a disability.

The Building Commission's survey data has delivered mixed signals on the cost of 5 Star—a February 2005 survey showed mean costs almost three times those used in the original analysis of the 5 Star regulation, whereas a survey in September 2005 showed incremental costs closer to those of the original analysis. Notwithstanding this uncertainty, the Victorian Competition and Efficiency Commission considers that Victoria's energy efficiency regulation (embodied in the 5 Star scheme) could be improved to better deliver at least cost against its

objectives, including in the future as technology changes. Some improvements that should be considered are:

- linking energy efficiency regulation more clearly with the government's energy efficiency objectives by removing the choice of rainwater tank in lieu of a solar water heating system and substituting the choice of an alternative high efficiency water heating system
- incorporating more flexibility through the accreditation and use of contemporary software packages (recommendation 5.3).

Similarly, the water saving regulation in the 5 Star scheme should be more clearly related to the government's water efficiency objectives by removing the tradeoff between water saving and energy saving measures and not including rainwater tanks in any mandated choice (recommendation 5.4).

Victoria should continue to support national progress on improving building access for people with a disability. However, the Commission considers it would be inappropriate at this time to introduce specific Victorian building regulation for accessible housing, given that other initiatives are underway and such regulation may not be the most cost-effective approach. Further, the piecemeal approach of local government regulation is unlikely to be an efficient or effective path for improving the level of accessible, visitable and adaptable private housing. There may be scope to develop better insights into the capacity of targeted, market related interventions to address the accessibility issue.

## **Building practitioner registration and licensing**

Registration of building practitioners and plumbers is an integral part of the regulatory framework, aimed at reducing defects and disputes by improving the quality of practitioners. But the registration system involves administration costs and reduces the number of practitioners. This raises the question of how extensive the coverage of the registration system should be. At the moment, building practitioners must be registered to undertake most domestic building work in excess of \$5000. This is in line with the threshold value above which builders and homeowners are required to enter into a major domestic building contract, but below the threshold for domestic builders warranty insurance (\$12 000). The Commission's view is that cost based thresholds for practitioner registration, major domestic building contracts, payment of the building permit levy, and owner-builders having to obtain a certificate of consent should be aligned, initially at \$12 000 but with provision to increase over time. The threshold for having to pay lodgment fees for building permits should be removed (recommendation 6.2).

The range of trades for which registration is required is a second important determinant of the coverage of the registration system. Changes to the classes of practitioner required to be registered are appropriately subject to an RIS, which assists assessment of the costs and benefits of changes. Some inquiry participants suggested, for example, that the restriction of metal roofing on houses to licensed plumbers increases the price of metal roof installation without necessarily improving the quality. A roof plumber requires four years of training to qualify, and there would be benefits from opening the installation of metal roof sheets to competition and extending the capacity to install metal roofs to include both licensed plumbers and other suitably qualified practitioners, as determined by the Plumbing Industry Commission, in consultation with the Building Practitioners Board (recommendation 6.4).

## **Monitoring and enforcement**

The building permit and registration system must be enforced to be effective. Enforcement, to the extent that it improves the quality of work, reduces complaints and disputes, and should be reflected in lower claims against domestic builders warranty insurance. Neither the Plumbing Industry Commission nor the Building Commission undertakes comprehensive, regular, review of the competency of registered practitioners. Rather, both stated that they have adopted targeted risk based monitoring and enforcement strategies, to alert them to bad performers. The requirement that registered practitioners have warranty insurance—and have thus passed the tests imposed by insurance providers—is another filter.

Regulators should publish regularly explanations of their monitoring and enforcement strategies, together with information on their expenditures on these strategies and their benefits. Others could then assess whether the regulators have chosen the right balance between assessing who should be permitted to practise and enforcing appropriate behaviour, encouraging feedback and improvement over time (recommendation 6.8).

Recent changes should mean that consumers better understand the consequences of taking on the risks of being an owner–builder. The new owner–builder arrangements (which restrict relevant projects to one every three years), however, need to be monitored to test whether they work as intended and deliver expected benefits (recommendation 6.6).

## Registration fees

Registration fees for some building practitioners are not necessarily set at efficient levels. The Commission has not tried to suggest levels at which these fees should be set, because they will be considered as part of the RIS process for the Building Regulations in 2006. Appropriate fees should be set with regard to the treatment of building levies (see below).

## Insurance

Builders warranty insurance gives consumers redress against faults or incomplete work, but only if the builder is insolvent, or dies or disappears. If the builder is available, contractual enforcement is necessary. The requirement that builders have domestic warranty insurance imposes direct costs (in the form of premiums and costs borne by builders in obtaining the insurance) and indirect costs that may discourage some builders from entering the industry. Insurance requirements do, however, protect consumers against a major risk.

Compulsion is not the only option. The government could, for example, inform consumers about the general nature of the risks to which they are exposed, and allow them to choose whether to take out insurance. The Commission does not favour this approach because consumers, even with this information, would be unable to assess the risks and could be exposed to substantial financial risk. Some inquiry participants suggested that the government should re-enter the market, as in Queensland. This approach, however, could undermine insurance provision by the private sector and result in the loss of benefits of competition.

The insurance market for builders warranty insurance has matured since the difficulties following the HIH collapse. Eight insurance providers now compete in this market in Victoria, and the network of brokers offering this product has also increased substantially. The risk pool includes New South Wales, which operates under similar arrangements. And premiums are falling. The Commission has concluded that there is an on-balance case for continuing with mandatory builders warranty insurance provided that improvements are made to the system.

More information could be provided to consumers so they better understand the protection this insurance provides. Consumer Affairs Victoria and the Building Commission should coordinate the production and timely placement of a document that describes builders warranty insurance and what it covers (similar to that provided for plumbers insurance)—for example, on application forms for building permits, attached to approvals of building permits, or included with template contract documentation. The Building Commission should also negotiate with industry associations the scope for including this information in the standard building contract (recommendation 7.1).



In addition, particularly given that builders warranty insurance is compulsory, guidelines should be implemented for the provision of information to the government so it can assess the effectiveness of the scheme. A code of conduct for builders warranty insurance should also be implemented, to give predictability for builders (recommendation 7.2). To provide an avenue of redress for builders who feel they are being treated unfairly by insurance providers, the Office of the Small Business Commissioner should further develop its services to facilitate advisory and dispute resolution services for small business builders, especially regarding builders warranty insurance issues (recommendation 7.3).

The Commission considers that moving to a voluntary builders warranty insurance scheme might be possible and preferable in the long term. However, the Commission's recommended improvements to other elements of building regulation would need to be bedded down before such a change is contemplated. In particular, Consumer Affairs Victoria would need to be able to provide assurances that consumer information systems had improved to meet consumer protection needs. Two years could be considered sufficient for the next reading on this. (Bearing in mind the long periods involved in bedding down insurance systems, that extra time would give insurers better risk information.) The Commission has not made a recommendation on this longer term possibility, given the many steps to be first satisfied.

## **Improved information**

A common theme through the report is that regulation will be more effective and efficient if consumers and those within the housing industry are more aware of their roles, rights and responsibilities under the regulatory framework. This awareness is difficult to achieve in a complex framework, which is why the Commission has suggested simplification.

It was noted earlier that regulators should provide more information to consumers about what they can and cannot expect from regulation (recommendations 6.7 and 7.1). Consumer Affairs Victoria and the Building Commission can better coordinate the suite of information needs of consumers (recommendation 8.4). But it is just as important that practitioners are fully informed. The Commission thus proposes that options be explored to provide building standards at zero cost (recommendation 5.1) and that the Building Commission establish a page on its website that lists selected building requirements of each local government (recommendation 5.7).

Consumers, practitioners and the government would all gain from having more information about the cost and benefits of regulation. Regularly published estimates of these costs would reveal, for example, how the costs are changing over time and where they are not as expected (recommendation 9.7).

## Improving the focus and accountability of regulators

The Commission believes that the best outcomes can be achieved from regulatory systems where:

- the government specifies the outcomes that it wants regulators to achieve
- roles are assigned to those best placed to undertake them
- measures exist to ensure regulators are held accountable for their actions.

A number of improvements are feasible in these areas.

### Outcomes

The outcomes that the government wants to achieve through regulation are listed in the Building Act. The Act specifies 10 objectives, but seven describe the instruments that can be used under the Act, and should not be included in a statement of objectives. Two objectives outline outcomes, defined in terms of five attributes of housing (amenity, health, safety, environmental efficiency and energy efficiency.) The Act does not define these attributes or indicate their relative importance—an important deficiency given the tradeoffs and the costs involved. The remaining objective is the achievement of an efficient and competitive building industry. Affordability of housing is not an explicit objective.

Some ambiguity is inevitable in the high level objectives included in regulation. Ambiguity, however, leads to uncertainty. Providing limited direction to regulators about what they should target limits their capacity to deliver and to report on their performance, thus reducing their accountability. Multiple and ambiguous objectives can breed regulatory confusion or growth.

The Commission considers that the regulators operating under the Building Act would have more focus if:

- instruments for achieving outcomes were not included as objects of the Building Act, because their inclusion encourages their enshrinement as outcomes rather than as a means to an end (recommendation 8.1)
- the number of desired outcomes in the Building Act were reduced, simplified, clarified and defined (recommendation 8.2)
- the government provided more direction to regulators on how to apply the regulatory instruments they are empowered to use (recommendation 8.3)
- there were more checks and balances on the imposition of new requirements (recommendations 8.5, 8.6 and 8.7).

The outcomes sought under the Building Act are closely linked to those specified in the Domestic Building Contracts Act. The Commission did not consider these

links or the relationships among the relevant agencies in detail, because a separate review of the Domestic Building Contracts Act was underway at the same time as the Commission's inquiry. However, the Commission has outlined options for improving the integration of these Acts and agencies, ranging from minor legislative drafting changes to integrating the consumer protection components of the two Acts.

## **Assignment of roles**

The effectiveness of regulation will be enhanced if roles are assigned to those best placed to undertake them. The most important roles are:

- administering the legislation and regulations
- registering practitioners
- enforcing construction in accordance with required standards
- operating mechanisms for dispute resolution between builders and consumers
- providing an avenue for appeal against regulators' decisions
- providing policy advice about the design of the framework and rules.

The statutory regulators should administer the legislation and Regulations. Approving practitioners, accrediting processes and enforcing standards are integral parts of regulatory administration, and should be undertaken by the Building Commission and Plumbing Industry Commission. Dispute resolution should (as now) use the expertise of Consumer Affairs Victoria, with technical support from the Building Commission. The appeals body for technical issues, such as permits and accreditation, should (as now) have appropriate independence from the regulator. The Victorian Civil and Administrative Tribunal remains as the backstop for the hearing of disputes.

Providing policy advice is a particularly important function because it influences how the broad regulatory framework, specific regulation and the costs and benefits of housing regulation change over time. The Building Commission considered that it has an important policy advisory role. The main argument for involving regulators in policy development is their first hand expertise in the practical implementation of policy. They may also be well placed to identify problems and to comment on the technical feasibility of policy options.

On the other hand, combining policy and regulatory functions increases the risk of regulatory 'creep', because it can be in the regulator's institutional interest to maintain and expand its role, while creating a more complex environment in which it is more difficult to assess regulators' performance. Moreover, playing a lead role in developing new regulation can compromise a regulator's independent administration and enforcement of regulation. Regulation has been growing, and

some inadequacies in past RISs have been identified. Whether or not the regulator is tempted to take an institutional interest in maintaining and expanding its role, it is better to ‘economise on virtue’ in such arrangements.

While those developing policy advice should have access to the experience of the regulators, a government department should have primary responsibility for policy advice, including coordinating the preparation of regulatory proposals and associated RISs. The department should communicate closely with the regulators about policy issues and technical aspects of proposed regulatory changes (recommendations 9.1 and 9.2). For a wider perspective on the regulatory framework, it could consult with the Building Advisory Council, which is supported by the Building Commission. While not the only option, separating the Building Advisory Council from the Building Commission and allowing it to provide input to the minister and department would be a useful organisational change, removing the policy advice role from the Building Commission (recommendation 9.8).

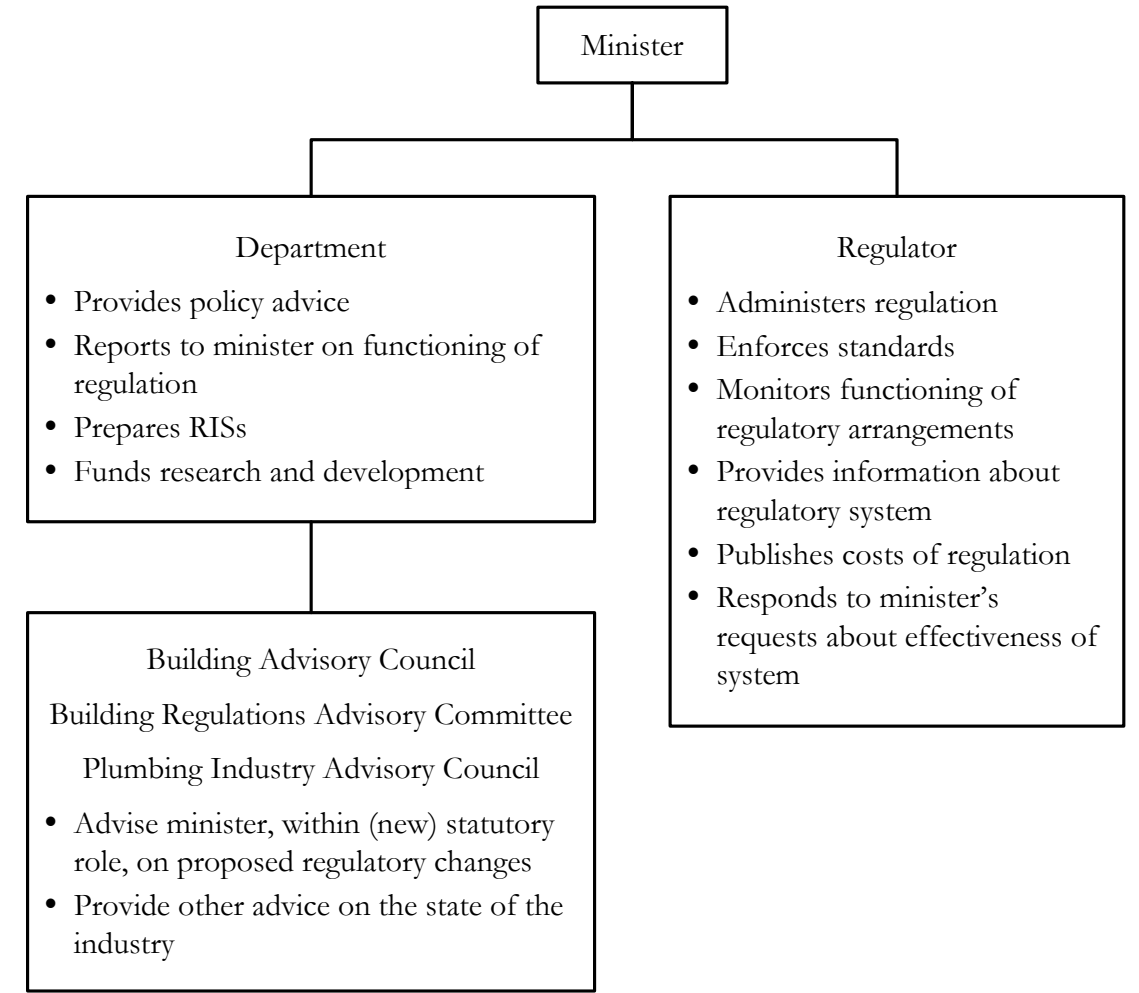
One broader issue with role clarity is that the Building Commission perceives itself as both a regulator and an industry leader, which may be a consequence of ambiguity in the Building Act. The commission has an active (but not fully explained and reported) research program and describes itself as ‘a high profile leader of standards and change’, whose ‘core direction’ includes having ‘a much stronger leadership role in building activities in Victoria’, as part of a strategy to achieve three outcomes: quality building, an attractive industry and satisfied consumers (BC 2002c, pp. 4–7).

The Victorian Competition and Efficiency Commission considers that an industry leadership role (beyond demonstrating how to comply with the regulatory framework) does not sit easily with the independent regulator’s core function of ensuring compliance with performance standards. A regulatory framework that has clarity and is impartially enforced by an accountable regulator should contribute to an attractive industry environment and satisfied consumers. Moreover, the industry is well established and has a broad cross-section of experienced and new participants, large and small. Where participants choose, they can draw on the services of well-resourced and active industry associations. A competitive environment inhabited by a neutral regulator is more likely to engender private sector enterprise that improves industry performance to the benefit of consumers.

Reducing the policy, research and leadership roles of the regulators, refocusing the various advisory bodies and separating them from the regulators would result in the revised organisational structure illustrated in figure 2. Further, the Commission believes that the chairs of the Building Commission and the Plumbing Industry Commission should be asked to identify opportunities for

cost savings from merging the two commissions' activities without loss of effectiveness (recommendation 9.9).

**Figure 2 Proposal for a simplified role allocation**



### **Making regulators more accountable**

Adequate rights of appeal against the regulators' decisions are an important part of an accountability framework. Appeal mechanisms are in place and seem to be working well. Another way to increase accountability is to link charges for regulators' services to regulators' use of revenue. This link is weak for the Building Commission because most of its revenue is raised through a levy linked to the value of building permits rather than to the cost of regulatory services provided. Rebalancing revenue raising away from the levy and towards fees for service would increase both accountability and efficiency (recommendation 11.3). There is also a strong argument to reduce the levy, of which the proceeds have been inflated over the long period of growth in the value of housing activity. A smaller levy would fit less wide-ranging activities by the Building Commission.

A performance reporting framework is the other important mechanism for imposing accountability. The Australian National Audit Office noted that:

Accountability relies on performance information. We are accountable to ministers, the Parliament, the general public and other key stakeholders for our programs' performance. Performance information is the currency of accountability. (ANAO 2000, p. 5)

The Building Commission and the Plumbing Industry Commission have introduced performance reporting through their business planning processes, but the Building Act's multiplicity and ambiguity of objectives and functions handicap the scope to develop good performance indicators. As these objectives and functions are simplified, the regulators should make more use of quantitative performance indicators—which should be linked more closely to the health, safety and sustainability outcomes set for the regulatory framework—and report publicly and regularly against these indicators. Developing such indicators would provide more detail on the high level outcomes specified in the Building Act. If they were included in the regulators' corporate plan and endorsed by the minister, this would provide a powerful tool for specifying the outcomes that the government wants the regulators to achieve (recommendation 10.1). The Commission also considers that there would be benefits from more transparent financial reporting by the regulatory bodies (recommendation 10.3).

Consumer Affairs Victoria publishes an annual activities report on Building Advice and Conciliation Victoria, but neither in this report nor in its annual report does it publish performance indicators of the extent to which it is achieving outcomes specified in the Domestic Building Contracts Act. Improved public reporting would enhance the agency's accountability and help the government make resource allocation decisions (recommendation 10.2).

## Improving integration

There are important complementarities between the Domestic Building Contracts Act and the Building Act and the agencies that administer them. To ensure integrated administration happens effectively and efficiently, the Victorian Competition and Efficiency Commission considers that the Building Commission and Consumer Affairs Victoria should formally agree on how they work together to administer the two Acts. These agreements should cover issues such as:

- the two agencies' roles and responsibilities and, where there is joint responsibility, which is the lead agency and how it will achieve outcomes in consultation with the other agency

- the agencies' responsibility for informing and educating consumers and building practitioners about their rights and obligations under the regulatory arrangements (including all matters identified in this report)
- the administration of Building Advice and Conciliation Victoria
- the sharing of complaints data to inform the monitoring and enforcement of practitioner registration.

The Building Commission and Consumer Affairs Victoria should publish these agreements on their websites and report in their annual reports on their performance in working together to achieve regulatory outcomes (recommendation 8.4).

## **Improving processes for new regulation**

Regulation can involve costs, and the quality of regulation will be enhanced if new regulation is introduced only after its costs and benefits have been evaluated, to demonstrate that the benefits exceed the costs. New obligations can be imposed through seven channels, of which five do not expose proposed regulation to close scrutiny.

First, state and territory amendments to the Building Code of Australia can be made without an RIS. The Master Builders Association of Victoria (sub. DR151, p. 15), the Building Products Innovation Council (sub. DR150, p. 3) and the National Association of Steel-Framed Housing Inc. (sub. DR122, p. 3) all indicated their opposition to state based variations to the code.

It seems inconsistent that amendments to the Building Regulations are subject to the RIS process, while state based amendments to the Building Code of Australia, which are called up by the Building Regulations, are not. Requiring an RIS to be undertaken for state based amendments would provide consistency and help to ensure these amendments are made only when they provide net benefits (recommendation 8.6).

Second, standards are called up by the Building Code of Australia. Victoria should continue to engage with the Australian Building Codes Board to monitor this process—in particular, appropriate cost–benefit evaluation of new standards should be the norm (recommendation 8.7).

Third, the Building Act entitles the minister to issue guidelines on various matters, which have considerable force, without prior external scrutiny. The government has previously rejected bringing all guidelines within the RIS process, but noted there is flexibility to selectively bring additional classes of regulatory instrument into this process. It would be good practice for the minister responsible for the Building Act to develop an RIS for guidelines that impose an appreciable burden and to release this for public comment. An

alternative, more robust approach would be for the government to regulate to make guidelines under the Building Act statutory rules for the purposes of the *Subordinate Legislation Act 1994*, to ensure guidelines that impose an appreciable burden are subject to the RIS process.

Fourth, through local provisions in planning schemes, Victorian councils have the power to apply municipal standards that are different from those in the Building Regulations. Section 11 of the Building Act provides that the local planning scheme prevails where there is inconsistency between that scheme and a state Building Regulation. Consequently, a myriad of variations to housing construction requirements may exist across Victoria, unless the minister withholds approval for planning provisions that create undesirable regulatory inconsistencies. A best practice model to guide local council thinking on their variations would help, as would a central information point on local government (recommendation 5.7).

There are good arguments for requiring planning scheme provisions that override the Building Regulations to be subject to an RIS process of the kind required under the Subordinate Legislation Act. This requirement would, however, have implications for local government powers and their relationship with the state government that extend beyond the housing construction sector and that could alter the costs and benefits of the proposal. The Commission considers that this proposal should be considered, but in a wider context than is possible in this inquiry.

Fifth, councils can introduce local laws on a limited range of housing matters after a process of public notice requirements. This process, according to the City of Boroondara, is ‘sufficiently transparent and gives opportunity for submissions to be lodged’ (sub. 66, p. 7). The Property Council of Australia, however, commented that it:

... strongly believes that the processes for introducing new regulations affecting housing construction at a local level are not sufficient to take into account the full costs and benefits involved. (sub. 69, p. 3)

Exposing new local laws to the cost–benefit scrutiny required by an RIS process would improve the quality of such regulation. The Commission is also attracted by the Productivity Commission’s proposal that local governments should have to seek Victorian Government approval before applying building requirements that are inconsistent with the Building Code of Australia. This proposal, however, also needs to be considered in a wider context.

Following a recommendation by the Scrutiny of Acts and Regulations Committee, the Department for Victorian Communities should report on implementing the government’s intention to consider an appropriate scrutiny process for local laws (recommendation 5.6).



## Development contributions

The government also asked the Commission to comment on the development contributions system, which was recently the subject of a prolonged and comprehensive review. (Development contributions are part of development charges applied to new housing development.) The review has led to the staged implementation of changes (beginning in May 2003) designed to address shortcomings in the previous system, but left that system fundamentally intact. The most recent changes were approved in December 2004, although supporting guidance material (along the lines of the building practice note or guidance notes released in 2003) has yet to be updated.

The current development contributions system has a short performance history, and it is premature to judge whether the changes are ‘working’, at least for the most recent reforms. The Victorian system accords with best practice principles for developer contributions (for example, as described in the Productivity Commission report on first home ownership) (PC 2004a, p. 155). Nevertheless:

- the system lacks a formal mechanism to monitor/audit how it is operating. There should be an annual, selective, independent audit to assess councils’ adherence to the conditions of their development contribution plans (recommendation 12.2).
- local government should provide in their annual reports a statement of compliance with the development contribution guidelines and ensure internal governance arrangements help monitor contributions for compliance with these guidelines (recommendation 12.1)
- the Department of Sustainability and Environment should publish revised guidance material to support the December 2004 reforms (recommendation 12.3).

## The benefits of a simplified regulatory framework

The Commission considers that its recommendations would lead to a simplified, more focused and more effective regulatory environment. They should allow consumers to observe regulatory outcomes being achieved at lower cost, in time. As mentioned, a target cost reduction of at least \$1500 for the majority of new houses seems possible. The reduction would vary substantially, however, across houses and circumstances—for example:

- the Building Commission’s surveys suggest a large range in the costs that the 5 Star water and energy requirements impose on different types of house, so flexible application of this regulation could lead to considerable savings
- reducing the building levy would also lower costs to consumers

- streamlined regulation should trim compliance costs for building practitioners, who would, in this competitive market, pass savings on to consumers
- consumers who are better informed about the limits of regulatory protection may be more diligent in protecting their own interests
- improving the accessibility of information to builders about regulation should increase compliance.

Many of the Building Regulations ‘sunset’ soon and will need to be re-made by June 2006, and an RIS is being developed for these Regulations. It seems reasonable for the government to seek, through this and other processes, to reduce the overall cost of regulation by at least \$1500 for the majority of new house construction, without compromising the outcomes sought through the Regulations.

## Recommendations

The recommendations are listed in the order that they appear in the report, and they need to be understood in the context of the discussion in respective chapters.

### Regulation of housing design and construction

- 5.1 That the Victorian Government test, through the Australian Building Codes Board, the merit of pursuing the following options to provide building standards electronically at zero cost:
  - The Australian Building Codes Board pay Standards Australia an appropriate royalty for the right to publish essential primary referenced standards online, linked to the Building Code of Australia.
  - Standards Australia provide online access on a free subscription basis and then receive compensation from the board for revenue forgone (that is, based on the number of subscribers).
- 5.2 That regulatory impact analysis of a standard referenced in the Building Code of Australia consider (1) whether the standard would preclude retaining practices that have performed satisfactorily in Victoria in the past, and (2) the costs and benefits of that change.
- 5.3 That the implementation of the 5 Star scheme be more clearly related to the Victorian Government's energy efficiency objectives. The choice of a rainwater tank in lieu of a solar water heating system should be removed and substituted with the choice of an alternative high efficiency water heating system. In addition, the scheme should incorporate more flexibility through the accreditation and use of more contemporary software packages.
- 5.4 That the water saving regulation in the 5 Star scheme be more clearly related to the Victorian Government's water efficiency objectives via the removal of the tradeoff between water saving and energy saving measures. Further, rainwater tanks should not be included in any mandated choice. Rather, individual consumers should be left to decide whether they would invest in this facility on its own merits as a water saving measure.
- 5.5 That the requirement relating to the checking and tagging of power tools be subject to a regulatory impact analysis, with particular attention given to identifying alternative means of delivering the implicit objective of safer use of electrical tools on building sites.

- 5.6 That the Department for Victorian Communities report within six months on a timetable for implementing the Victorian Government's intention to consider an appropriate scrutiny process for local laws.
- 5.7 That, to restrain the cost of inappropriate local government variations to building regulation, the Building Commission establish—as an interim measure pending changes arising from reviews—a web link listing selected 'building' requirements of each local council to provide a central reference point for building practitioners.
- 5.8 That the Building Commission assess whether regulation is warranted to allow an exemption for alterations and additions from r803(2)(a) of the Building (Interim) Regulations 2005 (concerning termites). The exemption would allow owners, after being informed of the risks they face, to opt out of applying control measures where the main building is not protected.

### **Permits and registration**

- 6.1 That the regulatory impact statement for the Building Regulations 2006 consider the most appropriate options for making exemptions from building permits, and the process through which these exemptions are administered, to achieve an appropriate balance between health and safety objectives and regulatory intervention and cost.
- 6.2 That cost based thresholds be aligned for building practitioner registration, major domestic building contracts, the payment of the building permit levies, and owner-builders having to obtain a certificate of consent, initially at \$12 000 but with provision to increase over time in response to further information. The threshold for the payment of lodgment fees for building permits should be removed.
- 6.3 That continuing professional development (CPD) not be made compulsory until rigorous cost-benefit analysis shows it is warranted. In the meantime, the Building Practitioners Board should facilitate voluntary CPD, including as a tool for marketing the skills of registered building practitioners to consumers.
- 6.4 That in order to create less restrictive pathways into the installation of metal roofing, the Victorian Government prepare draft Regulations for inclusion in the Plumbing Regulations 1998, which would more narrowly define 'plumbing (roofing (stormwater))' work and contain more focussed and flexible competency requirements for aspects of this work that continue to require registration and licensing. These draft Regulations could be subject to the regulatory impact statement process.

- 6.5 That the Building Commission continue to monitor the impact of regulation on the incentives for part time work by building practitioners. The commission should also encourage insurance providers to offer products that account for some practitioners' desire to reduce their hours of work before retirement.
- 6.6 That the Building Commission monitor and report publicly by July 2007 on the impacts of the new owner–builder requirements introduced by the *Building (Amendment) Act 2004*, and that the Victorian Government use this information to review the new requirements. This review should consider non-regulatory alternatives to the present arrangements.
- 6.7 That the Building Commission coordinate the provision of information about the role of the inspection process, the occupancy permit (or certificate of final inspection), building surveyors and other key building practitioners—what they are intended to achieve and *not* intended to achieve—to applicants for building permits through councils, architects, building designers, draftspersons and other practitioners involved early in the building process. This information could be reiterated in a letter from the Building Commission to consumers granted a building permit.
- 6.8 That the Building Commission and the Plumbing Industry Commission publish in their annual reports the rationales for their monitoring and enforcement strategies, the funds allocated to monitoring and enforcement, and the two agencies' performance indicators, to permit assessment of their strategies and identify any lessons learned.

## **Insurance**

- 7.1 That Consumer Affairs Victoria and the Building Commission coordinate the production and timely placement of a document that describes builders warranty insurance and what it covers (similar to that provided for plumbers insurance)—for example, in the letter sent to consumers granted a building permit. The Building Commission should also negotiate with industry associations to include this information in standard building contracts.
- 7.2 That the Victorian Government finalise and implement guidelines for the provision of information and a code of conduct for builders warranty insurers, as a matter of urgency.
- 7.3 That the Office of the Small Business Commissioner further develop means to facilitate advisory and dispute resolution services for small business builders, especially relating to builders warranty insurance issues.

- 7.4 That Consumer Affairs Victoria assess whether to amend current Building Advice and Conciliation Victoria (BACV) arrangements to include:
- a rule for allocating costs against a party that seeks resolution in the Victorian Civil and Administrative Tribunal without first seeking to resolve a dispute through BACV
  - access for builders to the BACV process
  - fees for access to the BACV process.
- 7.5 That for commercial, industrial and high-rise residential buildings, plumbers insurance not be mandatory for air conditioning and mechanical services.

### **Improving the regulatory framework**

- 8.1 That the instruments that can be used to achieve the revised objectives of the *Building Act 1993* be set out in the Act separately from the objectives.
- 8.2 That the Victorian Government simplify, reduce and clarify the current objectives of the Building Act. A starting point for this process could be the following objectives:
- (1) achieving minimum standards of buildings, to preserve health, safety and amenity in the construction, maintenance and use of buildings
  - (2) promoting energy and environmental efficiency as they relate to buildings, having regard to the costs and benefits involved.

If outcomes such as health, safety, amenity, environmental efficiency and energy efficiency are retained in the Act, they should be defined.

- 8.3 That the Victorian Government provide, where necessary, additional direction on how entities established under the *Building Act 1993* are to apply the instruments permitted under the Act to achieve the Act's objectives. This direction might indicate that the use of these instruments should:
- be targeted at an identified problem
  - generate benefits to the community greater than the costs (that is, net benefits)
  - be imposed only when there is no regulatory or non-regulatory alternative (whether or not under the responsibility of the entities established under this Act) that would generate higher net benefits
  - be used to assist consumers to make well-informed choices.

Direction should be provided either in the Building Act or in a Direction from the minister administering the Act. Entities established under the Building Act should explain in their annual reports how they have applied these principles.

8.4 That the Victorian Government direct the Building Commission and Consumer Affairs Victoria to formalise agreements on how they will work together, when appropriate, to administer the *Building Act 1993* and the *Domestic Building Contracts Act 1995*. These agreements should cover issues such as:

- the roles and responsibilities of the Building Commission and Consumer Affairs Victoria and, in cases where there is joint responsibility, agreement on which is the lead agency and how it will achieve outcomes in consultation with the other agency
- responsibility for informing and educating consumers and building practitioners about their rights and obligations under the regulatory arrangements
- the administration of Building Advice and Conciliation Victoria
- the sharing of complaints data to inform the monitoring and enforcement of practitioner registration.

These agreements should be completed by June 2006 and published on the agencies' websites. Performance measures for each agency should incorporate integrated administration objectives. The agencies' annual reports should detail how the agencies have worked together to achieve regulatory outcomes.

8.5 That the exemption from the obligation to prepare a regulatory impact statement, as provided by s9A of the *Building Act 1993*, be removed.

8.6 That Victorian variations to the Building Code of Australia be introduced only after being subject to regulatory impact assessment applicable to Regulations under the *Subordinate Legislation Act 1994*.

8.7 That the Victorian Government support re-negotiation of the memorandum of understanding between Standards Australia International and the Australian Building Code Board and revision of the referenced documents protocol, requiring regulatory impact statement-type analysis to be undertaken early in the development of standards likely to be referenced in the Building Code of Australia and to have non-minor effects.

## **Regulators' roles and responsibilities**

9.1 That the Building Commission and the Plumbing Industry Commission not have primary responsibility for providing policy advice to the minister on the regulation of housing construction, although they should be consulted on the practicality of policy options and the implementation of regulation. They should continue to be able to draw regulatory problems to the government's attention. The commissions' functions should be re-drafted to make it clear that they are not responsible for policy advice. The Victorian Government should seek to maintain information flows among those responsible for providing policy advice, regulators, consumers and the housing construction industry.

9.2 That regulatory impact statements should be prepared by agencies responsible for advising governments about regulatory policy, rather than by those responsible for administering and enforcing regulation, although the regulator could assist in settling technical aspects of the Regulations.

9.3 That the Victorian Government:

- provide guidance on the types of research project that regulators can undertake, in the context of regulatory matters relating to the industry
- assess research proposals of the regulators and approve their funding as appropriate.

That the Building Commission and Plumbing Industry Commission:

- evaluate how research projects have contributed to the operation of the regulatory system
- publicly report any expenditure on research into regulation of the housing sector, through either annual reports or a special report. This reporting should show the purpose and anticipated cost of each new project and how performance will be evaluated. For projects completed during the year, expenditure and the results of the evaluation should be reported.

9.4 That the Building Commission's function 'to promote better building standards both nationally and internationally' be replaced by 'to represent Victoria's interests in the development of national building regulation'.

9.5 That the Building Commission's annual report detail both the funds allocated to each regulatory entity and function, and the rationale for the allocation. The annual audit by the Auditor-General's office should independently review this analysis.



- 9.6 That the Building Commission's and the Plumbing Industry Commission's functions be redrafted to require these entities to provide information to consumers, as well as practitioners, about their rights and responsibilities under the building regulatory framework, so as to increase consumers' ability to understand the regulatory system and make informed choices within that framework.
- 9.7 That the Minister for Planning request that regulators publish estimates at least every third year of the extent to which building regulation adds to the cost of building houses. The estimated benefits of regulation and the estimation method and assumptions should also be published. If the Building Commission or the Plumbing Industry Commission prepares the estimates, an independent source should verify those estimates.
- 9.8 That:
- a government department be responsible for providing policy advice about the regulation of housing construction, but in consultation with the Building Commission and the Building Advisory Council
  - the Building Advisory Council, the Building Regulation Advisory Committee and the Plumbing Industry Advisory Council be separated from the Building Commission
  - a new entity be established within the Building Commission to undertake the accreditation role currently provided by the Building Regulations Advisory Committee.
- 9.9 That the Victorian Government task the chairs of the Building Commission and the Plumbing Industry Commission with identifying opportunities for cost savings from merging the two commissions' activities without loss of effectiveness.

### **Performance reporting**

- 10.1 That the Building Commission and the Plumbing Industry Commission review their reporting frameworks to ensure they indicate how well they are performing against their aims and objectives, which should be derived from the outcomes sought under the *Building Act 1993*. These indicators should satisfy criteria relating to their focus, balance, robustness, cost-effectiveness and integration into the business planning process. The two commissions should present proposed indicators for Victorian Government approval by June 2006, and provide annual public reports of their performance against these indicators, beginning in 2006-07.

- 10.2 That Consumer Affairs Victoria review its reporting framework in relation to its housing construction related responsibilities to ensure it indicates performance against aims and objectives. Performance indicators should satisfy criteria relating to their focus, balance, robustness, cost-effectiveness and integration into the business planning process. Consumer Affairs Victoria should present proposed indicators for Victorian Government approval by June 2006, and provide annual public reports of performance against these indicators, beginning in 2006-07.
- 10.3 That the annual reports of the Building Commission and the Plumbing Industry Commission provide more information about the allocation of funds to related regulatory bodies, and the rationale for this allocation and for expenditure on research and development. The Building Commission's annual report should outline its expenditure on each special project and link this to outcomes.

### **Fees and charges**

- 11.1 That the Building Advice and Conciliation Victoria levy apply only to building permits for residential building activity, corresponding with building activity formerly covered by so-called 'first resort' builders warranty insurance.
- 11.2 That the Department of Treasury and Finance be responsible for developing more extensive Victorian cost recovery guidelines that better impart (a) how to ensure charges are set according to an efficient cost base, (b) the principles for splitting costs between industry and taxpayers, and (c) how to design robust cost recovery arrangements that do not generate unintended incentives. These guidelines should be developed using a consultative process and publicly released within 12 months.
- 11.3 That the Victorian Government, following the release of new cost recovery guidelines, amend the Building Commission's cost recovery arrangements to make them consistent with the new guidelines, with a focus on:
- clearly identifying the costs of the regulatory activities and designing efficient charges that are linked to those activities
  - investigating avenues to reduce the cost and range of activities undertaken by the Building Commission (consistent with the Victorian Competition and Efficiency Commission's recommendations on the objectives and activities of the Building Commission), and to reduce the size of levies and fees accordingly

- where consistent with the application of the cost recovery guidelines, moving towards more fees for specific regulatory activities and reducing the building permit levy accordingly
- specifying all major fees in the Building Regulations or providing an equivalent mechanism to ensure the costs and benefits of these fees are fully analysed
- establishing a program to independently monitor and review the effectiveness and ongoing appropriateness of the charging arrangements.

11.4 That the Department of Treasury and Finance formally monitor the implementation of its cost recovery guidelines as they impact on housing construction regulators. Relevant housing construction regulators should report annually on their cost recovered activities and revenue, and on the implementation of the Victorian Government's cost recovery guidelines.

### **Development contributions**

12.1 That local councils provide, in their annual reports, a statement of compliance with the *Development contributions guidelines* and ensure internal governance arrangements facilitate the monitoring of contributions for compliance with these guidelines. Within their reports, local governments should disclose the collection and disbursement of development contributions to facilitate transparency and accountability.

12.2 That a random sample of councils be regularly audited to assess their adherence to the conditions of their development contribution plans and to the relevant requirements in the *Planning and Environment Act 1987* and related guidance material (such as that contained in the *Development contributions guidelines*). A suitable body to undertake this audit might be the Victorian Auditor-General or the Department of Sustainability and Environment.

12.3 That the Department of Sustainability and Environment produce revised guidance material needed to support the December 2004 reforms to the development contributions system, and make it publicly available by June 2006.



# **Part A**

# **Context**



# 1 Introduction

This chapter provides the background to the inquiry and outlines the inquiry process and approach taken by the Victorian Competition and Efficiency Commission in preparing this report. It also outlines the structure of the report.

## 1.1 Background to the inquiry

The housing construction sector is a major part of Victoria's economy, providing income and jobs directly to thousands of workers and businesses, and indirectly via its extensive links with other sectors of the economy. As a measure of its importance, the housing construction industry in Victoria in 2004-05 accounted for over \$10 billion in new housing and renovation activity (ABS 2005c), representing about 64 per cent of the state's total building activity by value (ABS 2005c) and about 2.7 per cent of Victoria's gross state product (in 2003-04). The building industry (residential and non-residential) in June 2005 employed 146 600 persons, almost 6 per cent of the state's workforce (BC 2005 undated A). In addition, the cost and quality of housing are vital to the standard of living of all Victorians. Our housing has a profound effect on the quality of our everyday life and is generally the largest single purchase we ever make.

In recent years, the price of housing has increased faster than incomes, although today's new dwellings tend to be larger and of higher quality than those of former years, and related infrastructure and community facilities are also generally much better (PC 2004a, pp. 25–6). The real price of houses<sup>1</sup> in Melbourne increased by 7.5 per cent per year between 1994 and 2004. In recent years, the most widely reported indices show that this rise in house prices has been associated with a considerable decline in housing affordability for first home buyers (PC 2004a, pp. 27–8). In view of this trend, it is natural for governments to be concerned about the drivers of the cost and quality of housing, including the role of regulation. For this reason, national reviews in recent years have examined regulation in the housing construction sector with a view to moderating housing costs, improving the quality, safety and environmental performance of housing, and delivering improved consumer protection arrangements. These reviews have included, for example, housing affordability, building regulation reform and homebuilders warranty insurance.<sup>2</sup>

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<sup>1</sup> Nominal house prices (DSE 2005) were deflated using the price index for materials used in house building (ABS 2005g).

<sup>2</sup> See, for example, Allen 2002; PC 2004a, 2004c.

The focus of these reviews has meant that they were valuable in identifying aspects of regulation requiring attention by governments, but applying their findings to Victoria requires a more detailed, state based consideration. Moreover, Victoria’s core building legislation governing the housing construction sector is over 10 years old, and the associated Building Regulations are due to be revisited under ‘sunsetting’ requirements. Given this context, and claims by industry organisations that regulation in Victoria imposes substantial costs on housing construction (both absolutely and relative to regulatory costs in other states), a review of regulation of this sector is appropriate and timely.

## **1.2 Scope of the inquiry**

The Victorian Government has asked the Victorian Competition and Efficiency Commission to conduct an inquiry into regulation of the housing construction sector in Victoria and related issues. The terms of reference define the scope of the inquiry, directing the Commission to inquire into and report on:

- the competition and other impacts of Victorian regulation affecting housing construction in the state, including, but not limited to, the approval, design, building and maintenance of housing
- the benefits and costs, duration and impact on competition of permits, licences and fees issued by Victorian regulatory bodies for housing construction and related practitioners
- opportunities to improve regulation in the sector
- ways to improve the processes for developing, administering and enforcing regulation in the sector
- current arrangements and opportunities to improve the existing development contributions system
- the appropriateness of performance indicators for regulatory bodies in the Victorian housing construction sector.

The Commission has interpreted ‘housing construction’ to embrace all residential construction—for example, both low-rise dwellings and apartments. However, while the housing construction sector is under reference, the regulation affecting it frequently applies more generally. Regulation that mandates that plumbers be licensed and their work audited, for example, captures residential plumbing activity as well as that related to commercial and industrial building. Similarly, regulation that mandates insurance cover for specific building practitioners affects the operation of building activity beyond housing construction. For this reason, some of the Commission’s findings and recommendations have implications broader than the sector under review. In addition, any institutional changes will need to account for regulators’ responsibilities beyond the housing construction sector.



The terms of reference specifically exclude the following from the inquiry scope:

- taxation arrangements
- land development issues (such as land supply, zoning and infrastructure service provision)
- industrial relations
- native vegetation management.

### **1.3 Conduct of the inquiry**

The Commission advertised the inquiry in the daily press and by circular to those whom its preliminary analysis suggested would be interested parties. In doing so, it invited any interested party to make a submission to the inquiry. The terms of reference and inquiry particulars were also listed on the Commission's website at [www.vcec.vic.gov.au](http://www.vcec.vic.gov.au).

The Commission received a total of 176 submissions. Most submissions were from those involved in regulating the housing construction sector or those representing the 'supply side' of the sector (such as building practitioners or their representative bodies, and material suppliers). Almost one quarter of the submissions received were from 'consumers' of housing, particularly from groups representing people with disabilities. Appendix A contains a list of submissions.

In addition, the Commission met with a wide range of interested parties to help identify and assess issues relevant to the inquiry. Appendix A contains a list of those with whom the Commission met. The Commission also held public hearings on 7 and 9 March 2005. Appendix A details the inquiry participants who appeared at those hearings. A transcript of the hearings is available on the Commission's website.

#### **1.3.1 The Commission's approach**

Although regulation may cover a spectrum of regulatory approaches (box 3.1), this inquiry has focused on regulation where government backing enables rules to be legally enforced—that is, explicit government regulation, co-regulation and some forms of quasi-regulation, but not self-regulation. Moreover, within this set of regulation, the Commission has given particular attention to regulation that is delivered through the rules set in primary and subordinate legislation, mandatory codes of practice, ministerial directions or binding guidelines. This has meant the Commission has concentrated on core building regulation such as that contained in the *Building Act 1993* (Vic.), the *Building Regulations 1994* (Vic.), the *Domestic Building Contracts Act 1995* (Vic.) and their various amendments.

In assessing the regulatory arrangements covered by the terms of reference and how they might better achieve the purpose of government, the Commission has used the following principles to guide its thinking:

- Regulation should be understandable and introduced only after proper consultation.
- Regulatory effort should be the minimum necessary given the scale of the problem (and generally should not restrict competition).
- Regulation should not be unduly prescriptive.
- Regulation should be consistent with other laws and regulation.
- Regulation should be enforceable.
- There should be pressures for continual improvement.
- Regulators should be accountable.

The remainder of this report is organised into three parts. The first provides the context within which regulation in the housing construction sector is being considered; the second assesses the main instruments that are used to regulate housing construction in Victoria; and the third discusses whether there are ways in which the overall regulatory framework could be improved.

## **Part A: Context**

- *Chapter 2* describes the Victorian housing construction sector (for example, its size, structure and regional composition) and how it has changed in recent years. It provides information about recent movements in house prices and affordability. Comparing house prices with the estimated costs of the regulation affecting housing construction helps to place the significance of this regulation in context. The chapter also provides limited information on health and safety outcomes in homes.
- *Chapter 3* discusses the economic rationale underpinning regulation of the housing construction sector and building related practitioners. It discusses the challenges facing government if regulation is to deliver better outcomes for society, and outlines the characteristics of a good regulatory framework to achieve that end.
- *Chapter 4* considers the main Victorian legislation and regulation affecting the housing construction sector, and outlines how standards under the Building Code of Australia are adopted into Victorian regulation. It also considers the role of local government in regulating the sector. It describes the key regulatory bodies involved in administering the core legislation and regulation affecting the sector.

## **Part B: The instruments**

- *Chapter 5* examines core regulation that governs the housing design and the choice of construction materials and building techniques. Its main focus is on Victorian Government regulation (including that adopted via the Building Code of Australia) but it also discusses elements of local government regulation. It also comments on the cost of particular regulations (including those of most concern to inquiry participants).
- *Chapter 6* describes the operation of Victoria's building permit and building practitioner registration systems. It considers the rationale for these regulatory systems and identifies issues with their operation. Where shortcomings are identified, the chapter discusses arrangements that might address them.
- *Chapter 7* describes insurance arrangements for building practitioners required under Victorian regulation (such as builders warranty insurance and professional indemnity insurance). The chapter assesses whether regulation is warranted and what, if any, changes to current arrangements might be needed. It does so against a background of a maturing insurance market, the ongoing need for regulation to protect consumers, and the effect of that regulation on the supply of building practitioners and housing affordability.

## **Part C: The regulatory framework**

- *Chapter 8* assesses the objectives of the core legislation governing the housing construction sector (the Building Act and the Domestic Building Contracts Act) against best practice principles and examines how those objectives might be improved. It also examines existing processes for assessing new regulation and possible improvements to those processes.
- *Chapter 9* examines the multitude of functions prescribed for the regulatory bodies established under the Building Act and the allocation of responsibilities among those bodies. It considers whether the existing functions and division of responsibilities are appropriate, and whether changes to current arrangements are warranted to deliver better regulatory outcomes.
- *Chapter 10* describes the characteristics of a performance reporting framework that can be considered to be 'appropriate'. It describes performance indicators being reported by the main regulatory bodies, summarises evidence on the regulators' performance and discusses ways in which performance reporting could be improved.
- *Chapter 11* examines whether the level of fees and charges set by regulation is consistent with best practice principles. In doing so, it discusses whether changes to existing arrangements appear warranted.

- Finally, *chapter 12* considers Victoria’s development contributions system and outlines recent changes in this area. It identifies concerns addressed in recent reviews, along with areas where (recent changes notwithstanding) regulation may not be operating well or may not be adequate to address emerging issues. Where shortcomings are identified, the chapter assesses whether alternative arrangements are needed to address them.

Supporting appendixes provide:

- information on parties consulted during the course of the inquiry (via meetings, roundtable discussions, submissions and public hearings)
- a framework for setting regulatory fees and charges
- estimates of the costs of a broad range of regulation (in terms of their impact on an ‘average’ dwelling and in aggregate for the housing sector)

The report considers a wide range of issues and regulation relating to the housing construction industry. In doing so, it has needed to set priorities so as to focus on those areas where there appears to be the greatest scope for improving the regulatory framework and delivering real benefits for the industry and consumers. Nevertheless, improvements in regulatory frameworks should encourage progress also on issues and regulation given less attention in this report.

## 2 The housing construction sector

This chapter describes the size, structure and regional composition of the Victorian housing construction sector, and how these have changed in recent years. It provides information about recent movements in house prices and affordability. Comparing house prices with the costs and benefits of the regulation that affects housing construction helps to place the economic significance of this regulation in context.

### 2.1 Introduction

The housing construction sector is part of the broader building and construction sector that is generally defined to include residential and non-residential building and engineering construction. Because most official data are collected for the building and construction sector as a whole, it is difficult to map precisely the size and composition of activity and employment in housing construction.

#### Box 2.1 Building types that comprise the housing construction sector

The Building Commission in Victoria allocates *building use* into eight categories. Of these, domestic and residential comprise the housing construction sector. The other building uses include commercial, retail, industrial, hospital/health care, public buildings and ancillary. In the following extract, the Building Code of Australia building class is attached in parentheses.

##### Domestic

One or more buildings which in association constitute—

A single dwelling, being—

- (a) a detached house (class 1a); or
- (b) one or more attached dwellings, each being a building, separated by a fire-resisting wall, including a row house, terrace house, town house or villa unit, which is not located above or below another dwelling or class of building other than a private garage (class 1a). A non-habitable building, being a private garage, carport, shed or the like (class 10a).

##### Residential

One or more buildings which in association constitute a boarding house, guest house, hostel or the like with total floor area not exceeding 300m<sup>2</sup>, in which not more than 12 persons would ordinarily be resident, which is not located above or below another dwelling or class of building other than a private garage (class 1b).

(continued next page)

## Box 2.1 **Building types that comprise the housing construction sector (continued)**

A building containing 2 or more sole-occupancy units, each being a separate dwelling (class 2).

A residential building, other than class 1 or 2, which is a common place of long term or transient living for a number of unrelated persons, including—

- (a) a boarding-house, guest house, hostel, lodging-house or backpackers accommodation (class 3); or
- (b) a residential part of a hotel or motel (class 3); or
- (c) a residential part of a school (class 3); or
- (d) accommodation for the aged, disabled or children (class 3); or
- (e) a residential part of a health-care building which accommodates members of staff (class 3); or
- (f) a residential part of a detention centre (class 3).

A dwelling in a building that is class 5, 6, 7, 8 or 9 if it is the only dwelling in the building (class 4).

The Building Commission also uses the term *residential sector* (as distinct from the building use), which refers to building work under Building Code of Australia classes 1, 2 (fewer than four storeys of building) and 10 (associated with such buildings).

The Australian Bureau of Statistics (ABS) also collects data relevant to the Victorian housing construction sector. It uses building type definitions that differ from those used by the Building Commission and do not correlate directly with the building classes defined by the Building Code of Australia. The ABS defines a *residential building* as ‘a building predominantly consisting of one or more *dwelling units*’, and a *dwelling unit* as ‘a self-contained suite of rooms, including cooking and bathing facilities and intended for long-term residential use’ (ABS 2005c). The latter excludes units (self-contained or not) in buildings offering institutional care (such as hospitals) or temporary accommodation (such as motels, hostels and holiday apartments).

*Residential buildings* include *houses* and *other residential buildings*. The ABS defines a *house* as ‘a detached building predominantly used for long-term residential purposes and consisting of only *one dwelling unit*’, and an *other residential building* as ‘a building other than a house primarily used for long-term residential purposes and which contains (or has attached to it) more than one *dwelling unit*’ (ABS 2005c). The latter includes, for example, blocks of flats, home units, attached townhouses, villa units, terrace houses, semi-detached houses, and apartment buildings.

Sources: BC undated F; ABCB 2004a; ABS 2005c.

Compiling a statistical description of the housing construction industry is further complicated by the varying definitions and methods of data collection used by different agencies. Box 2.1 outlines the main building types that comprise the housing construction sector, as used by Victoria’s Building Commission and the Australian Bureau of Statistics (ABS). These differing definitions complicate the analysis of trends in housing construction. In this chapter, data relying on both

ABS and Building Commission definitions are used. Broadly, ABS data are used for aggregate measures of the industry; Building Commission data are used for regional breakdowns and to show the amount of work done by different types of builder.

## **2.2 Size and composition of the housing construction sector**

### **2.2.1 Value of residential work**

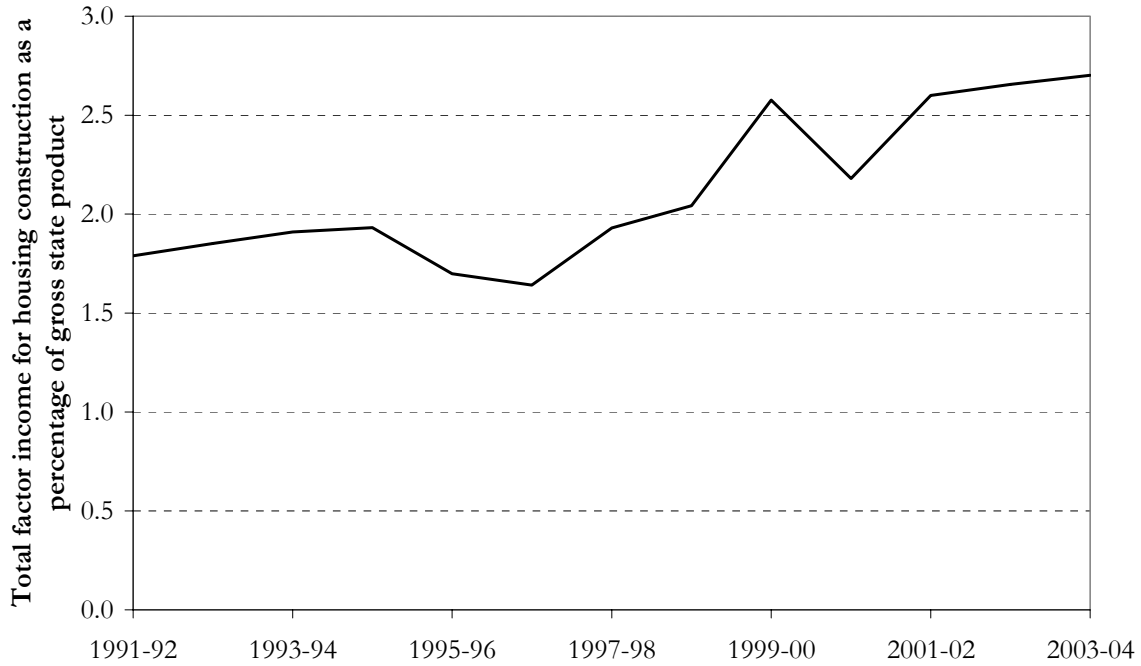
The housing sector, as measured by the total value of residential construction using ABS data, is large and has been growing rapidly:

- The nominal value of housing construction work undertaken in Victoria exceeded \$10 billion in 2004-05. This represented 64 per cent of all building activity in Victoria, or 47 per cent of total construction activity (including building activity and engineering construction activity) (ABS 2005c).
- In 2003-04, housing construction total factor income<sup>1</sup> contributed an estimated 2.7 per cent of Victoria's gross state product (figure 2.1), compared with 5.4 per cent for the whole construction sector, 12.9 per cent for manufacturing, 10.9 per cent for property and building services, 7.9 per cent for finance and insurance, and 5.6 per cent for health and community services.
- The total value of annual housing construction work in Victoria has increased by around 115 per cent, in real terms, since the beginning of the current growth period in 1995-96 (figure 2.2). The real value of housing construction decreased by 2.1 per cent in 2004-05, after having grown every year since 1995-96, except in 2000-01, when activity declined partly because building work was brought forward ahead of the introduction of the goods and services tax (GST) in July 2000.
- Over the period between 1995-96 and 2004-05, the value of housing construction work in Victoria grew by 8.9 per cent per year in real terms, more than in any other state. The equivalent annual rates of increase in other states were 2.6 per cent in New South Wales, 7.1 per cent in Queensland, 8.3 per cent in South Australia, 4.8 per cent in Western Australia and 4.1 per cent in Tasmania (ABS 2005c).

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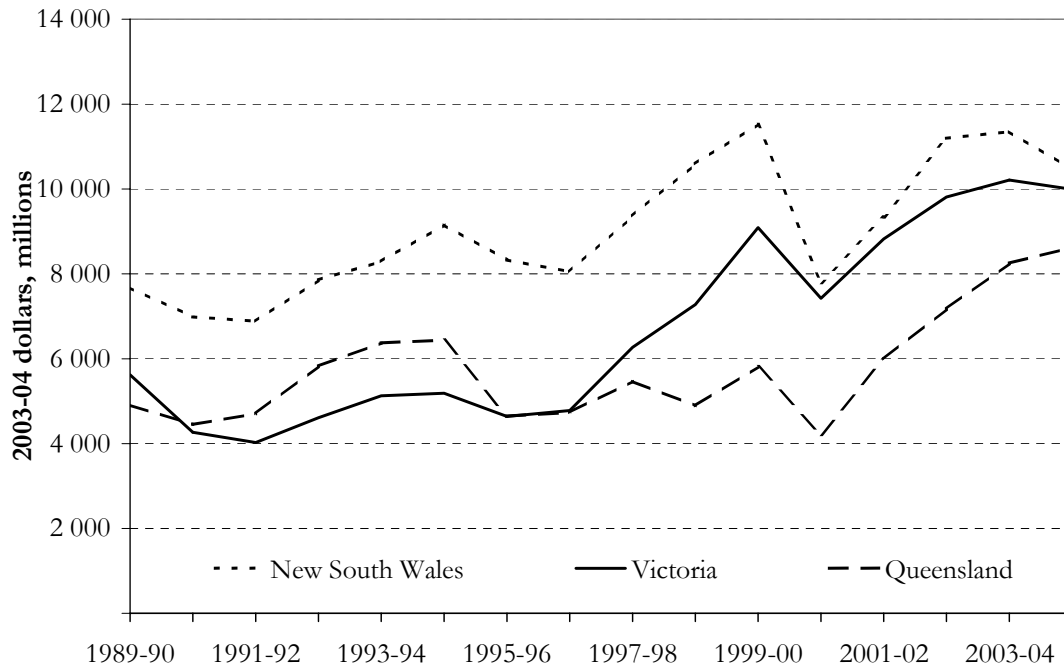
<sup>1</sup> Total factor income is that part of the cost of producing the gross domestic product that consists of gross payments to factors of production (labour and capital). It represents the value added by these factors in the process of production and is equivalent to gross domestic product less taxes plus subsidies on production and imports (ABS 2004a). Total factor income for housing construction is not published. It was estimated here by multiplying the proportional contribution of the value of housing construction to the value of all construction work by the total factor income of the whole construction sector.

Figure 2.1 **Contribution of the housing construction sector to the Victorian economy**



Sources: ABS 2004a, 2005b.

Figure 2.2 **Real value of residential construction work in Victoria, New South Wales and Queensland**



Source: ABS 2005b.

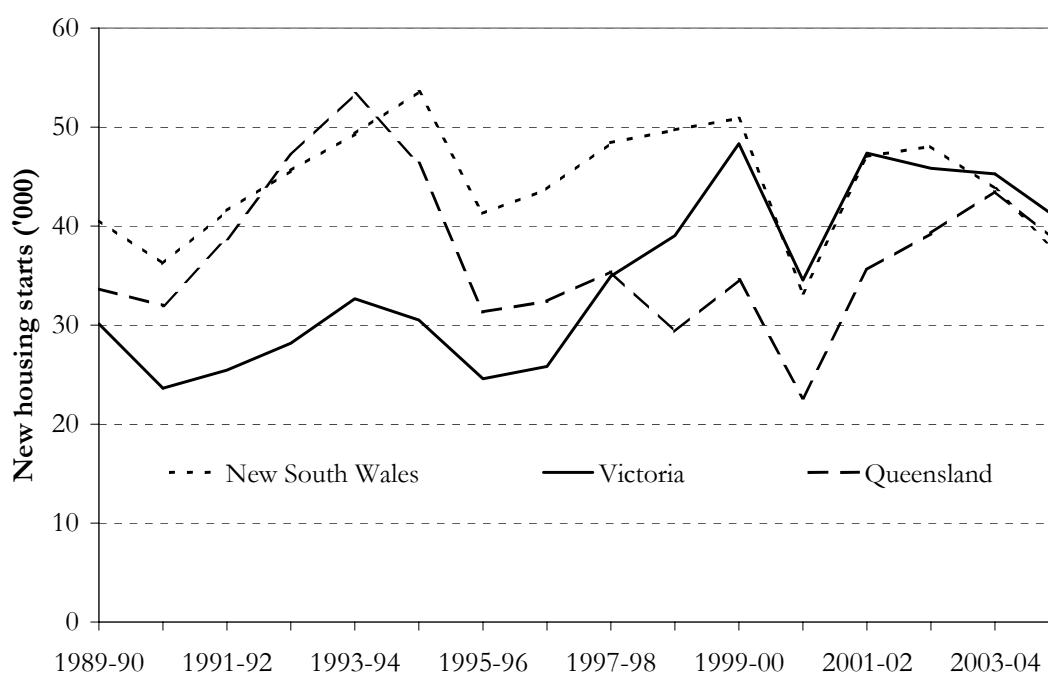


## 2.2.2 New housing starts

The number of new housing starts is another important housing construction indicator (figure 2.3). Between 1995-96 and 2004-05, the number of new building starts per year in Victoria increased by 66 per cent, from 24 588 to 40 707 (ABS 2005e). The real value of new residential work increased by around 127 per cent over this period, suggesting that the average real value of new houses increased significantly.

New housing starts in Victoria peaked in 1999-2000 but have fallen every year since 2001-02, with a 10 per cent fall in 2004-05.

Figure 2.3 **New housing starts<sup>a</sup>**



<sup>a</sup> Includes new houses, new 'other residential' and conversions, as defined by the ABS.

Source: ABS 2005e.

In terms of growth in both new housing starts, and the value of residential construction, Victoria has outperformed both New South Wales and Queensland since 1995-96. The housing construction market is influenced by many factors, including population growth, household formation, household income growth and housing finance costs, as well as the regulatory framework.

### 2.2.3 Type and location of construction

Most Victorian housing construction occurs in the Melbourne metropolitan area. Between 1998 and 2004, however, the proportion of total housing building work in regional areas increased from 20 per cent to 28 per cent (table 2.1).

Table 2.1 **Victorian housing construction value, by region**

	<i>Melbourne (\$m)</i>	<i>Melbourne (%)</i>	<i>Rural (\$m)</i>	<i>Rural (%)</i>
1998	4526	79.9	1136	20.1
1999	5288	78.4	1459	21.6
2000	5205	78.9	1394	21.1
2001	6537	78.6	1776	21.4
2002	7246	76.7	2205	23.3
2003	7372	74.8	2485	25.2
2004	7198	72.4	2749	27.6

Source: BC undated E.

Table 2.2 **Melbourne housing construction value, by region**

	<i>Inner Melbourne (\$m)</i>	<i>Inner Melbourne (%)</i>	<i>Outer Melbourne (\$m)</i>	<i>Outer Melbourne (%)</i>	<i>Total Melbourne (\$m)</i>
<i>Domestic</i>					
1998	1602	42.5	2168	57.5	3770
1999	1839	40.3	2719	59.7	4558
2000	1656	38.2	2684	61.8	4339
2001	1928	36.7	3323	63.3	5251
2002	1949	33.2	3914	66.8	5863
2003	2117	34.8	3966	65.2	6082
2004	2278	37.2	3850	62.8	6128
<i>Residential</i>					
1998	708	93.7	48	6.3	755
1999	668	91.4	63	8.6	730
2000	787	90.9	79	9.1	866
2001	1214	94.4	72	5.6	1286
2002	1248	90.2	135	9.8	1383
2003	1180	91.5	110	8.5	1290
2004	1003	93.8	67	6.2	1070

Source: BC undated E.

**Table 2.3 Housing construction, by region and municipal area—number and value of permits, 2004**

	<i>Domestic<sup>a</sup></i>		<i>Residential<sup>a</sup></i>	
	<i>Building permits (no.)</i>	<i>Value of building permits (\$'000)</i>	<i>Building permits (no.)</i>	<i>Value of building permits (\$'000)</i>
<i>Metropolitan Melbourne</i>				
<b>Inner Melbourne</b>				
Melbourne (Melbourne)	418	77 063	205	362 731
Central Bay (Hobsons Bay and Port Philip)	1 793	204 329	183	227 662
Inner West (Maribyrnong and Moonee Valley)	2 315	209 623	69	58 878
Inner North (Banyule, Darebin and Moreland)	5 192	444 142	128	39 712
Yarra (Yarra)	773	85 062	158	123 776
Mid east (Monash and Whitehorse)	4 120	373 813	38	31 322
Inner east (Boroondara, Glen Eira and Stonnington)	5 415	670 915	212	113 002
Bayside (Bayside)	1 646	212 783	42	46 363
<b>Total inner Melbourne</b>	<b>21 672</b>	<b>2 277 730</b>	<b>1 035</b>	<b>1 003 446</b>
<b>Outer Melbourne</b>				
South western (Wyndham)	3 656	497 311	1	1 800
Western (Brimbank and Melton)	4 594	564 159	18	9 204
North western (Hume)	2 635	317 126	4	5 470
Northern (Nillumbik and Whittlesea)	2 775	327 202	7	3 707
Eastern (Knox, Manningham, Maroondah and Yarra Ranges)	6 288	505 510	62	27 040
South eastern (Cardinia, Casey, Greater Dandenong and Kingston)	9 607	1 001 785	41	13 677
Peninsula (Frankston and Mornington Peninsula)	5 796	636 766	21	5 624
<b>Total outer Melbourne</b>	<b>35 351</b>	<b>3 849 859</b>	<b>154</b>	<b>66 522</b>
<b>Total Melbourne</b>	<b>57 023</b>	<b>6 127 589</b>	<b>1 189</b>	<b>1 069 968</b>
<i>Rural Victoria</i>				
South west (Colac–Otway, Corangamite, Glenelg, Golden Plains, Greater Geelong, Moyne, Queenscliff, Southern Grampians, Surf Coast and Warnambool)	8 562	781 882	86	67 324
North west (Ararat, Ballarat, Central Goldfields, Hepburn, Hindmarsh, Horsham, Mildura, Moorabool, Northern Grampians, Pyrenees, West Wimmera and Yarriambiack)	5 478	431 651	60	13 733
North central (Buloke, Campaspe, Gannawarra, Greater Bendigo, Loddon, Macedon Ranges, Mitchell, Mount Alexander and Swan Hill)	6 074	487 817	38	8 156
North east (Alpine, Benalla, Falls Creek, Central Shepparton, Indigo, Mansfield, Moira, Mount Buller, Mount Hotham, Murrindindi, Strathbogie, Towong, Wangaratta and Wodonga)	5 032	391 064	67	16 205
Gippsland (Bass Coast, Baw Baw, East Gippsland, Latrobe, Mount Baw Baw, South Gippsland and Wellington)	5 834	507 230	67	45 260
<b>Total rural Victoria</b>	<b>30 980</b>	<b>2 599 664</b>	<b>318</b>	<b>150 678</b>
<b>TOTAL VICTORIA</b>	<b>88 003</b>	<b>8 727 233</b>	<b>1 507</b>	<b>1 220 646</b>

<sup>a</sup> Based on the Building Commission's definitions, as explained in box 2.1.

Source: BC undated E

Within Melbourne, the composition of housing construction varies significantly between inner and outer Melbourne (table 2.2). Over 90 per cent of the value of residential construction (using the Building Commission definition, which includes apartment buildings but excludes detached houses) is undertaken in the inner suburbs of Melbourne. Domestic construction (which includes single dwellings such as detached houses, terrace houses and units, but excludes apartments) is more evenly spread between the inner and outer suburbs of Melbourne.

Even though housing construction has been growing more quickly in the outer suburbs, where the density of housing tends to be lower, the overall density of housing construction in the Melbourne metropolitan area has increased. Between 1999 and 2002, medium density dwelling approvals (that is, ‘grouped houses’ and other residential buildings defined as ‘semi-detached’) increased from 13.9 per cent to 25.5 per cent of all dwelling approvals, while low density dwelling approvals (one house per single lot) fell from 66.1 per cent to 54.8 per cent. The proportion of high density dwellings (flats, units, apartments and so on) remained constant over this period (ABS 2003b). At the municipal level (table 2.3), the City of Melbourne had by far the largest value of residential work in 2004, but a relatively small amount of domestic construction. Domestic work was spread more evenly across municipalities.

## 2.2.4 Construction by registered builders and owner-builders

Most Victorians contract with a registered builder to undertake building work for them. Some people (called owner-builders) build houses that they own; they are not necessarily registered builders. (These terms are explained more fully in chapter 4.) Owner-builders who are registered builders tend to take on work with a higher average value than that of work by registered builders in general or owner-builders who are not registered builders (table 2.4).

Table 2.4 Mean value of work conducted, 2004

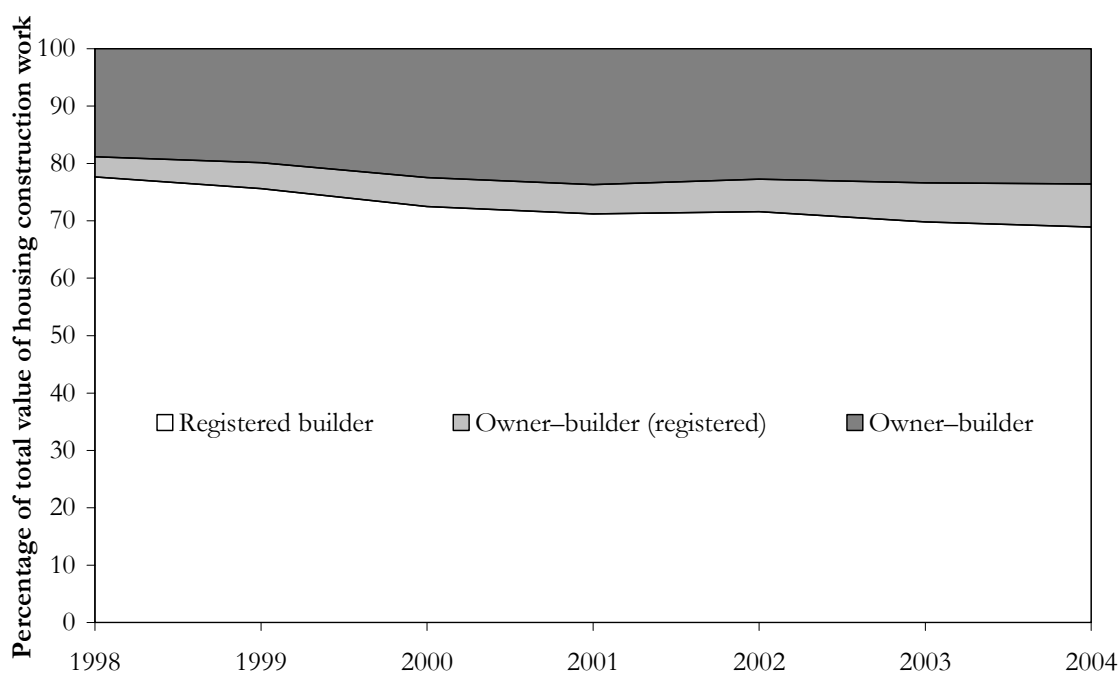
	<i>Registered builder (\$)</i>	<i>Owner-builder registered (\$)</i>	<i>Owner-builder (\$)</i>
New building	219 526	279 607	195 513
Re-erection	40 950	61 500	41 370
Extension/alteration	49 992	62 622	29 346
Change of use	122 020	265 357	69 124
Demolition/removal	6 640	7 000	10 868
Other	19 370	23 145	11 790

Source: BC 2005f

Registered builders who were not owner-builders accounted for 69 per cent of the value of domestic building work undertaken in Victoria in 2004. Owner-builders who were registered builders accounted for 8 per cent of building work, while those who were not registered builders accounted for 24 per cent.

The proportion of the value of housing construction work undertaken by owner-builders has increased in recent years (figure 2.4). Between 1998 and 2004, the value of work conducted by owner-builders who were not registered builders increased by 125 per cent, from \$915 million to just over \$2 billion. Over the same period, work conducted by owner-builders who were registered builders increased by 282 per cent (from \$172 million to \$657 million), while the work conducted by registered builders (not owner-builders) increased by 59 per cent (from \$3.8 billion to \$6.0 billion). Between 1998 and 2004, the number of domestic building permits given to registered builders (excluding registered owner-builders) decreased by 8.1 per cent, while the number given to unregistered owner-builders increased by 62 per cent.

**Figure 2.4 Value of housing construction, by builder type**

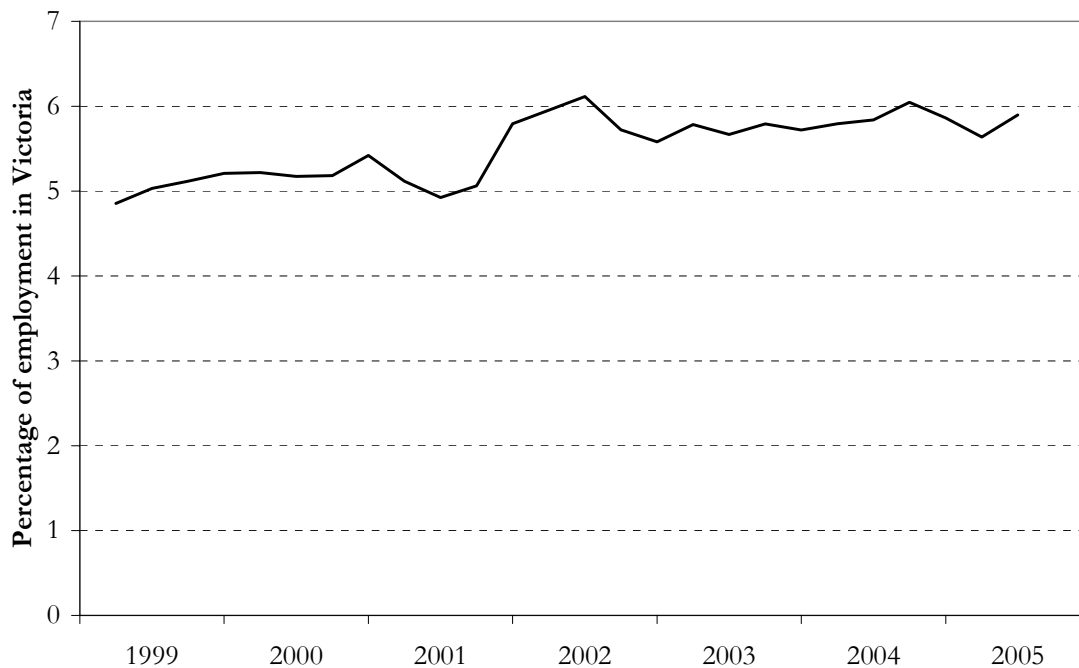


Source: BC 2005f

## 2.2.5 Employment

While official data for employment in the housing construction sector are not available, data for building construction as a whole are indicative. This industry employed 146 600 persons in the June quarter of 2005, making it one of the largest employers in Victoria, with almost 6 per cent of the state's workforce (figure 2.5). Employment grew by 30 900 between 1999 and 2002, but has since declined slightly.

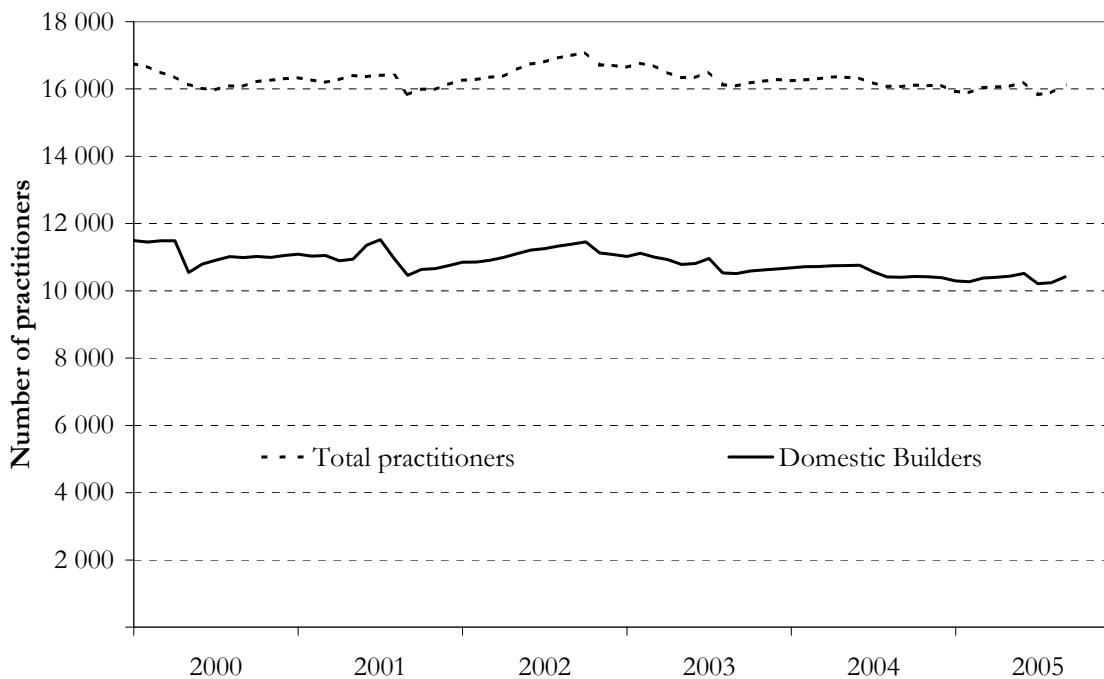
Figure 2.5 **Proportion of Victorian employment in the building industry**



Source: BC undated A.

The number of registered building practitioners remained fairly constant over the past five years. These practitioners account for less than 10 per cent of total employment in the building construction industry. In June 2005, there were about 16 200 registered building practitioners, of whom just over 10 000 were registered as domestic builders (figure 2.6). According to a Building Commission survey in 2003, the average age of registered building practitioners (47 years) tends to be older than that of the total building and construction labour force (36 years in 2001).

Figure 2.6 **Number of registered building practitioners in Victoria**



Source: BC undated A.

Other licensed professionals working in the housing construction industry include plumbers, architects, land surveyors, and electricians. In June 2004 in Victoria, there were:

- 19 361 people who held a plumbing licence and/or registration in Victoria (PIC 2004a, p. 23)
- 1104 surveyors (Surveyors Board of Victoria 2004, p. 5)
- 3269 individuals registered as architects and 594 approved architectural practices (Architects Registration Board 2004, p. 70)
- more than 8400 registered electrical contractors, over 320 licensed electrical inspectors and over 33 000 licence holders (including 24 000 licensed electricians) (OCEI, sub. 18, p. 7).

These professionals are involved in the whole Victorian construction industry and may not work solely within housing construction.

## 2.2.6 Structure and profitability

Small companies have traditionally dominated housing construction. More than 8000 builders construct dwellings in Victoria, and the average business employs two people (ABS 2003a). The push for urban consolidation has led to denser and more varied housing construction in recent years and a more complex housing construction industry. Higher density housing tends to be constructed by larger firms, and there is a new, substantial and relatively sophisticated multi-unit building sector (DOI 2002, p. 4). Nonetheless, by number, small businesses still dominate the industry. These small, and often family owned, businesses have typically built single-story houses for private clients in urban fringe locations.

In recent years, however, more homebuilders have become involved in constructing higher density dwellings, employing direct rather than contract labour. Some of these builders are new enterprises, while others have shifted or expanded into residential construction following a major slump in commercial and industrial construction in the early 1990s (Burke & Hayward 2000).

In Victoria, the 20 largest housing construction companies were responsible for 28 per cent of new dwelling starts in 2003-04, down from 31 per cent in the previous year (HIA 2004a, p. 6). The larger players in the industry are principally involved in land development in the outer suburbs and multi-storey development in the inner suburbs. Of the top five housing construction companies in Victoria in 2003-04, three were involved only in house construction, one focused on apartments and one was involved in both areas (HIA 2004a, p. 6).

In the national construction industry, nearly two thirds of businesses provide specialist trade services, including plumbers, electricians, carpenters, bricklayers, concreters, tilers and plasterers (HIA 2005a, p. 3). In Victoria, subcontractors accounted for over 80 per cent of residential construction employment in 1996-97 (Burke & Haywood 2000, pp. 24–9).

There are little data on the profitability of the housing construction industry in Victoria. Nationally, there were 48 201 residential building businesses in 2002-03, of which 51.6 per cent earned less than \$100 000 and accounted for 2.7 per cent of the industry's operating income. In comparison, businesses earning more than \$10 million per year represented less than 1 per cent of businesses in the industry, but 42.7 per cent of the income (ABS 2003a). The Building Commission reported in 2004 that 45 per cent of Victoria's domestic builders believed their profitability had increased in the preceding two years (BC undated A).

Such sketchy data do not give a complete picture of the extent of competition in Victorian housing construction. Moreover, the available data are statewide and may not represent the situation in regional markets. However, the Productivity



Commission's conclusion about the national residential construction industry seems likely to apply in Victoria:

While barriers to entry have increased in recent years because of growing regulation and more expensive insurance, there remains a large number of businesses competing for building work. Moreover, while the market share of large building companies providing project homes has increased, this has tended to stimulate competition. ...

There were concerns about the competitiveness of some sections of the commercial sector involved in high-rise and medium density residential construction, where there are fewer and larger businesses. But even here, there is a sufficient number of suppliers, along with the presence of the detached housing sector, to ensure the market is kept competitive. (PC 2004a, p. 182)

Chapters 6 and 7 discuss the extent to which regulation affects competition.

## **2.3 Productivity**

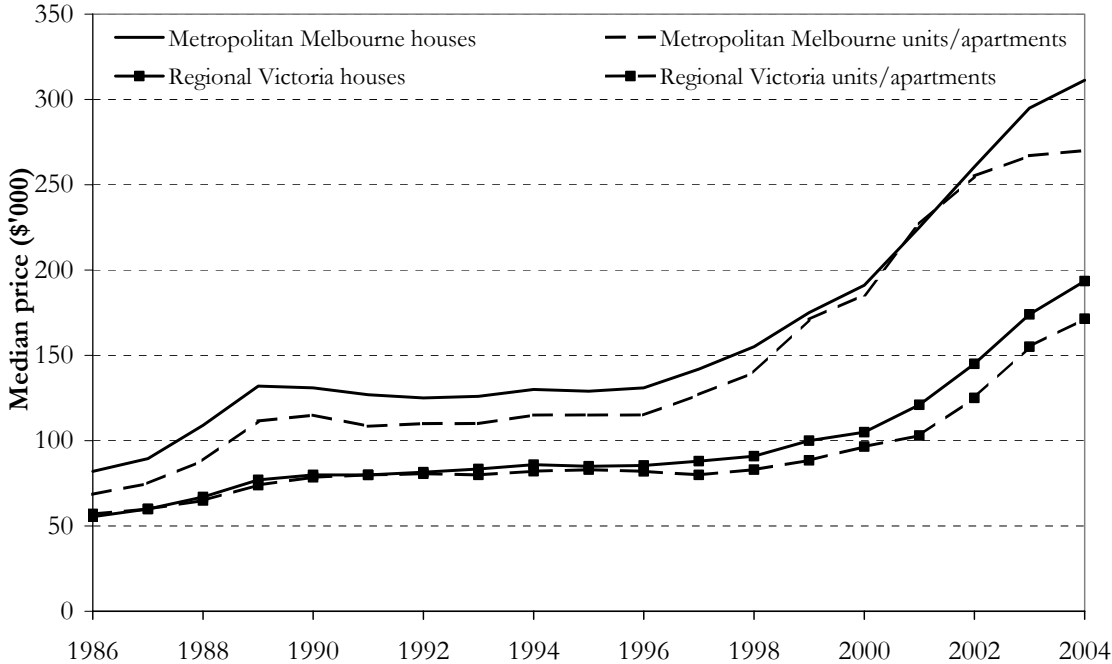
The Victorian Competition and Efficiency Commission has not been able to access data about the productivity of the housing construction sector. In its recent report on first home ownership, the Productivity Commission reported some studies on productivity in the construction sector as a whole, which provided a mixed picture of the sector's productivity performance here relative to other countries. Regarding housing construction, the Productivity Commission noted that a study by Econtech 'suggested that lifting productivity in the commercial sector to the same level as in the residential sector would reduce commercial construction costs by 6 per cent' (PC 2004a, p. 183).

## **2.4 House prices**

Figure 2.7 reports median prices for houses in Melbourne and non-metropolitan Victoria. In 2004, the median price of houses and units in Melbourne was \$311 250 and \$270 000 respectively (DSE 2005, p. 16). The median price of vacant house blocks in Melbourne was \$135 275, suggesting that land accounts for over 40 per cent of the median house price. In country Victoria, the median price of houses and units was \$193 500 and \$171 500 respectively in 2004, while the median price of a vacant land block was \$75 500 (DSE 2005, p. 18). These figures mask significant variations—for example, median house prices in Melbourne ranged from \$170 000 in Melton South to \$1 702 500 in Toorak; in country Victoria, the range was from \$38 300 in Wycheproof to \$679 000 in Lorne (DSE 2005, pp. 35–41).

House prices have risen substantially since the mid-1990s (figure 2.7). Between 1996 and 2004, the median house price in Melbourne increased by \$180 250 (from \$131 000 to \$311 250). Over this period, the median price of a vacant house block increased by \$80 275 (from \$55 000 to \$135 275) (DSE 2005, p. 16). While a comparison of the median prices of houses and vacant house blocks is indicative only, higher land prices appear to have been a substantial component of the increase in house prices in the past 10 years.

**Figure 2.7 House and unit prices, Victoria**

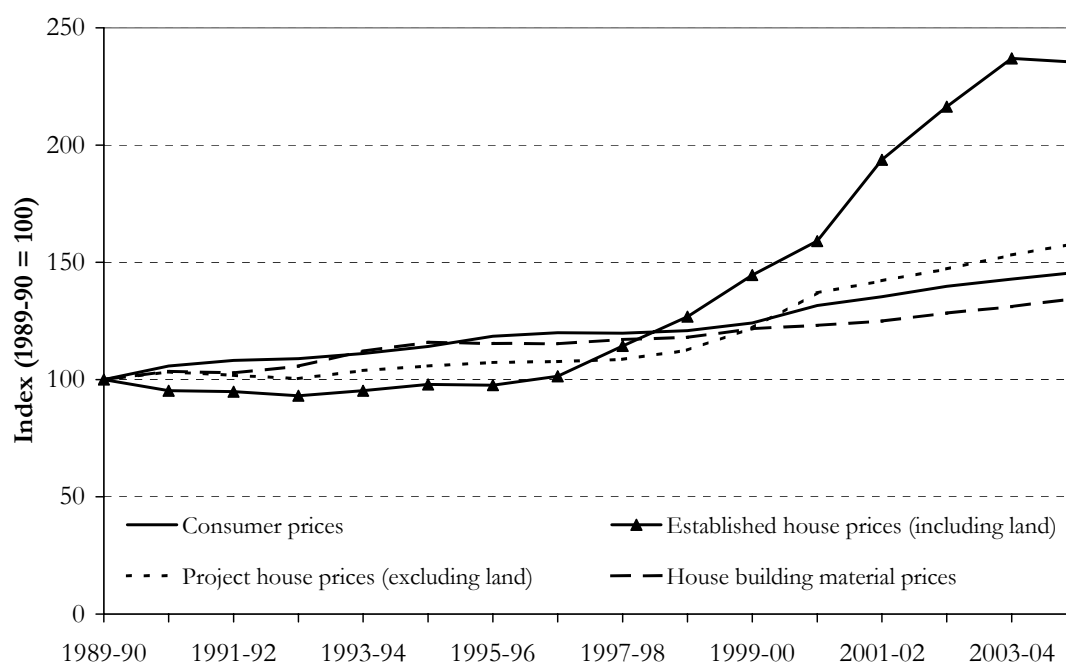


Source: DSE 2005.

Figure 2.8 supports this conclusion with some different data, which show that Melbourne house prices (including land) have risen much more rapidly since the mid-1990s than have prices of project houses (excluding land) or house building material prices. In this environment, affordability has become a contentious issue, because some measures indicate that housing costs are taking a higher proportion of household incomes. The Productivity Commission reviewed several different measures of housing affordability in 2004, concluding that ‘the commonly reported indexes, while not without deficiencies, collectively suggest that affordability for first home buyers has declined considerably in the past year or two’ (PC 2004a, p. 13). After the Productivity Commission’s report was published, affordability in Melbourne according to one of these indexes (the Home Industry Association (HIA)–Commonwealth Bank index of affordability for first home buyers) improved by 13.3 per cent in 2004 and a further six per

cent in the first half of 2005. Notwithstanding this improvement, affordability according to this index is still well below the level in 1998 (HIA & CBA 2004, p. 3; HIA & CBA 2005, p. 3). New composition adjusted house price data released by the Reserve Bank of Australia shows that house prices in Melbourne increased from approximately four and a half times average wages in 1997 to over seven times average wages in 2004 (RBA 2005a, p. 38).

**Figure 2.8 Trends in house and building material prices, Melbourne**



Sources: ABS 2005d; 2005f; 2005g.

## 2.5 Regulation and house prices

Given this inquiry's focus on the regulation of housing construction, the Victorian Competition and Efficiency Commission was interested in the extent to which regulation increases house prices. The availability of quantitative data on both the costs and benefits of housing construction regulation is limited however.

Of the available estimates, the HIA had estimated that regulation could add approximately \$18 000 to the cost of constructing a house. Work undertaken for the Building Commission estimated that regulation could add over \$15 000 (or 5 per cent) to the cost of a typical \$300 000 house (Davis Langdon Australia Pty Ltd 2005, p. 21). A survey conducted for the Building Commission found that 36 per cent of respondents believed 5 Star energy requirements alone would add

between three to five per cent of the cost of a new house. A further 32 per cent of respondents believed the added cost would be greater than five per cent (Chant Link & Associates 2005, p. 47). A more recent survey conducted for the Building Commission, however, found average incremental costs to achieve a 5 Star rating to be substantially less. It found the average incremental cost to achieve a 5 Star rating is \$2841–5908 depending on the size of the home and whether it is single or double story (Jettaree 2005).

As a cross-check on the size and composition of these estimates, the Commission undertook a small survey of builders and architects, which is reported in appendix C.

In the draft report (VCEC 2005a), the Commission reported that its survey respondents estimated that selected Victorian and local government regulation represents at least 4 per cent of the value of an average house<sup>2</sup> (table C.2). This was the lower bound of respondents' estimates—the estimated cost of complying with regulation is much higher for some respondents. In addition, estimates were not sought for other regulation affecting housing construction in Victoria.

Since the draft report, the sample size has increased from 12 to 32. The estimates of the cost of the selected regulation vary substantially across surveyed builders, from 2 per cent to almost 20 per cent. This variation is partly the extent to which respondents could provide estimates for all the selected regulations varied, but also because respondents had different views about the incremental cost attributable to regulation. Further, the cost estimates vary according to the type of house—for example, the cost of scaffolding is higher for double-storey houses than single-storey houses—and its siting and location—for example, the costs of some regulation is higher in regional areas than metropolitan Victoria.

In its draft report, the Commission suggested that it would be reasonable to infer, assuming the experience of the surveyed practitioners is representative of the industry more broadly, that the selected regulations impose a cost equal to at least 4 per cent of the value of housing construction in Victoria. With the value of housing construction in Victoria exceeding \$10 billion, this suggests that housing construction regulation cost at least \$400 million in 2004-05. The larger sample surveyed since the draft report has not changed this estimate and may even suggest it is conservative (as is explained in appendix C).

The estimate excludes the costs of levies, including the building permit levy (0.064 per cent), the Building Advice and Conciliation Victoria levy (0.064 per cent) and the HIIH levy (0.032 per cent)—totalling 0.16 per cent of the

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<sup>2</sup> 'House' as used in this section refers to only the value of the building itself. The value of land is excluded.

cost of all housing construction work. Based on 2004-05 construction activity, the additional cost of levies was approximately \$16 million in 2004-05.

Together, the selected housing construction regulation and the levies appear to have cost at least \$416 million in 2004. While this is a conservative estimate of the total cost of housing construction regulation, the extent to which it represents the incremental costs of regulation is unclear. Some activities required by regulation might be undertaken even if there were no regulation. Based on the evidence provided, however, the Commission considers that its estimate is unlikely to overstate the incremental costs substantially. The estimate is based on the lower bound of survey participants' estimates and is consistent with other attempts to measure some or all of the regulatory costs.

Participants in the inquiry's cost estimation exercise identified four areas that impose relatively high compliance costs:

- (1) 5 Star energy efficiency (including water saving devices), for which most estimates of additional cost were between \$4000 and \$30 000, or 1.4–8.0 per cent of the cost of an 'average' house, although one builder suggested the \$250 to obtain an energy rating is the only additional cost (table C.5)
- (2) builders' warranty insurance, for which the estimates ranged between \$794 and \$4120, or between 0.4 per cent and 1.8 per cent of the cost of an 'average' house (table C.6)
- (3) scaffolding, with an estimated cost for a double-storey house of between \$2000 and \$16 375, or between 0.3 per cent and 5.1 per cent of the costs of an 'average' house (table C.7)
- (4) termite protection, with estimates ranging between \$400 and \$4500, or between 0.1 per cent and 3.1 per cent of an 'average' house (table C.8).

The percentage cost estimates reflect differences in respondents' cost estimates and the costs of an 'average' house for each respondent.

The Department of Sustainability and Environment criticised the Commission's estimates in the draft report, on the grounds that the sample size was small, it is difficult to estimate if the costs quoted were incremental, and the Commission did not compare the costs with the benefits of regulation (sub. DR 172, p. 3). The Commission acknowledges the limitations of its analysis, but points out that the estimates (notwithstanding the increase in survey respondents) were clearly intended only as a cross-check on other estimates. It accepts that the costs should be compared with benefits of regulation, but even less information seems to be available about the benefits of regulation (from the Department of Sustainability and Environment or anywhere else) than is available about its costs (see below). Given the significance of housing construction to the Victorian

economy, the Commission considers that the availability and monitoring of data on the costs and benefits of housing construction regulation are unsatisfactory.

That regulation adds costs does not mean these additional costs are not warranted. Good regulation will generate benefits larger than its costs, which is why this inquiry has focused on whether appropriate processes are in place to help ensure the benefits of regulation exceed its costs. Moreover, costs may decline over time (for example, as the new 5 Star regulations are bedded down, or as competition continues to trim building insurance premiums). The main messages that the cost data suggest for this inquiry are that:

- the costs of regulation are not insignificant, so it is worthwhile to ensure regulation is imposed only where warranted and in the least costly way possible
- reducing the cost of regulation and restraining its growth should contribute to improving housing affordability, but alone will not reverse the decline in affordability experienced in recent years.

## **2.6 Health and safety in the home**

Given that important objectives of housing regulations are to protect the community's health and safety (chapter 4), the Commission has looked for information about injuries associated with housing structures.

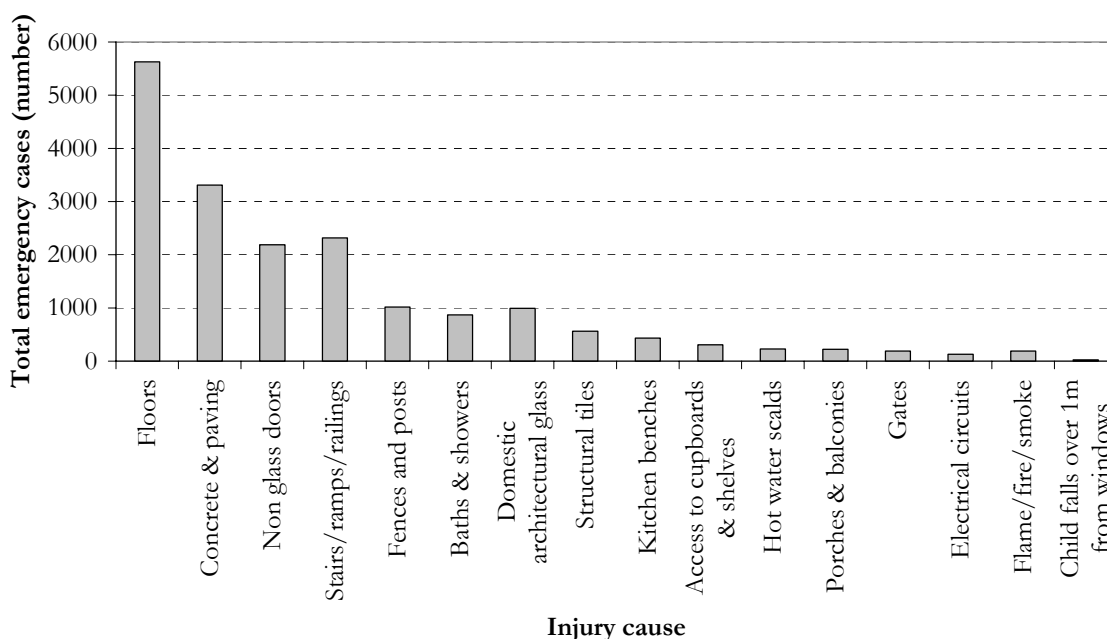
The Australian Building Codes Board operates a database that registers relevant information sources relating to health and safety risks in commercial and residential buildings (Atech Group 2003). Information is collected from Australia (on a national and state-wide basis), Canada, Japan, New Zealand, United Kingdom and the United States.

A relevant Victorian data source reported in the Australian Building Codes Board database is the Monash University Accident Research Centre, which operates the Victorian Injury Surveillance and Applied Research System. The centre collects, analyses and reports on injury data in the state and produces a quarterly report, *Hazard*, to provide information about injuries and their prevention. The September 1997 edition, *Safe home design* (Ashby & Routley 1997), found the following:

- The home is the most common location for injury, representing 49 per cent of child and 29 per cent of adult emergency department cases between 1988 and 1996. Of these cases, at least 30 per cent and 26 per cent respectively were related to structures, fixtures and other features incorporated into a home at the design, building or renovation stage.

- The most frequent and most easily identified structural causes of injury between 1989 and 1996 were floors, concrete and paving, doors, stairs/steps, fences and fence posts, bath and shower bases, domestic architectural glass, structural tiles, bench tops, access to cupboards and shelves (child poisoning), and bathroom hot water (figure 2.9).
- The most severe structural causes of injury (measured in terms of hospital admissions as a proportion of emergency cases) were bathroom hot water (scalds) (45 per cent), access to cupboards and shelves (child poisoning) (43 per cent), electrical circuits (42 per cent), child falls over 1 metre from windows (42 per cent), gates (35 per cent) and flame/fire/smoke (35 per cent).

Figure 2.9 **Injuries related to structural features in Victoria, by frequency of cause, 1989–96**



Source: Derived from Ashby & Routley 1997.

Since the draft report, the Commission has sought time series data on injuries related to structural features of housing, to assess whether there is any correlation between regulatory changes and safety outcomes. It has not found any further published information but notes that the Monash University Accident Research Centre can provide updated data that may allow this

comparison.<sup>3</sup> Such data could also help regulators to identify areas where possible improvements (regulatory or non-regulatory) could be made.

### **Finding 2.1**

Housing construction in Victoria is a competitive industry, a large employer and a substantial contributor to the Victorian economy.

The sector has been growing rapidly (although growth has now slowed) and experiencing considerable change in the type and location of construction, the size distribution of businesses, and the relative importance of owner-builders.

### **Finding 2.2**

The costs of regulation are significant, so it is worthwhile to ensure regulation is imposed only where warranted and in the least costly way possible.

Given the significant costs and benefits involved in housing regulation, the availability and monitoring of costs and benefits data are unsatisfactory.

### **Finding 2.3**

Reducing the cost of regulation and restraining its growth should improve housing affordability, but alone will not reverse the decline in affordability experienced in recent years.

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<sup>3</sup> It may be difficult to attribute a decrease in the number of injuries to the introduction of housing regulations because there can be other influences. Improved housing design, the removal of obstacles and the absence of surface contaminants, for example, can contribute to reduced slips and falls.



## **3 Building regulation: its purpose and rationale**

The terms of reference for the inquiry direct the Victorian Competition and Efficiency Commission to inquire into the regulation of the housing construction sector in Victoria and related issues. This chapter outlines what constitutes ‘regulation’ in this regard, and the purpose and rationale of that regulation. It discusses the challenges facing government if regulation is to deliver improved outcomes for society, and outlines characteristics of a good regulatory framework that facilitate achieving that purpose. In doing so, it provides a framework to assess the regulation of the housing construction sector.

### **3.1 What ‘regulation’ is under review?**

The Commission is required to undertake a systematic and comprehensive review of Victorian regulation affecting the housing construction industry, to identify where that regulation might be improved and how any improvements might be made. The Organisation for Economic Cooperation and Development (OECD) defines regulation as ‘the instruments by which governments place requirements on enterprises, citizens and government itself, including laws, orders and other rules issued by all levels of government and by bodies to which governments have delegated regulatory powers’ (OECD 1997, p. 6). That is, regulation involves the imposition of some rules, supported by government authority, that are intended to influence behaviour.

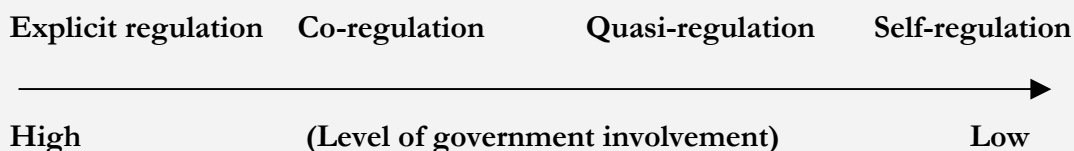
Although regulation may cover a spectrum of regulatory approaches (box 3.1), this inquiry has focused on regulation where government backing enables rules to be legally enforced—that is, explicit government regulation, co-regulation and some forms of quasi-regulation, but not self-regulation.<sup>1</sup> Within this set of regulation, the Commission has given particular attention to regulation affecting housing construction in Victoria that has been delivered through the rules set in primary and subordinate legislation, mandatory codes of practice, ministerial directions or binding guidelines. Chapter 4 contains a detailed outline of the regulation being considered by the Commission in this inquiry.

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<sup>1</sup> This approach is consistent with that adopted by the Commission in its previous inquiry into regulatory barriers to regional economic development (VCEC 2005b).

### Box 3.1 Regulatory approaches

The term ‘regulation’ can cover a spectrum of regulatory approaches that differ by the level of government involvement and range across explicit government regulation, co-regulation, quasi-regulation and self-regulation:



**Explicit regulation** consists of primary legislation (Acts of Parliament), subordinate legislation (Regulations) and administrative decisions and instruments. The *Building Act 1993* (Vic.), for example, establishes the legal framework for the regulation of building construction, building standards, maintenance of specific building safety features, and specific building occupations.

**Co-regulation** usually refers to the situation where industry develops and administers its own arrangements but the government provides legislative backing to enforce those arrangements. Self-regulation by building designers, for example, is underpinned by state licensing legislation for building practitioners in Victoria.

**Quasi-regulation** refers to rules, instruments and standards that do not form part of explicit government regulation but for which the government influences compliance. Examples of quasi-regulation include government endorsed guidance notes, industry–government agreements and national accreditation schemes. The 12 national qualifications that constitute the Australian Qualifications Framework are an example of a national accreditation scheme (AQF 2004).

**Self-regulation** is characterised by industry formulating rules and codes of conduct, and being solely responsible for enforcement. In some cases, government may also be involved in a limited way—for example, by providing advisory information.

Source: Derived from Office of Regulation Review 1998, pp. B2–B3.

## 3.2 Purpose and rationale for regulation of the housing construction sector

Governments recognise that freely functioning markets are the best available way in which to determine what goods and services are produced, how they are produced and how they are distributed. However, market forces may not always be sufficient to deliver efficient or equitable outcomes. Where markets do not exist, or where they exist but fail to deliver efficient or equitable results, government intervention (through regulation or any other means) may be warranted. The case for government regulation in housing or any other market

rests on demonstrating that the government action can improve market outcomes in terms of economic efficiency or equity considerations.

In principle, government intervention through regulation may aim to improve the way in which goods and services are produced (technical efficiency), how they are priced (allocative efficiency) or their production and pricing over time (dynamic efficiency). Government intervention through regulation may also aim to improve equity outcomes. Given the high rate of home ownership in Australia, and its importance to living standards, governments want to ensure people have access to affordable, comfortable and safe housing.

Demonstrating that there is scope to improve market outcomes is not, however, sufficient justification for intervention through regulation. Government intervention may be problematic for a range of reasons and, depending on how it is managed, can impose significant costs on society. To justify intervention through regulation, therefore, it is necessary to also demonstrate that the benefits from improved market outcomes outweigh the costs of government intervention. The Department of Sustainability and Environment summarised this view:

The rationale for government intervention through regulation rests largely on the identification of market failure. The market failure in question needs to be sufficiently large as to justify regulatory action and it needs to be established that regulation is the most efficient response. ... At issue is whether the building industry faces problems that cannot be solved by the industry or by those using building services. (sub. 84, p. 4)

The following sections consider in more detail the range of potential benefits and costs of government regulation of housing construction markets.

### **3.3 Market failures in housing construction**

As noted, government may be able to improve market outcomes where there is market failure. What is the range of possible market failures in housing construction? And what are the potential consequences for economic efficiency and equity?

The three main types of market failure in the housing construction sector are generally considered to be:

- (1) information disadvantages facing consumers (commonly referred to as information asymmetry)
- (2) positive and negative spillovers associated with housing construction
- (3) the merit characteristics of housing.

### 3.3.1 Consumers' information disadvantage

In many markets, consumers generally have poorer information than have suppliers about the key attributes of a product or service, such as quality and costs of provision. Builders are generally better informed than consumers about the features, quality and cost of housing construction, for example. Most consumers find it difficult to ascertain whether builders are providing the desired quality of service at a price that reflects the cost of provision.

Information asymmetry (where information is known to some people but not to others) can distort the functioning of markets by causing a trend towards reductions in the quality of goods and services. This occurs because buyers have to assume that sellers are offering goods or services at an average level of quality. But sellers of higher than average quality products will be unwilling to sell to consumers at the average price, so will either not offer their services or lower the quality of their offering. The withdrawal of these higher quality goods and services also reduces the average level of quality and, therefore, consumer assumptions about quality. In extreme cases, the end result is a downward spiral in quality and a decline in the size of the market as buyers and sellers withdraw.

Consumers are likely to have less information than have suppliers on key aspects of housing construction. These include structural soundness, the effectiveness of protection against fire, and the use and impact of materials that could damage the health of housing occupants (PC 2004c, p. 31). Consumer Affairs Victoria noted the effect of this information asymmetry on housing and construction markets:

In the market for housing construction services, building practitioners know more about the quality of their services than most prospective customers. As a consequence, most homeowners will assume that each builder is of average quality. Under the pressure of competition and in the absence of any constraint, builders will tend to offer lower quality services than they are capable of providing ... (sub. 91, p. 22)

Given that most market exchanges probably feature information asymmetries, why is housing construction any different? Various reasons have been suggested as to why information asymmetries may be relatively more significant for housing construction markets:

- The long-lived nature of housing assets means flaws may become apparent in housing only several years after construction is completed. A related issue is that many aspects of the building are hidden by the time a building is completed (PC 2004c, p. 31). The long lived and 'hidden' nature of some attributes of housing make it harder for consumers to assess and monitor the quality and cost of work. If the consumer cannot assess the financial status of the builder, there is the additional risk that the builder may not be around to remedy any faults that become apparent.

- Consumers are infrequent purchasers of housing construction services. This lack of experience also makes it more difficult for consumers to assess and monitor the quality and cost of work. The Housing Industry Association (HIA) noted that ‘homeowners tend to enter into home building infrequently (possibly only once or twice in their entire life) and accordingly are unlikely to be knowledgeable about how to ascertain whether a builder is capable of delivering a quality end product’ (sub. 58, p. 11).
- Consumer expenditure on housing construction services is also the largest item of expenditure that most people make. This means that consumers may be more cautious about their spending on housing and thus more sensitive to changes in the quality and cost.
- Like many production processes, housing construction is complex and involves a wide variety of skills and inputs. But unlike many complex production processes, it usually involves production of a heterogeneous product—that is, although houses have common features, significant tailoring usually occurs to meet the needs or desires of consumers. This can make it harder for consumers to assess the quality and cost of housing construction services by comparing the quality and value of different offers from suppliers. Other sectors sharing this characteristic include medical and legal services, both of which are subject to extensive regulation.
- Decisions about many features of a house are made or influenced by builders rather than consumers. Decisions about the type of insulation, the orientation of a house, and many of the fittings may be based on the upfront costs, with less regard to lifetime operating costs.

While these characteristics make the housing construction market different from many other markets, the market may not be unique. Many of its characteristics feature in other heavily regulated markets, such as those for medical services or for motor vehicles. With motor vehicles, for example, most consumers purchase infrequently, faults are hard to detect and may take time to appear, outlays on a car can represent a significant share of income for buyers and sellers, and sellers have better information about quality, especially for second-hand cars.

The conclusion that housing construction markets are characterised by market failure in the form of consumers’ information disadvantage is not sufficient justification for government intervention through regulation. The case for intervening also requires evidence that market institutions to correct for the information disadvantage are inadequate or can be usefully improved by government.

A number of market institutions and strategies have evolved to help bridge the information disadvantage and reduce the resulting risks for consumers:

- Private agents, such as architects and building surveyors, can represent the interests of consumers by negotiating with builders and/or monitoring their activities. But if many of the features of a building are difficult for anyone other than the builder to assess, then private agents may not be able to adequately assess some aspects of the construction process (PC 2004c, p. 31).
- Associations representing suppliers of housing construction services also have a strong incentive to expand housing markets by, for example, identifying good quality builders and reducing risks facing consumers. While the HIA and the Master Builders Association (MBA) focus on providing services to members, both also provide information and advice to consumers. The HIA provides, for example, plain English contracts and guides for consumers, and the MBA provides a consumer contact service.
- Many companies place a high commercial value on their reputations and market their services using testimonials from customers. Also, many consumers rely on the experience of family, friends and others in selecting suppliers. The housing construction sector, however, is considered to be different from many other markets because it comprises a large number of small scale producers. This difference may make it harder or more costly for consumers to obtain information on the reputation of suppliers, compared with consumers in other markets. Also, given the time that may elapse before some quality problems become evident, short term reputation may be an imperfect indicator for consumers.
- To support their reputations, many companies voluntarily provide warranties for the services they provide. Warranties may help to reduce the risks facing consumers, but many consumers may place little value on voluntary warranties. A warranty may have limited value if, for example, it is particularly difficult for the consumer to show that housing defects stem from faulty work, or if suppliers faced with large claims can avoid responsibility by exiting the industry.
- Consumers can use a variety of dispute resolution mechanisms to seek redress for poor quality services. In Victoria, the *Fair Trading Act 1999* extends consumer protection provisions in part V of the *Commonwealth Trade Practices Act 1974* to those parts of the economy that cannot be reached by the Commonwealth's constitutional powers, such as builders operating as sole traders. The Trade Practices Act requires, for example, that goods and services be 'fit for purpose' (chapter 4). This avenue of redress may be too expensive or risky for consumers (particularly for cases involving small claims). The Fair Trading Act provides a simplified procedure for resolving consumer claims against traders for amounts less than \$10 000.

These institutions and strategies can help address, but may not overcome, the information disadvantage facing consumers. The reason for this limitation is that each mechanism may impose a considerable cost on consumers. Hiring a building surveyor or architect to vet quotes from builders and closely supervise construction, for example, may be too expensive for many consumers.<sup>2</sup> And many consumers may place little value on the reputations or voluntary warranties of suppliers of housing construction services.

Building Ethics Australia elaborated on the difficulties of bridging the information disadvantage:

- Engaging external consultants may be feasible in some instances, usually where the project cost can justify the cost of the consultant. These costs are generally high and out of reach of most consumers. Added to this is the fact that the consumer will have no more ability in selecting a consultant who is capable of looking after their interests than in selecting a good and reputable builder initially.
- Testimonials can be a reliable barometer of a builder's performance, however issues exist with respect to consistency of performance (are the referrals selective and do they represent a genuine appraisal of the builder's performance?), financial status and current performance (how current are the referrals?). In the end, the consumer cannot possibly avail themselves of adequate knowledge without making exhaustive enquiries which may well be expensive and inconclusive.
- As a last resort, when the builder refuses to return to site and remedy any defects or even discuss problems, the consumer may approach BACV [Building Advice and Conciliation Victoria], CAV [Consumer Affairs Victoria] or VCAT [the Victorian Civil and Administrative Tribunal]. Any of these bodies may bring about resolution of the problem, however usually after considerable time, stress and expense. (sub. DR114, p. 6)

Governments have put in place specific regulatory interventions to reduce risks for consumers, which suggests there is widespread concern about the cost to consumers and/or the efficacy of market institutions and strategies. Unless carefully designed, however, regulation can also restrict the development of effective market institutions and strategies (discussed below).

### **3.3.2 Spillover benefits and costs**

Government intervention, through regulation and other means, has also been justified on the grounds that some housing construction activities generate positive and negative spillovers. Spillovers are benefits or costs generated by the

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<sup>2</sup> Regulation may crowd out some private agents or impede the development of such services at prices that may be attractive to consumers.

production or consumption of goods and services that accrue to third parties and that are not reflected in prices.

Some costs associated with the construction of a house—noise, dust and water run-off for example—may fall on others in the immediate or extended community (third parties), not just the parties involved in that transaction (the consumer or the builder). Another example is poorly sited or designed houses, which may adversely affect the amenity and safety of neighbours. Similarly, such houses can result in unnecessarily high energy consumption and greenhouse gas emissions that adversely affect a much broader range of parties. Spillover costs may also arise if consumers or builders do not bear all of the costs associated with the use of particular building materials, such as asbestos.

If consumers and builders do not bear the relevant costs or are unaware of them, then housing construction activities may have negative effects on surrounding communities. The Department of Sustainability and Environment noted:

Generally speaking individuals do not have an incentive to take fully into account the costs that their activities may impose upon others. The process of construction and the finished product itself can have negative impacts on inhabitants of buildings and the surrounding community. There is a need to ensure that property owners do not impinge upon the rights of other property owners. This covers issues such as excessive construction noise, poor drainage, and inadequate ventilation. Regulation attempts to provide an appropriate degree of protection to adjoining occupiers and others who may be negatively affected by building activity. (sub. 84, p. 5)

There may also be situations where consumers of housing construction services do not capture all of the benefits of their decisions. Investing in termite protection when a house is being built may provide a (spillover) benefit to neighbours and others if it discourages the spread of termites in an area. Without any intervention, homeowners will not consider these spillover benefits when deciding whether to invest in termite protection, possibly leading to less spending than is desirable from society's perspective.

Building research is another potential area where spillover benefits occur; if those producing such research cannot fully appropriate the value of that research, it will tend to be undersupplied (PC 2004c, p. 32). Partly to address this issue, the Australian Building Codes Board has been established to support and disseminate research.

### **3.3.3 Equity**

As noted, governments may also intervene in markets for equity (fairness) reasons. The national standards for access to public buildings by people with disabilities—currently being developed by the Australian Building Codes Board



under the aegis of all Commonwealth, state and territory governments—are an example. Equity concerns also underpin regulation aimed at protecting the disadvantaged or relieving social isolation, for example, by ensuring adequate community infrastructure in new housing developments (State Government of Victoria 2005b, p. 2-2).

Regulation is one avenue to achieve equity outcomes. Financial support, rather than regulation, may be the best way to assist people on low incomes to obtain housing or achieve appropriate levels of accessibility. The Productivity Commission, for example, noted that funding disadvantaged groups directly or subsidising buildings with specified characteristics might be a better option than mandating standards through regulation (PC 2004c, p. 33).

### **3.3.4 Significance of market failures in housing construction**

There is broad agreement that the market failures in the housing construction sector provide some justification for government intervention through regulation. The Department of Sustainability and Environment argued that the types of market failure discussed in this chapter provide a rationale ‘for accepting that some level of regulation of housing construction is required to protect consumers and ensure a minimum level of health, safety and amenity are met’ (sub. 84, p. 5). Moreover, it considered that the special features of the housing construction sector mean that market institutions and strategies for addressing these market failures (such as common law remedies and voluntary warranties) are unlikely to be sufficient to ensure consumer protection and public confidence in the industry and its products (sub. 84, p. 5).

However, the Master Builders Association of Victoria considered that the extent of market failure in housing construction markets does not warrant the current extent of government intervention in Victoria:

The presence of information asymmetries or externalities does not automatically justify government intervention. Market failures occur every day; buyers are regularly not as well informed as sellers and most transactions have consequences for third parties. (sub. 58, p. 12)

Whether the market failures discussed in this chapter are more prevalent in housing construction than in other areas of the economy is an empirical question, but there appears to be little empirical evidence on which to base a firm view on this issue. That said, Australian governments have introduced regulatory interventions in housing construction markets, indicating a strong view that these interventions can deliver significant benefits to society. The interventions are designed to overcome the information disadvantage facing consumers, address spillover benefits and costs, and achieve more equitable outcomes for particular groups in society.

Given the scale of the Victorian housing market, even small improvements in efficiency through government intervention hold the potential to deliver significant benefits to the community. As noted in chapter 2, the value of housing construction (broadly defined) in Victoria exceeded \$10 billion in 2004-05. On the other hand, small distortions in the market caused by government intervention can impose considerable costs on society (see below).

The extent to which government intervention through regulation of the housing construction sector may improve community welfare depends on how the intervention is designed. The next section considers challenges facing government in designing effective interventions in the sector. It also sets out some best practice principles for regulation that the Commission has used to assess the regulation of housing construction in Victoria.

### **3.4 Challenges for government**

As noted, the case for government intervention via regulation requires evidence that particular corrective mechanisms will deliver better outcomes for society than would relying on an imperfect market. Just as markets may fail to deliver desired economic and equity outcomes, regulation may also fail. The key is to avoid the potential for government failure by designing regulation carefully. The Victorian Government acknowledged this challenge in its *Victorian guide to regulation*:

... regulation, and its increasing complexity, can place a major burden on the parties being regulated. Regulation not only creates additional paperwork, but it can distort decisions about inputs, stifle entrepreneurship and innovation, divert managers from their core business activity, prolong decision-making, and reduce flexibility. Furthermore, poorly designed regulation can result in unintended, undesirable side effects. (State Government of Victoria 2005b, p. 1-3)

Government interventions may reduce welfare if they distort one or more of the elements of economic efficiency (technical, allocative and dynamic efficiency) or are ineffective, thereby imposing unnecessary administration and compliance costs on industry and consumers.

#### **3.4.1 Efficiency effects**

If government interventions such as housing construction regulation are poorly designed, they can reduce technical and dynamic efficiency by distorting business decisions about housing construction production processes. The Productivity Commission, on the other hand, found that the regulatory reforms implemented or overseen by the Australian Building Codes Board have helped to boost industry productivity by encouraging skills acquisition, reducing costs, and encouraging innovation (PC 2004c, p. 70).

Poorly designed or unnecessarily restrictive regulation may give people a strong incentive to find ways around the regulation. The effort devoted to circumventing regulation and to discouraging such behaviour represents a cost that society bears. In the housing construction industry, for example, there was a concern that some builders are encouraging their clients to register as owner-builders to avoid certain regulations. (Chapters 4 and 6 discuss recent regulatory changes to address this issue.)

As noted, imperfect housing construction markets may result in the average quality of housing being less than socially desirable. But a risk associated with regulation designed to increase the quality of housing is that standards will be set too high (gold-plating), thereby limiting choice for consumers who may prefer a lower standard and penalising the less well off who will face higher housing costs.

The likelihood that regulation will produce such unintended adverse effects can be influenced by the institutional arrangements around policy development, administration and enforcement.

On the policy front, governments commonly face pressures to intervene in markets. Some are short term pressures—for example, the collapse of a company may create community pressure to address the consequences of the collapse. Given that government intervention through regulation frequently produces winners and losers, government may experience ongoing pressures from the winners to intervene. A potential consequence of tightening the requirements for entry to a building profession, for example, is that it becomes harder for new suppliers to enter. The winners are incumbent suppliers; the losers are those who wish to enter the trade or profession, and consumers, who may face higher prices if competition is reduced.

Faced with these pressures, good processes for developing policy are important. Rigorous assessment of the likely effects of proposed interventions can aid decision making by revealing whether short term responses will create longer term problems, or whether the intervention is the minimum necessary to address the particular problem. Making this assessment public can aid the process of developing interventions by highlighting any unintended effects and the arguments of those supporting or opposing intervention.

In implementing any intervention, government will often face internal ongoing pressures to extend the scope of activities such as regulation. A well-recognised issue in the literature on government intervention is the risk that those charged with administering interventions such as regulation will push for additional responsibilities and resources (Brown & Jackson 1990; Mueller 1989). This risk arises where public sector managers' pay and job satisfaction is linked to their responsibilities. As a result, managers have an incentive to bid for extra

responsibilities and resources. Without appropriate checks on managers' activities, government activities tend to expand (giving rise to regulatory creep).

To combat the risk of regulatory creep, governments typically put in place mechanisms such as statements of objectives and functions, performance agreements and monitoring, and periodic reviews (such as sunseting arrangements), and seek independent advice on policy matters. The likelihood of regulatory creep occurring depends on the quality of these accountability and monitoring mechanisms. As chapters 8–11 of this report note, there is scope to improve the accountability and monitoring mechanisms in housing construction regulation.

### **3.4.2 Effectiveness**

The effectiveness of government intervention will also depend on the instruments that government uses to achieve its objectives. Regulation is often one of a number of possible responses to market failures in housing construction and other markets. Some of the main mechanisms used to address failures in housing construction markets include:

- technical standards and outcomes for housing construction
- licensing and accreditation of housing construction service providers
- warranty and indemnity insurance
- standard contract provisions
- dispute resolution services
- information provision.

Many of these mechanisms are designed to shift risk from consumers to service providers and/or to reduce transaction costs. Licensing requirements, technical standards, standard contract provisions and indemnity insurance are intended to shift risk from consumers to providers by giving an assurance that licensed suppliers, contracts and housing meet minimum standards and that consumers have some recourse if the builder cannot rectify any defects. Information provision and dispute resolution services can help to reduce the costs to consumers and producers of housing construction by making markets work more effectively and by resolving disputes faster and more cheaply. Chapters 5, 6 and 7 examine the effectiveness of the major mechanisms used in Victoria.

While government intervention via the regulatory mechanisms listed above can benefit consumers by addressing market failures, it can also discourage the development of market based institutions and arrangements to mitigate risks and transaction costs. As noted, a number of market institutions and strategies have evolved to help bridge the information disadvantage and reduce the resulting risks for consumers. These include private agents to represent consumers,

voluntary warranties, supplier reputation and information networks. In some cases, government intervention could reduce the market for private agents or lead consumers to take on more risk.

Depending on the mechanisms used and their design, government intervention can also affect consumer behaviour in undesirable ways. Government backed licensing and insurance arrangements, for example, can discourage consumer effort to gather information and monitor building activity, particularly if consumers do not fully understand the limitations of these mechanisms in reducing risk.

While the discussion in this chapter has highlighted imperfections in housing construction markets, it also highlights challenges for government in correcting these imperfections. These challenges have resulted in efforts to develop best practice principles to help ensure interventions such as regulation are effective and improve economic efficiency.

### **3.5 Characteristics of a good regulatory framework**

Given the significant challenges facing governments in improving market outcomes, what can be done to ensure that regulation delivers on its objectives at least cost to the community? Widely recognised principles that have evolved over time indicate the characteristics of a regulatory framework that is likely to achieve the objectives of regulation, at least cost to the community.

In assessing the regulatory arrangements covered by the inquiry terms of reference and how they might better achieve the purpose of government, the Commission has drawn on the following principles to guide its analysis:

- Regulation should be understandable and introduced only after proper consultation.
- Regulatory effort should be the minimum necessary given the scale of the problem (and generally should not restrict competition).<sup>3</sup>
- Regulation should not be unduly prescriptive.
- Regulation should be consistent with other laws and regulation.
- Regulation should be enforceable.
- There should be pressures for continual improvement.
- Regulators should be accountable.

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<sup>3</sup> One of the agreed principles of the National Competition Policy, endorsed by the Victorian Government in the *Victorian guide to regulation*, is that legislation (both primary and subordinate) should not restrict competition unless it can be shown that the benefits of the restriction outweigh the costs and that the objectives of the legislation can be achieved only by restricting competition (State Government of Victoria 2005, p. 5-17).

Box 3.2 elaborates on the elements within these general principles. The principles were described more fully in the Commission's draft inquiry report *Regulation and regional Victoria: challenges and opportunities* (VCEC 2005b) and broadly accord with those in the *Victorian guide to regulation* (State Government of Victoria 2005b).

### **Box 3.2 Principles of best practice regulation**

**(1) Regulation should be understandable and introduced only after proper consultation:**

- Regulation should be developed through consultation that tests specific proposals, including the estimates of costs and benefits, and identifies the potential for unintended consequences.
- Regulation should be easy to understand and readily available.
- Timely advice should be available on general issues of interpretation and compliance.

**(2) Regulatory effort should be the minimum necessary given the scale of the problem:**

- Objectives should be tightly defined, and there should be clear evidence of a problem not able to be addressed by other means.
- Regulation should be targeted at the specific problem to achieve the objectives.
- Overall benefits to the community should clearly justify costs.
- Regulation should be the best feasible alternative.
- Benefits and costs relevant to key subgroups, such as small business, should be considered.
- Regulation should not restrict competition unless the benefits outweigh the costs and the objectives can be achieved only by restricting competition.

**(3) Regulation should not be unduly prescriptive:**

- Regulation should usually be performance and outcome focused.
- Regulation should not be overly prescriptive about how outcomes are to be achieved.
- Regulation should be flexible enough to accommodate changes over time and different circumstances.

**(4) Regulation and its administration should be consistent with other regulation:**

- Overlap and duplication with other state or Commonwealth government regulation should be avoided.
- Any differences from the regulation and administration of other industries, or from that applied by other Australian governments to the industry being regulated, should be transparent, and the costs and benefits of these differences should be carefully considered. Consistency need not require uniformity.

(continued next page)

### Box 3.2 Principles of best practice regulation (continued)

**(5) Regulation should be enforceable:**

- Regulation should provide the minimum incentives necessary for reasonable compliance.
- Regulation should be fairly and consistently enforced.
- Regulation should be developed to achieve a reasonable level of voluntary compliance and community support.
- Regulation should be able to be effectively monitored and policed.

**(6) There should be processes for the continual improvement of regulation:**

- All regulatory instruments (such as legislation, mandatory guidelines and codes of practice) that impose a significant burden on the community should be reviewed every 10 years. These reviews should be subject to external scrutiny.
- Regulators should clearly explain their decisions, publicly where possible.
- There should be an appeal process for individual decisions that have substantive effects on individuals and businesses.
- There should be mechanisms for evaluating the operation of regulations, to assess how well the regulation is achieving its intended outcomes.

**(7) Regulators should be accountable:**

- There should be clear criteria for assessing each regulator's performance and public reporting of information, to allow Parliament, those regulated and the wider community to make that assessment.

Source: Based on VCEC 2005b.

## 3.6 Concluding comments

The operation of market forces in the housing construction sector cannot always be relied on to deliver economic, environmental and social outcomes consistent with what is best for the Victorian community. Housing construction markets are characterised by consumers who, for the most part, are poorly informed compared with suppliers, and who are often making the largest and most complex single purchase of their lifetime. The scale of the potential costs they may incur from a poorly informed decision is thus likely to have a large impact on consumers' economic and emotional wellbeing.

Coupled with the importance of housing in defining community living standards, the inherent characteristics of the housing construction sector provide a case for some regulation, mainly as a safety net for consumers and to achieve community goals for social and environmental outcomes. The nature of the market failure or problem to be addressed will influence the form that regulation might take.

The information problems characterising housing markets suggest a role for government in providing information and advice to consumers, to help them make better informed decisions. Given the high costs to consumers in collecting reliable information about suppliers of housing construction services, government may have a role in supporting initiatives such as standardised contracts, the licensing or accreditation of suppliers, dispute resolution and warranty insurance, to reduce transaction costs and risks for consumers. But such interventions should be designed using best practice principles to ensure they do not crowd out market based initiatives that can help address the problems in housing construction markets, and to avoid giving consumers an incentive to take extra risks by giving them a false sense of security. Regulation, like markets, can be highly imperfect.

It is also important to be mindful of the transaction costs of changing regulation. Consumers and suppliers become used to regulation and structure their activities and investments around it; changes thus have costs (for example, the cost of having to learn about new regulation or buy new equipment). On the supply side, the fixed costs involved in regulatory change can be significant for many small businesses. Further, circumstances are constantly changing from evolving technology or national level regulation, for example—and governments need to be careful about adding more uncertainty.

Later chapters examine whether the particular form and extent of regulation in Victoria's housing construction sector are justified and appropriate.



## 4 The regulatory landscape

This chapter describes the core regulatory framework within which housing construction operates. It also describes the main regulatory bodies involved in administering and enforcing this framework. Subsequent chapters discuss how the legislation and other regulations affect the sector, along with ways to improve the regulatory environment.

### 4.1 The regulation hierarchy

Each of the three levels of government is involved in regulating housing construction. Constitutionally, the power to regulate the use of land resides with the states and territories, which are responsible for the statutory framework for land use, planning, development and building regulation. In Victoria, some of these powers are conferred on local governments, which are better placed to exercise discretion about the local issues involved in building matters. Victorian councils administer and enforce aspects of building regulation and can make local laws and planning requirements applicable within their municipality.

While building regulation is primarily a state responsibility, the Commonwealth Government is involved in shaping the regulatory environment to facilitate efficiency gains from national harmonisation, through its involvement in the Australian Building Codes Board (ABCB). The Commonwealth also has an interest in building regulation because it may overlap with other areas in which the government is involved—for example, access for people with disabilities, and accreditation standards for aged care facilities.

The ABCB was formed by an intergovernmental agreement in 1994, and its objectives include establishing nationally consistent codes, standards and regulatory practices. The ABCB is responsible for the Building Code of Australia (BCA), which is a set of technical provisions for the design and construction of buildings and other structures. Compliance with the code can be achieved by satisfying its provisions, formulating an alternative solution that complies with specified performance requirements or formulating an alternative solution shown to be at least equivalent to that deemed to satisfy BCA provisions. All states and territories have adopted the code, but most have variations to it.

Three main instruments embody regulation relating to the building process: Building Regulations that adopt the BCA; state and territory legislation; and local government by-laws.

Figure 4.1 Regulation of the building process

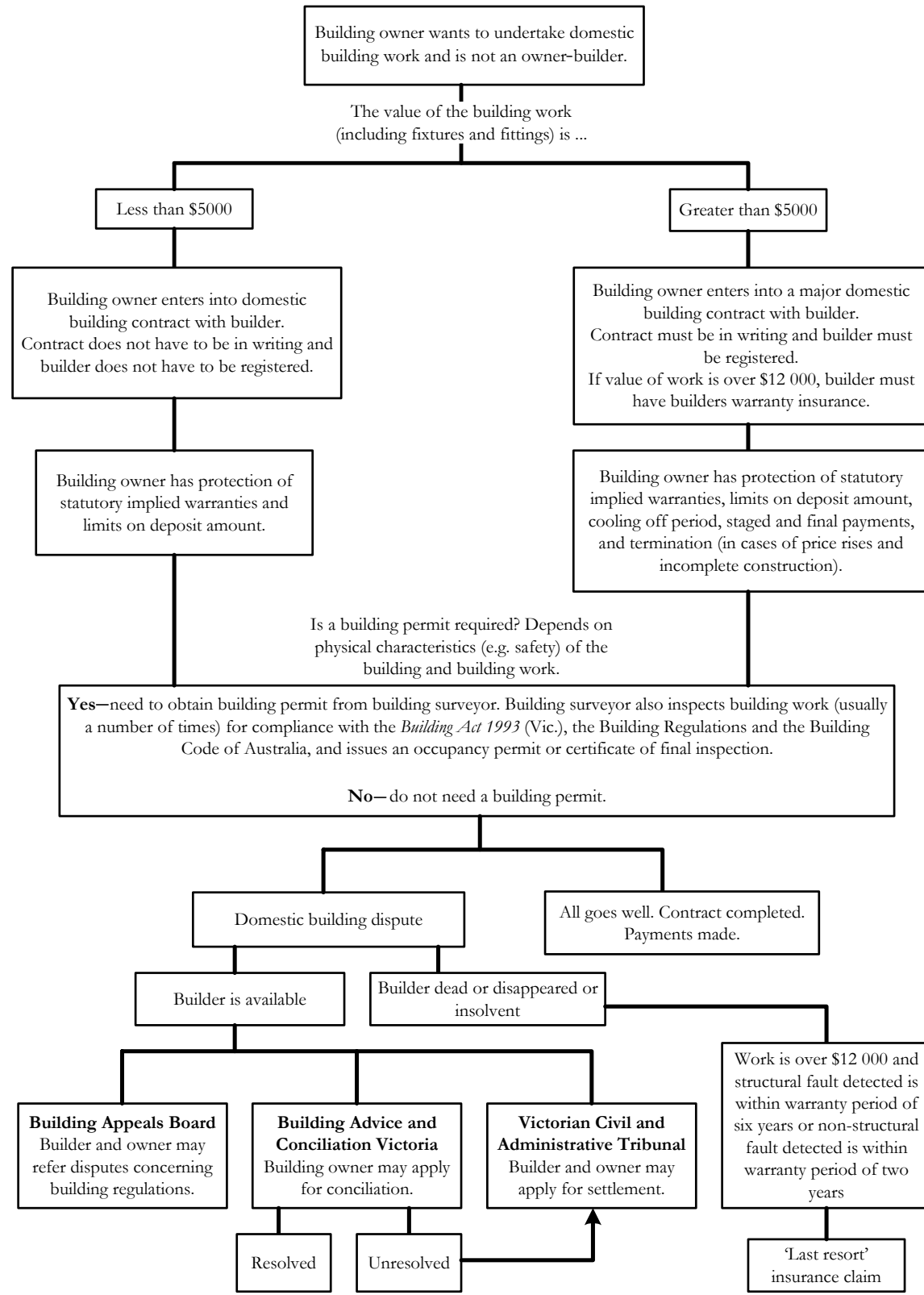


Figure 4.1 provides a perspective on Victoria's regulatory process governing building by illustrating the steps that are triggered once someone decides to commission domestic building work that is not otherwise exempted. It illustrates that building owners who engage builders to undertake domestic building work have the protection of the *Domestic Building Contracts Act 1995* (Vic.). Where the value of the building work (including the cost of fixtures and fittings) is less than \$5000, the building owner has the protection of statutory implied warranties.

Further protections apply where the value of the building work is greater than \$5000, such as limits on the deposit amount, a cooling off period, the builder must be registered, and so on. These protections are not available to owner-builders.

In addition, the *Building Act 1993* (Vic.) provides that building work not exempt from the Building Regulations cannot be carried out legally unless a building surveyor has issued a building permit, which can be issued only if a number of requirements are met. That is, the building permit is the fulcrum of the regulatory system under the Building Act (box 4.1).<sup>1</sup>

#### **Box 4.1 Requirements for issuing a building permit**

A building surveyor must not issue a building permit unless he or she is satisfied that the following requirements have been met:

- A relevant planning permit has been obtained, if required. (The interface between the processes for granting planning and building approvals is described in section 4.3.)
- Each building practitioner to be engaged in the building work holds a building practitioner's certificate, issued under part 11 of the *Building Act 1993* (Vic.), and each architect is an insured architect (s24A). Building practitioners include engineers, draftspersons and various classes of builders (s4).
- Each builder holds domestic builders insurance.
- If an owner-builder is involved, he or she has a certificate of consent from the Building Practitioners Board where the cost of the work is more than \$12 000.
- The building work will comply with the Building Act and Building Regulations. The Regulations incorporate the Building Code of Australia and regulate daylight to existing windows, the overshadowing of recreational private space, overlooking and other matters.

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<sup>1</sup> Tradespeople carrying out specialised domestic building tasks as a single trade in a range of areas specified in the Domestic Building Contracts and Tribunal (General) Regulations 1996 are exempt from registration and from the requirement to hold builders warranty insurance. However, if the same tradespeople carry out more than one trade to complete domestic building work that exceeds \$5000, they are required to be registered and to enter into a major domestic building contract (CAV 2004b, p. 7).

To improve the timeliness and efficiency of the permit process, the Building Act creates an important role for private building surveyors who, like municipal building surveyors, may issue building and occupancy permits and inspect building works during construction.<sup>2</sup> Building surveyors collect levies to fund the regulatory process (chapter 6) and must inspect the building work on completion of four nominated mandatory stages (s34);<sup>3,4</sup> they may also cause inspections at other times (s35). Building surveyors have significant powers to ensure the effectiveness of the inspections (s36) and may give directions to ensure the building work complies with the building permit (s37).

In addition, if a building permit states that an occupancy permit is required, a person must not occupy the building unless a building surveyor issues an occupancy permit acknowledging that the building is suitable for occupation (s39). Once a private building surveyor has been appointed to issue a building permit and has begun to issue the permit, he or she cannot be replaced by another surveyor before construction is completed, without the written consent of the Building Commission (s81(4)). This prevents a client or builder dispensing with the services of a surveyor who refuses to pass an inspection. It also recognises that the knowledge the surveyor has gained in earlier stages can inform later stages in the inspection process.

As a further safeguard for owners, some building practitioners are required to have insurance cover for their work, in accordance with the provisions in part 9, division 3 of the Building Act. The minister establishes the classes of building practitioners that are required to have insurance, through an Order published in the *Victorian Government Gazette* (s135). Building practitioners such as draftspersons, builders, engineers, building surveyors and building inspectors are required to carry prescribed professional indemnity insurance, which is designed to protect the consumer from loss owing to acts or omissions by the professional acting on his or her behalf (CAV 2004b, p. 80). Commercial builders are required to carry structural defects insurance, while domestic builders are required to carry domestic builders insurance. Insurance for domestic building work required by the domestic building insurance ministerial Order is 'last resort insurance', in that homeowners can make claims against the insurer for defects and incomplete work only when the builder has died, or become insolvent or disappeared. Such home warranty insurance is not required for apartments over three storeys and is

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<sup>2</sup> Planning approvals, unlike building permits, can be processed only by council employees.

<sup>3</sup> Section numbers refer to sections in the Building Act.

<sup>4</sup> The four steps are (1) before placing a footing, (2) at completion of a framework, (3) before pouring an *in situ* reinforced concrete member nominated by the relevant building surveyor, and (4) on completion of all building work (Building Regulations, s7.1).

not currently offered, although CGU Insurance Ltd is considering offering it in addition to the statutory product (sub. 15, p. 4).

Section 31 of the Domestic Building Contracts Act requires insurance details to be given to the owner. (Insurance is discussed in chapter 7.) If faults are found before or after a job is completed, and the builder can be pursued, then this is a contractual issue between the builder and the owner. Building Advice and Conciliation Victoria (BACV) provides a free service to help to resolve such disputes.

The *Wrongs Act 1958* (Vic.) requires the courts to determine an award of damages in a building action that is in proportion to each defendant's responsibility for the loss or damage. The repeal of the law of joint and several liability for building actions has 'made it possible for a larger number of building professionals to obtain insurance at a reasonable cost' (State Government of Victoria 2004, p. 11). It has also focused the attention of claimants away from 'deep pockets'.

## **4.2 Victorian Government legislation and regulation**

The state legislative framework that applies to housing construction in Victoria is complex because numerous laws apply to domestic building activity. It consists of (a) legislation that applies only to building, and (b) legislation that applies across industries and to other activities but can have an important impact on housing construction. This section describes the former, while section 4.3 describes the latter.

### **4.2.1 Domestic Building Contracts Act**

The Domestic Building Contracts Act regulates the terms of domestic building contracts and their enforcement to protect home owners.

When a person decides to build or renovate a home or undertake any other domestic building work, he or she will normally enter into a domestic building contract with a builder, which specifies both parties' commitments and provides the point of reference if a dispute arises. The contract is a 'major domestic building contract' under the Act if the contract price, including fixtures and fittings, is more than \$5000 and consequently attracts additional regulation.

Alternatively, a person may decide to carry out domestic building work as an owner-builder, without entering into a domestic building contract with a builder. The owner-builder would then enter contracts with various tradespeople to undertake particular work. In this case, the Act does not apply and the owner-builder does not have the benefit of its protections.

The Act regulates the content of domestic building contracts and the procedures for resolving contract disputes. Its stated objectives (s4) are to:

- provide for the maintenance of proper standards in domestic building work in a way that is fair to both builders and building owners
- enable disputes involving domestic building work to be resolved as quickly, efficiently, cheaply and fairly as possible
- enable building owners to access insurance funds if building work under a major domestic building contract is incomplete or defective.

The Act protects building owners by specifying warranties to be implied in domestic building contracts—for example, that work will be carried out in a ‘proper and workmanlike manner and in accordance with plans and specifications set out in the contract’ and with ‘reasonable care and skill’ (s8(a) and (d)). It also implies a warranty that domestic building work will be carried out in accordance with all laws and legal requirements, including the Building Act and Regulations (which are described in sections 4.2.2 and 4.2.3). The warranties ‘run with the building’ and accordingly are enforceable by a subsequent building owner (s9). A person cannot sign away the right to take advantage of these warranties (s10).

Nevertheless, inspections under the Domestic Building Contracts Act are not required to ensure warranties are met. Building surveyors’ inspections under the Building Act do not account for the plans or the terms of the contract for the building. This is because the building surveyor is concerned with applying the minimum standards in the building Regulations. The specifications in a particular building design and contract will often exceed the minimum standards. Building surveyors do not inspect building works to check that express or implied terms of the building contract have been met. Misunderstandings about the scope of inspections ‘give rise to large numbers of disputes’ (CAV, sub. 91, p. vi).

The Domestic Building Contracts Act imposes restrictions on the nature and content of all domestic building contracts: the amount of deposits payable to a builder is limited (s11); arbitration clauses are void (s14); cost escalation clauses are restricted (s15); and the builder must not seek payment of more than the contract price (s16).

The Act also imposes additional building owner protection measures for major domestic building contracts where the contract price exceeds \$5000: the builder must be registered (s29); the contract must be in writing, set out all its terms, provide a detailed description of the work to be done and include plans and specifications; the building owner has a five day cooling off period in which he

or she may withdraw from the contract without penalty (s34); and the progress payments that a builder may require are restricted (s40).<sup>5</sup>

The Act provides for BACV to conciliate domestic building disputes that are the subject of complaint by building owners (part 2A): BACV is ‘a one-stop-shop for owners and builders providing free advice and assistance to resolve domestic building disputes’ (BC & CAV 2004). Consumer Affairs Victoria (CAV) and the Building Commission manage BACV.

The Act also facilitates dispute resolution by providing that a building owner or builder may ask the Building Commission to appoint an inspector to examine whether the domestic building work is defective (part 4).

In addition, a building owner or builder may apply to the Victorian Civil and Administrative Tribunal to resolve a building dispute, and that organisation has a range of powers for this purpose (part 5).

#### **4.2.2 Building Act**

Another central component of Victoria’s building regulatory system is the Building Act, whose main purpose is to provide for the regulation of building and building standards (s4). The Act consolidates building controls and standards, and substantially enacted the *National Model Building Act* (Cwlth), which the Australian Uniform Building Regulations Co-ordinating Council completed in 1991 (Freehills Regulatory Group 1999, p. 58).

The Building Act is supplemented by the Building (Interim) Regulations 2005, which adopt the BCA and prescribe standards, fees and other matters to give effect to the Act. It is also supplemented by ministerial guidelines relating to fees, charges and the functions of building surveyors (s188) and guidelines relating to the design and siting of single dwellings (s188A).

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<sup>5</sup> Section 40(2) of the Domestic Building Contracts Act provides that a builder may not require payment of more than stipulated percentages of the total contract price at varying stages of the building works under a major domestic building contract. In the case of a contract to build to lock-up stage, the builder may not demand more than 20 per cent of the contract price at the base stage or more than 25 per cent at the frame stage. In the case of a contract to build to fixing stage, the builder may not demand more than 12 per cent at the base stage, 18 per cent at the frame stage or more than 40 per cent at the lock-up stage. In the case of a contract to build all stages, the builder may not demand more than 10 per cent at the base stage, 15 per cent at the frame stage, 35 per cent at the lock-up stage or more than 25 per cent at the fixing stage.

## Coverage

The Act broadly defines ‘building’, so its reach is extensive. It applies to the construction of both the largest office building and a temporary marquee (s3). This inquiry is limited to housing construction, including low-rise dwellings and high-rise apartments. The Act provides the framework for:

- the regulation of the construction of buildings
- the setting of building standards
- the maintenance of specific safety features in buildings
- insurance requirements. (CAV, sub. 91, p. 6)

The Building Act has been subject to three major amendments. First, part 12A Plumbing Work was inserted into the Act in 1996, to ensure plumbing work is carried out safely and competently. Part 12A operates ‘by and large’ separately from the rest of the Act (s221A). The second amendment was the insertion of part 5A Registration of Cooling Tower Systems in 2000; it is outside the terms of reference for this inquiry. The third major amendment was the *Building (Amendment) Act 2004* (Vic.), which has special provisions for owner-builders. It is discussed in section 4.2.4.

## Objectives

The Act has 10 objectives (s4):

- (1) to establish, maintain and improve standards for the construction and maintenance of buildings
- (2) to facilitate (i) the adoption and efficient application of national uniform building standards and (ii) the accreditation of building products, construction methods, building designs, building components and building systems
- (3) to enhance the amenity of buildings and to protect the safety and health of people who use buildings and places of entertainment
- (4) to facilitate and promote the cost-effective construction of buildings and the construction of environmentally and energy efficient buildings<sup>6</sup>
- (5) to provide an efficient and effective system for issuing building and occupancy permits, administering and enforcing related building and safety matters and resolving building disputes
- (6) to regulate building practitioners and plumbers
- (7) to regulate plumbing work

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<sup>6</sup> In 2004, s221ZZZV of the Building Act was amended to permit the Governor in Council to make Regulations prescribing standards in terms of water efficiency, as well as environmental and energy efficiency, for plumbing work.



- (8) to reform aspects of the law relating to legal liability in relation to building and plumbing matters
- (9) to aid the achievement of an efficient and competitive building and plumbing industry
- (10) to regulate cooling tower systems.

The third and fourth objectives are the only ones that refer to desired outcomes for those who construct or use buildings, while the ninth objective outlines desired characteristics of the building industry—namely, that the industry be ‘efficient and competitive’. Freehills Regulatory Group (1999, p.60) pointed out that productivity growth before the Building Bill was introduced had been poor in the construction industry compared with other industries, and that the legislation was intended to increase efficiency in the Victorian building sector.

The seven other objectives, rather than describing desired outcomes, outline the instruments or approach adopted under the Act—for example, issuing building and occupancy permits; regulating building practitioners; maintaining and improving standards for the construction and maintenance of buildings; reforming aspects of the law relating to legal liability; and regulating cooling tower systems. Chapter 8 discusses the extent to which these objectives provide adequate guidance for those administering the Building Act.

### **4.2.3 Building (Interim) Regulations**

The Building Act authorises Building Regulations, which contain detailed regulatory requirements relating to building permits, building inspections, occupancy permits, the maintenance of buildings and the enforcement of the Building Regulations. The Regulations, which adopt the BCA, prescribe the processes to be followed in relation to:

- standards for the construction and demolition of buildings
- matters relating to the use and maintenance of buildings
- matters relating to the accreditation of building products, construction methods, design, components and systems
- qualifications and other matters relating to registration of building practitioners
- fees. (CAV, sub. 91, p. 7)

In addition, they:

- prescribe various features of the siting and external features of buildings
- describe how building practitioners should behave and the qualifications that they need
- impose specific obligations (usually on councils) in relation to buildings in special areas (for example, areas that are flood or termite prone)
- prescribe special conditions for swimming pools.

Box 4.2 lists the provisions in the Building Regulations, to illustrate the breadth of issues that are covered.

**Box 4.2 Table of provisions in the Building (Interim) Regulations 2005**

Part 1 Preliminary  
Part 2 Owner-builders  
Part 3 Building Permits  
Part 4 Siting  
Part 5 Allotments and Projections  
Part 6 Building Work  
Part 7 Building Work Safety Requirements  
Part 8 Building Work in Special Areas  
Part 9 Inspections Notices and Orders  
Part 10 Occupancy Permits and Certificates of Final Inspection  
Part 11 Places of Public Entertainment  
Part 12 Maintenance of Buildings and Places of Public Entertainment  
Part 13 Cooling Tower Systems  
Part 14 Building Product Accreditation  
Part 15 Building Practitioners  
Part 16 Building Appeals Board  
Part 17 Infringement Notices  
Part 18 Exemptions  
Part 19 Transitional Provisions  
Part 20 Expiry

Part 4 of the Regulations, introduced in 2001-02:

... responds to government's planning policy known as ResCode. It deals with matters including overlooking, overshadowing and private open space by means of siting and design requirements. This is an example of the interdependency between building and planning legislation and considerable consultation was required to achieve the policy outcomes desired by government. (sub. 57, p. 7)

ResCode is not a single document. Its provisions are incorporated into planning standards as well as the Building Regulations. Part of the ResCode package included flexibility for councils to alter a number of standards in their planning

scheme. These standards are then recognised in the Building Regulations, to maintain consistency in a municipality (BC 2004b, p. 13). Amendments to the Regulations are subject to regulatory impact statement (RIS) procedures under the *Subordinate Legislation Act 1994* (Vic.) and consequently subject to cost–benefit reviews of their economic, social and environment impacts.<sup>7</sup>

#### **4.2.4 Building (Amendment) Act**

The Building Act now has specific provisions for a domestic owner–builder who constructs or renovates his or her home. An owner–builder ‘does not contract a professional builder to do the complete task for them but instead takes full responsibility for the tradespeople, their work and the risk that a registered builder would otherwise accept for the entire project’ (CAV 2004b, p. 57). Owner–builders can avoid the initial builders registration fee (\$540–680), the annual registration fee (\$120–180) and the requirement to have domestic building insurance unless the home is sold within six years. Between 1998 and 2004, unregistered building work in Victoria increased from 26 per cent of building permits and 19 per cent of the value of building work to 38 per cent and 24 per cent respectively (BC 2005f, p. 10).

The City of Boroondara suggested that the costs of regulation explain the growth of owner–builders:

The high cost on the builder for warranty insurance, and the limits on the amount of work a builder can carry out in any one year under their warranty insurance, has forced many builders to take out Building Permits as owner/builders. This gives no protection to the homeowner and leaves them vulnerable if the builder disappears or if there are accidents to tradespersons etc on the site. (sub. 66, p. 4)

Mr Phil Graf, chief executive officer of BuildSafe and Australian Owner Builders, also argued that the growth of owner–builders is a response to the cost of regulation, suggesting that ‘owner–builder numbers only increase when building costs are perceived to be too high’ and that:

Smaller builders are being squeezed out via a variety of restrictions including severe warranty requirements tied to personal assets and the constraints of increased red tape for smaller businesses. (sub. 62, p. 2)

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<sup>7</sup> Nineteen amendments have been made to the Building Regulations by statutory rules since the principal Regulations came into operation.

The RIS supporting a new registration fee for owner-builders agrees that the growth of owner-builders may be a reaction to the regulatory framework:

Where one group of market participants is able to exploit regulatory arrangements to obtain cost savings, they may have an unwarranted advantage. The current ease by which people can avoid registration by nominating the builder as the owner is clearly such a case. (BC 2005d, p. 17)

In response, the Victorian Government introduced the Building (Amendment) Act, which came into force on 14 June 2005. This Act requires that:

- owner-builders obtain a certificate of consent from the Building Practitioners Board (BPB) before they can obtain a building permit for work over \$12 000. (The Building Appeals Board hears appeals against BPB decisions.)
- owner-builders are eligible for only one building permit in each three year period unless the permits relate to the same property and unless there are special circumstances approved by the BPB
- educational material on building work is provided to owner-builders, who are obliged to read the material.

#### **4.2.5 Building and Construction Industry Security of Payment Act**

The objective of the *Building and Construction Industry Security of Payment Act 2002* (Vic.) is to ensure any person who carries out construction work or who supplies related goods and services under a construction contract is entitled to receive, and is able to recover, progress payments. In her second reading speech, the Minister for Planning said that the Act is intended 'to remove the inequitable practices in the building and construction industry whereby small contractors are not paid on time, or at all, for their work' (Delahunty 2002b, p. 427). The Act deems payments to be payable at specified intervals, even if the construction contract makes no provision for progress payments, and it negates any 'pay when paid' provisions. It sets out procedures for recovering progress payments and prohibits contracting out of its provisions.

The Building Commission administers the Act and is responsible for monitoring its operation and effectiveness. Since the Act commenced operation in January 2003, 45 applications for adjudication and 29 determinations have been made. Ninety-eight per cent of all determinations have been made in favour of the claimant (DSE, sub. 84, p. 68).

## 4.3 Other state legislation

The regulatory framework that applies to housing construction is more extensive than just the BCA and the legislation described above. Other Victorian laws and regulations that are generally applicable have an impact on housing construction, including the *Architects Act 1991*, the *Electricity Safety Act 1998*, the *Gas Safety Act 1997*, the *Fair Trading Act 1999*, the *Occupational Health and Safety Act 2004* and the *Planning and Environment Act 1987*.<sup>8</sup> Also relevant are the *Estate Agents Act 1980*, the *Property Law Act 1958*, the *Sale of Land Act 1962*, the *Subdivision Act 1988* and the *Transfer of Land Act 1958*.

The existence of such a large number of Acts and the dispersal of regulatory authority make it difficult for consumers to understand and enforce their rights, and for builders to understand their obligations.

### 4.3.1 Architects Act

The main purposes of the Architects Act (s1) are to:

- provide for the registration of architects
- provide for the approval of architectural partnerships and architectural companies
- regulate the professional conduct of architects
- provide a procedure for handling complaints against architects
- regulate the use of the words ‘architect’, ‘architectural services’, ‘architectural design’ and ‘architectural design services’
- establish the Architects Registration Board of Victoria.

The Act restricts the use of the term ‘architect’ to persons who are registered by the Architects Registration Board of Victoria and who meet requirements relating to qualifications, experience and conduct. The board’s approval is required for a partnership to call itself an architectural partnership and for a company to call itself an architectural company.

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<sup>8</sup> Five ministers administer Acts affecting housing construction:

- (1) The Minister for Planning administers the Building Act, except for parts 5B and 5C, which the Minister for Health administers.
- (2) The Minister for Consumer Affairs administers the Domestic Building Contracts Act.
- (3) The Minister for Energy Industries administers the Gas Safety Act and the Electricity Safety Act.
- (4) The Minister for Planning administers the Building and Construction Industry Security of Payment Act and the Planning and Environment Act.
- (5) The Minister for WorkCover administers the Occupational Health and Safety Act.

Regulations prescribe the fees for registration (\$100) and for approval of architectural partnerships and companies (\$120). The annual renewal fees are \$150. Regulations also specify that architects must act in the interests of their clients and potential clients, and must not favour their own interests over the interests of their clients and potential clients (r7).

A tribunal established under the Act can discipline architects, architectural partnerships or companies for misconduct. It has the power to cancel or suspend their registration or approval. Cancellation or suspension prevents architects and architectural partnerships and companies from describing themselves as such; it does not prevent them from continuing to provide the same building design services. The regulatory effect of the Act, therefore, is to assist consumers of building design services to choose service providers who have satisfied gateway requirements concerning qualifications, experience and ongoing conduct, and who hold insurance of the kind and amount ordered by the minister.

### **4.3.2 Electricity Safety Act and Gas Safety Act**

The Electricity Safety Act created the Office of the Chief Electrical Inspector (OCEI), whose responsibilities include the safety of electrical installations in industrial, commercial and domestic premises. The Act restricts prescribed electrical works to contractors on a register maintained by the OCEI. A licensed electrical inspector must inspect prescribed electrical installation work before it is connected to the electricity supply. The Gas Safety Act established the Office of Gas Safety, which has general responsibilities for ensuring the safe supply and use of gas.

The OCEI and the Office of Gas Safety (as well as the pipelines safety functions of the Department of Primary Industries) were combined to form one office, Energy Safe Victoria, on 10 August 2005.

### **4.3.3 Occupational Health and Safety Act**

The Occupational Health and Safety Act was substantially amended in 2004 (following a major review of the earlier Act), with most provisions coming into effect on 1 July 2005. The new Act clarifies and brings Victoria's workplace safety law up to date, to reflect modern workplaces and arrangements. Its principal objects are to secure the health, safety and welfare of employees and other persons at work, as well as the health and safety of members of the public (s2). The Act states principles of health and safety protection, including that 'employees, other persons at work and members of the public be given the highest level of protection against risks to their health and safety that is reasonably practicable in the circumstances' (s4).

The stricter health and safety measures introduced under the Act and Regulations are likely to affect the cost of housing construction in cases where new protective measures are required. Particularly significant are the Occupational Health and Safety (Prevention of Falls) Regulations 2003, which came into effect in March 2004. Designed to reduce workplace hazards in all industries, including the building industry, the Regulations require the use of scaffolding for work conducted 2 metres above ground level.

#### **4.3.4 Planning and Environment Act**

The Planning and Environment Act establishes ‘a framework for planning the use, development and protection of land in Victoria in the present and long-term interests of all Victorians’ (s1). Its objectives include ‘the fair, orderly, economic and sustainable use and development of land’ and ‘the protection of natural and man-made resources’. Relevant to the building industry, its objectives also include securing ‘a pleasant, efficient and safe working, living and recreational environment for all Victorians’ (s4).

A system of planning schemes is the principal way of setting out objectives for the use, development and protection of land in Victoria. Each municipality is required to develop a planning scheme to control the use and development of land. These planning schemes must include state standard provisions selected from the Victorian Planning Provisions, which the Minister for Planning is authorised to prepare and approve (s4A).

The minister may prepare and amend a planning scheme for any municipal district in Victoria. In addition, a municipal council—referred to as a planning authority—may prepare amendments to the state standard provisions and the local provisions of a planning scheme in force in its municipal district (s8). In preparing an amendment, a planning authority must account for any significant effects the amendment might have on the environment, and may account for its social and economic effects (s12).

A planning authority, such as a municipal council, must give notice of the preparation of a planning scheme amendment to various persons specified in the Act, including ‘every minister, public authority and municipal council that it believes may be materially affected by the amendment’ (s19). Moreover, a planning authority must publish a notice of any proposed planning amendment in a newspaper generally circulating in the area to which the amendment applies (s19). Section 20 provides that the minister may grant a limited exemption from the requirement to give notice and that the exemption may be subject to conditions.

Any person may make a submission to the planning authority on a proposed amendment of which notice has been given (s21) and the planning authority

must consider the submission (s22). In addition, an amendment is subject to approval by the Minister for Planning, who is responsible for the Building Act as well as the Planning and Environment Act (s35). The minister is in a position, therefore, to refuse consent to an amendment that is inconsistent with the thrust of the Building Act and Regulations. Further, the minister must give notice of every planning amendment to Parliament, which has power to revoke approval of any planning amendment placed before it (s38).

The Act also provides for permits to be granted (or refused) in accordance with the provisions of planning schemes (s47 and ff). A responsible authority, such as a municipal council, must not include in a permit a condition that is inconsistent with the Building Act or Regulations (s62).

Planning permits are sometimes required before a building permit can be issued. The Department of Sustainability and Environment described the link between the two permits in the following way:

... for multi-dwelling developments or a single development that requires a planning permit on the basis of a lot size trigger (i.e. lots less than 300 sqm or 500 sqm), heritage or neighbourhood character overlays, the siting and design standards are assessed as part of the planning permit process. For all other single dwelling developments, the siting and design assessment is made through the building permit system ... Under the residential zones of planning schemes, a permit may not be required to use land for the purpose of a dwelling, but a planning permit is always required for the construction and extension of medium density housing and residential buildings meeting set criteria. (sub. 84, p. 15)

#### **4.3.5 Fair Trading Act**

The Fair Trading Act provides some protection to all consumers in Victoria, including home builders: it ‘extends consumer protection provisions in part V of the Commonwealth Trade Practices Act to those parts of the economy that cannot be reached by the Commonwealth’s constitutional powers, such as sole traders’ (CAV, sub. 91, p. 5).

The Act prohibits unconscionable conduct (s7), misleading and deceptive conduct in trade or commerce (s9), the provision of false testimonials (s14) and other forms of unfair trading.

Section 124A of the Domestic Building Contracts Act incorporates monitoring, inspection and enforcement provisions of the Fair Trading Act to promote compliance with its provisions.



### **4.3.6 Sale of Land Act**

The Sale of Land Act regulates the sale of land and real property, including off-the-plan sales for property to be built under domestic building contracts, such as high-rise apartments. Amendments to the Act in 2003 provided for closer regulation of vendor bidding, quotation of a range of bids by agents, and the disruption of auctions. The Act does not regulate contracts between builders and owners.

## **4.4 Organisations established under the Building Act**

The Building Act establishes six bodies to perform specified functions. A seventh body—BACV, which is a non-statutory body established jointly by the Building Commission and Consumer Affairs Victoria—receives funding under the Act. Five of the bodies are related to the Building Commission and two are related to the Plumbing Industry Commission. These regulators are self-funding, with a total annual expenditure of about \$28 million (detailed in chapter 11). (Their separate costs of operating are not publicly reported.) They employ about 160 staff in total.

The Building Act specifies more than 50 functions (chapter 9) for these bodies. Broadly, the entities related to the Building Commission undertake the core functions of the regulatory framework, including:

- administering the Building Act and Regulations
- registering builders
- accrediting building products and processes
- undertaking inquiries into registered builders
- hearing appeals against decisions emerging from these inquiries
- providing advice on Regulations and administration of the Act
- resolving building disputes.

Chapter 9 discusses whether so many bodies are necessary and whether they need all of the functions allocated to them. Given the potential tensions and trade-offs between some of their functions, governance arrangements need assessment.

### **4.4.1 Building Commission**

The second reading speech for the Building Act described the Building Commission as ‘the overseeing body for the building control system’ (MacLellan 1993, p. 1689), having regard to the broad functions conferred by s196. The commission is a statutory authority established under the Building Act.

The Victorian Competition and Efficiency Commission has seen four descriptions of the Building Commission's functions or activities. First are the functions defined under the Building Act and reported in box 4.3.

### **Box 4.3 Functions of the Building Commission**

The *Building Act 1993* defines the following functions (s196) for the Building Commission:

- (a) to keep under regular review the administration and effectiveness of this Act and the Regulations
- (b) to advise the minister on amendments to improve the administration and effectiveness of this Act and the Regulations
- (c) to advise the minister on the impact on the building industry of other Acts and Regulations
- (d) to seek the views of the building industry and other interested groups on the effectiveness of this Act and the Regulations
- (e) to coordinate the preparation of draft proposals for Regulations under this Act
- (f) to conduct or promote research into matters relating to the regulation of the building industry
- (g) to promote better building standards both nationally and internationally
- (h) to liaise with any organisation established to promote national building standards
- (i) to disseminate information on matters concerning building standards
- (ia) to disseminate information on matters relating to the registration of cooling tower systems
- (j) to provide information and training to assist persons and bodies in carrying out functions under this Act or the Regulations
- (k) to monitor the system of collection of the building permit levy and advise the minister about its effectiveness
- (l) to charge and collect fees (determined in accordance with this Act) for information and training services provided by it
- (m) to administer the Building Administration Fund
- (n) to accept any gifts or donations of money or other property by deed, will or otherwise
- (o) to advise the minister on any matter referred to it by the minister.

Second, the Building Commission describes its role as to 'oversee building legislation, regulate building practices, advise government and provide services to industry and consumers' (BC undated D). It perceives itself as more than a regulator, performing 'its function not only as the regulator of the Victorian building industry, but also as a facilitator that partners with industry stakeholders to improve industry effectiveness and efficiency' (DSE, sub. 84, p. 2).

Third, Consumer Affairs Victoria suggested that the functions of the Building Commission are to:

- advise the Victorian Minister for Planning on building policy and building legislation
- regulate housing construction in terms of the *Building Act 1993* and the Building Regulations
- set minimum standards for the design, construction and maintenance of buildings
- communicate the regulatory requirements for housing construction to the community
- provide information and training to the housing construction industry on the requirements of the *Building Act 1993* and the Building Regulations
- keep consumers informed about their rights and responsibilities under the *Building Act 1993* and the Building Regulations
- help to resolve building disputes through BACV conducted jointly by the [Building] Commission and CAV
- promote improved building standards both nationally and internationally
- encourage sustainable building design and construction
- provide administrative support for the :
  - Building Practitioners Board
  - Building Appeals Board
  - Building Regulations Advisory Committee and
  - Building Advisory Council. (sub. 91, p. 11)

Fourth, the Auditor-General Victoria (2000, p. 91) suggested that the role of the Building Control Commission (as the Building Commission was then called) includes:

- reviewing the effectiveness of the Act and Regulations, and proposing changes
- conducting research on building activities, disseminating information and promoting better building standards both nationally and internationally
- carrying out various administrative activities, including monitoring the system for collecting the building permit levy and advising the minister as to the effectiveness of the system
- carrying out performance audits involving an examination of the work of registered practitioners
- completing investigations into complaints and, if warranted, initiating prosecutions for breaches of the Act

- performing the role of municipal building surveyor in relation to the construction of temporary structures, prescribed places of public entertainment and the enforcement of building orders
- allocating resources among the various entities established under parts 10, 11 and 12 of the Act and providing staff, accommodation, financial services, administration and information technology support for them.

Some functions listed by Consumer Affairs Victoria and the Auditor-General that are not in the statutory functions are:

- regulating housing construction in terms of the Building Act and Building Regulations (mentioned by CAV)
- setting minimum standards for the design, construction and maintenance of buildings (mentioned by CAV)
- encouraging sustainable building design and construction (mentioned by CAV)
- providing administrative support for the other statutory entities (mentioned by CAV)
- carrying out performance audits (mentioned by the Auditor-General)
- investigating complaints (mentioned by the Auditor-General)
- allocating resources among the various entities (mentioned by the Auditor-General).

Chapter 9 discusses whether there is scope to clarify or simplify the functions of the Building Commission, to increase its accountability.

#### **4.4.2 Building Practitioners Board**

The BPB is an independent statutory body responsible for administering a registration system for Victorian builders and building professionals. It is also responsible for supervising their conduct and making recommendations to the minister about the qualifications for registration (s183). Its membership includes:

- a chairperson
- one legal practitioner
- one consumer representative
- one member for each category (currently eight) of building practitioner.

Neither the Building Commissioner nor a member of the Building Appeals Board can be a member of the BPB.

The BPB offers three types of registration (for which fees are set in accordance with guidelines set by the minister):

- (1) limited registration, which allows the person to do only work listed on his or her certificate of registration
- (2) unlimited registration, which allows the person to complete any building works
- (3) manager registration, which allows the person to arrange the carrying out of building works. (CAV 2004b, p. 25)

Building practitioners, building surveyors, building inspectors, engineers in the building industry, quantity surveyors, draftspersons, demolishers and tradespeople who carry out domestic building work under a major domestic building contract, as defined by the Domestic Building Contracts Act, are required to be registered with the BPB. Relevant tradespeople who require registration include bathroom renovators, bricklayers, cabinet makers/kitchen installers, carpenters, concreters, re-roofers and restumpers. Floor and wall tilers, glaziers, painters and plasterers do not require registration to perform building work that can be carried out under a contract that applies to a single trade. However, 'if any of these tradespeople use a combination of trades to complete work that exceeds \$5000, then they will need to be registered' (CAV 2004b, p. 25).

Registration applies to natural persons. A company or partnership can operate as building practitioner as long as one partner or director is registered in the relevant category. Unregistered tradespeople can operate within the industry, as long as they work for a registered building practitioner. Registration is required for practitioners engaged directly by owner-builders to carry out domestic building work (BPB, sub. 26, p. 6). The BPB must be satisfied that applicants for registration are of good character and hold qualifications as prescribed in the Regulations or their equivalent (s170). Registrations last until cancelled, but an annual fee is payable and insurance, where applicable, must be maintained (s172).

The BPB must maintain a register of the names and classes of registered building practitioners (s173). It can suspend registration for a number of reasons, including when the practitioner is not covered by required insurance or refuses to comply with the insurer's reasonable direction to complete or rectify defective work (s174).

The BPB also has the power to inquire into the conduct or ability to practise of registered building practitioners. It can do so on its own initiative, on referral by the Building Commission, the Victorian Civil and Administrative Tribunal or an insurer, or on the recommendation of someone it has appointed (s178). Following an inquiry, it can take disciplinary actions, including reprimanding the

practitioner, awarding costs against the practitioner, and suspending or cancelling registration (s178). Chapter 6 (table 6.2) provides information on inquiries held by the BPB.

### **4.4.3 Building Appeals Board**

The Building Appeals Board determines disputes and appeals arising from the Building Act and Regulations, including BPB decisions (part 10, division 1). Its members include a legal practitioner, a person with experience in the building industry, at least one person who can represent the users of building practitioners, and ‘as many others as the minister considers necessary’ with experience in the building industry or related matters (s166(3)). (The Building Commissioner and members of the BPB and the Building Advisory Council cannot be members.)

The Auditor-General described the board’s work in the following way:

Appeals are effectively rehearings by the board of decisions made during the course of the approval process on specific building works. By way of example, property owners can appeal against decisions not to grant a building or occupancy permit or conditions placed on building notices and orders. It also hears appeals against decisions of the commission and the Building Practitioners Board on appointment of building surveyors and registration of building practitioners, respectively. (Auditor-General Victoria 2000, p. 67)

### **4.4.4 Building Advisory Council**

The Building Advisory Council advises the Minister for Planning on the administration of the Building Act and Regulations, the impact on the Building Regulations of Regulations made under other Acts, and issues relating to the building permit levy (s208). Its members include the Building Commissioner, a legal practitioner, nominees from the Royal Australian Institute of Architects, the Master Builders Association of Victoria, the Housing Industry Association (HIA), the Property Council of Australia and the Australian Institute of Building Surveyors, a person with experience in the building industry and a consumer representative (s207). The council was intended to provide ‘senior representatives of relevant peak industry bodies with a forum in which they will develop recommendations to the minister on key issues concerning the regulation of building standards’ (Maclellan 1993, p. 1689).

According to the Department of Sustainability and Environment, the council's key recent achievements have been:

- undertaking the review of the categories of the Building Practitioner Registration in Victoria
- influencing changes in the Security of Payment and Owner-builders legislation
- oversight of the development of the 5 Star energy rating standard
- oversight of the CPD [continuing professional development] program
- guidance to the Building Commission during the insurance market crisis (sub. 84, p. 22)

#### **4.4.5 Building Regulations Advisory Committee**

The Building Regulations Advisory Committee provides advice on draft building Regulations and any matter referred to it by the minister. In addition to providing advice, it accredits building products, construction methods and design components or systems connected with building work (s211). A certificate of accreditation is evidence that a product or system complies with the Regulations or the BCA. Building Commission staff first assess applications for accreditation, and then provide recommendations to the committee for consideration. Since the Building Act has been operating, 63 applications have been made to the committee, of which:

- 52 have been granted certificates of accreditation in part or in full (an average of under six per year)
- one has been refused
- 10 have been withdrawn or await action by the proposer. (sub. 57, p. 7)

The Building Regulations Advisory Committee has 15 members appointed by the Minister for Planning from nominations by relevant ministers and professional and trade associations. One member must be able to represent the interests of users of the services of building practitioners (s210). The Building Commissioner chairs the committee (sub. 57, p. 1).

#### **4.4.6 Building Advice and Conciliation Victoria**

The Act also provides for funding, via a levy, for BACV (a joint initiative between the Building Commission and Consumer Affairs Victoria), which provides free advice to help resolve domestic building disputes. BACV was established in response to changes to statutory building warranty insurance in July 2002 (CAV, sub. 91, p. 10).

Consumer Affairs Victoria provides conciliators, investigators to check whether laws have been broken, and solicitors who may prosecute builders who have

broken laws. The Building Commission provides technical experts and building inspectors who check for defective work, and refers builders who refuse to fix work to the BPB for disciplinary action (CAV 2004b, p. 73).

#### **4.4.7 Plumbing Industry Commission**

Plumbing work is regulated in part 12A of the Building Act—a part that ‘by and large’ operates separately from the rest of the Act (s221A). The Plumbing Industry Commission, established under part 12A, has a variety of functions:

- to restrict the use of the titles ‘plumber’, ‘gasfitter’ and ‘drainer’ to someone who is registered or licensed
- to ensure plumbing work is carried out only by plumbers who are licensed or registered, have relevant skills or competencies and are covered by the required insurance
- to require that licensed plumbers provide compliance certificates for most plumbing work that they carry out
- to provide for the inspection of sanitary drainage and other work
- to resolve disputes about the interpretation of the plumbing guidelines (with appeal to the Victorian Civil and Administrative Tribunal)
- to suspend the licence of a licensed plumber who is no longer covered by the required insurance or who has failed to comply with a reasonable direction of the insurer to complete or rectify defective plumbing work.

#### **4.4.8 Plumbing Industry Advisory Council**

Although the Building Act requires systems of registration, accreditation, enforcement and appeal for plumbing, as for building, the only separate plumbing entity is the Plumbing Industry Advisory Council, which provides advice to the Minister and the Building Commission in relation to part 12A of the Building Act. The council also advises the Plumbing Industry Commission on the performance of the regulatory system and potential improvements. In 2003-04, for example, it:

- assisted the Plumbing Industry Commission to develop regulatory and organisational strategies for water and energy efficient houses
- ‘considered and endorsed for consultation with industry and government agencies’ the concept of registration of plumbing contractors and registration of all operatives working on fire protection systems (PIC 2004a, p. 5).



## **4.5 Local government**

The Council's role in regulating building construction is derived from the Building Act, the Local Government Act and the Planning and Environment Act.

### **4.5.1 Role of councils in regulating building construction under the Building Act**

Division 5 of part 12 of the Building Act sets out the responsibilities of councils in regulating building construction. Section 212(1) sets out significant administration and enforcement powers as follows:

Except where otherwise expressly provided in this Act or the building regulations, a council is responsible for the administration and enforcement of parts 3, 4, 5, 7 and 8 and the building Regulations in its municipal district.

Part 3 of the Building Act deals with the issue of building permits, part 4 with the inspection of building work, part 5 with the occupation of buildings (including the granting of occupancy permits), part 7 with the protection of adjoining property, and part 8 with the enforcement of safety and building standards. The other provisions in division 5 of part 12 deal with a variety of matters. Section 214 enables a council to agree with another council or the Building Commission for the municipal building surveyor of the second council or the Building Commission to perform some of its functions. Section 216 requires a council that performs work outside its municipal district to charge commercial rates for that work. Section 215 enables a council to appoint private building surveyors to consider applications for certain types of building permit. Section 216A provides that the minister may exempt a council from considering applications when sufficient private building surveyors are available.

Part 4 of the Building Regulations<sup>9</sup> confers significant responsibilities on councils, which permit them to vary the Regulations on design and siting issues such as street setback, building height, site coverage, side and rear setbacks, daylight to new and existing windows, overshadowing of open space, overlooking, private open space and front fences.

Further, s8(1) of the Building Act provides that the Regulations may empower councils to make local building laws on any matter set out in part 1 of schedule 1. Part 1 of schedule 1 lists 34 different matters, including 'Moisture content of buildings' and 'Noise resistant construction of buildings', on which councils may

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<sup>9</sup> Part 4 is a major element of ResCode, which is a package of residential development provisions that came into effect across Victoria in August 2001. ResCode provisions are also found in planning schemes, which protect neighbourhood character.

be empowered to make local laws. Nonetheless, no provision in the Building Regulations gives councils power to make such laws. The Building Act and Regulations do not give councils the power to make local building laws, although councils are given limited powers to do so under the Local Government Act for matters that can affect the building process (discussed below).

#### **4.5.2 Role of councils in regulating building construction under the Local Government Act**

The Local Government Act gives councils a limited power to make local laws on matters, including building construction, for which they have a function or power under an Act. Section 111(1) provides as follows:

A council may make local laws for or with respect to any act, matter or thing in respect of which the council has a function or power under this or any other Act.

It was noted above that each council is responsible under s212 of the Building Act for the administration and enforcement of parts 3, 4, 5, 7 and 8 of the Act and the Building Regulations in its municipal district. Consequently, by virtue of s111(1) of the Local Government Act, councils may make local laws on the matters covered by these parts. This power that s111(1) confers on councils does not permit councils to make laws on building design and construction, however, because such matters are not included in the functions that s212 of the Building Act confers on councils.

The power of councils to make local laws on building matters is also restricted by s13(1) of the Building Act, which provides as follows:

A local law made under part 5 [such as s111] of the *Local Government Act 1989* has no force or effect to the extent that it provides for any matter set out in part 1 of schedule 1.

Part 1 of schedule 1 of Building Act sets out a list of matters on which Regulations may be made, ranging from the design and siting of buildings to the safety of buildings. Consequently, pursuant to s13(1), councils may not make local laws on these matters. Their power to make local laws is also restricted by s111(2), (3) and (4), which provide that a local law must not be inconsistent with any Act or Regulation (including the Building Act and Regulations) or with a planning scheme. A local law is invalid to the extent of the inconsistency.

Under the Local Government Act, many councils have made local laws that require building sites to have specified fencing, rubbish receptacles and toilet facilities for the use of site workers. Local laws also require arrangements for the protection of council roads, land and other assets from damage during building works. These local laws are not invalidated by s13(1) of the Building Act because

they do not provide for matters dealt with in the Regulations or by s111 of the Local Government Act because they are not inconsistent with an Act or Regulation.

The City of Boroondara commented that there is a need for such local laws:

Councils would prefer not to have to introduce local laws, but a failure by the industry to regulate sections of their own members forces councils to introduce local laws such as asset protection, public protection, site security and litter control. (sub. 66, p. 4)

Nonetheless, there are some concerns about local laws: these laws are not subject to a rigorous public impact assessment, and there is no mechanism to promote uniformity across Victoria in local building laws.<sup>10</sup>

The HIA, in its submission to the Productivity Commission inquiry into first home ownership, suggested ‘there has been a growing trend for local governments to impose requirements on the design and construction of buildings that are in excess of those of the BCA’ and:

A recent example relates to the regulation of sound insulation between attached dwellings whereby some local councils have been requiring higher levels of insulation than the minimum requirements of the BCA. This trend has the potential for the development of over 700 sets of building requirements throughout Australia and must be stopped. State governments must legislate to prevent local governments from establishing their own building control requirements for all issues that are regulated through the BCA. HIA understands that this is presently the case in some jurisdictions; however the level of enforcement of the legislation appears to vary significantly. (HIA 2003b, p. 90)

The Building Products Innovation Council commented:

The significant benefits of the BCA can and are being eroded by the activities of local government where the planning provisions of the state legislation are apparently applied to impact on the technical aspects of a particular building. (sub. 46, p. 1)

Whatever is the case in other jurisdictions, Victorian councils do not have the power under the Building Act or the Local Government Act to make local laws on design and construction matters, such as sound insulation. This does not mean that they do not make such laws, although the Victorian Competition and

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<sup>10</sup> The procedure for making a local law is set out in s119 of the Local Government Act. The procedure includes publication in the *Victorian Government Gazette* of a notice stating that any person affected by the proposed local law may make a submission to the council.

Efficiency Commission is not aware of any. In any event, these laws are unenforceable. The Productivity Commission stated:

HIA noted that the introduction of additional building requirements at a local level is occurring, despite some states and territories having legislation to prohibit local authorities requiring higher standards on any design and construction matter that is addressed within the BCA. (PC 2004c, p. 175)

Any local laws made by Victorian councils under the Local Government Act that impose building requirements of the type noted in part 1 of schedule 1 of the Building Act have no legal effect because councils do not have power to make such local laws. Other local laws made under the Local Government Act, such as requiring toilets to be installed on building sites, are validly made where they relate to a council function or power under an Act.

### **4.5.3 Imposition of building controls through council planning schemes**

Through the provisions of local planning schemes, councils have limited powers to impose building controls that are unique to a municipality. The Planning and Environment Act provides for planning schemes to promote the objectives of planning in Victoria within the area covered by a scheme (s6). These objectives include securing ‘a pleasant, efficient and safe working, living and recreational environment for all Victorians’ (s4(1)(a)). Planning schemes thus have an impact on building construction.

They must include state standard provisions and local provisions made by the council (s7(1)). The local provisions must include ‘a municipal strategic statement’ and ‘may include any other provision which applies only to the area of the planning scheme’ (s7(3)(b)).

Councils also have power through ResCode to introduce local overlays, such as a neighbourhood character overlay. This overlay typically includes a range of controls to retain an existing character or achieve a preferred character, and can be used by a council to:

- require a planning permit for one house
- change most of the design and siting requirements relating to single or multiple houses to make them more locally responsive
- require a planning permit for tree removal and the demolition of a building.

These planning powers give considerable discretion to local councils. The Victorian Competition and Efficiency Commission heard many complaints about the exercise of the planning power, including inconsistencies within and between councils and the placing of expensive and unwarranted (it was claimed) conditions on development applications. (While those affected by adverse

planning decisions may have recourse to the Victorian Civil and Administrative Tribunal, the Commission noted a reluctance to do so due to the expense and delays involved.)

Nonetheless, the Department of Sustainability and Environment informed the Commission that local variations to planning schemes do not appear to cause major problems (DSE, pers. comm., 29 June 2005).

Under its planning scheme, a council may issue a planning permit for a proposed building that includes conditions additional to the requirements of the Building Act and Regulations. A council may not, however, include in a permit a condition that is inconsistent with the Building Act or Regulations (s62(4)). The exception is when a condition relates to the siting of buildings.

Local planning scheme provisions prevail over inconsistent Building Regulations in relation to the siting of buildings. If a Regulation is inconsistent with a planning scheme provision on the siting of buildings, the Regulation must be read as far as possible to resolve the inconsistency and, to the extent of the inconsistency, ceases to have effect in the municipality (Building Act, s11). However, as with local laws, there is no mechanism to promote uniformity across Victoria in planning provisions that affect building construction or even to assist builders to determine the content of local laws in particular municipalities. According to a submission from Fagan and Fagan:

Notification of local laws to the building industry is usually a limited process by way of public notices in local papers, advisory correspondence to stakeholders who undertake work in the municipal area, notification on the municipal website and through the gazettal process. (sub. DR123, p. 6)

The City of Melbourne noted that it is using its planning scheme to pursue building objectives:

An important part of Melbourne Planning scheme amendment C60 is the inclusion of accessibility requirements for dwellings, commercial buildings and the public domain ...

The Accessible Buildings Policy means that in all new dwellings (both single dwellings and multi-unit developments) a person with a disability can access a living room, food preparation and eating areas, bathroom with a hobless (i.e. step free) shower, toilet, and a room for staying overnight. (sub. 45, p. 5)

The Municipal Association of Victoria indicated:

Some councils are addressing significant community issues on environmental sustainability, access and off-site amenity. However, it is understood that the councils have introduced such measures are doing so through the planning system, not the building system. (sub. 64, p. 4)

The Productivity Commission (2004c, p. xxxvii) also noted a tendency for local governments to use their planning approval processes to extend or alter building requirements, and made suggestions for improving regulatory outcomes, including:

- subjecting changes to council building requirements to a suitably rigorous justification process involving impact analysis, via the originating state
- maintaining a register of state RISs undertaken for local government building regulations, to help inform ABCB discussions
- facilitating interjurisdictional discussions, to establish national agreement on a delineation between regulation making powers relating to planning and building
- assessing the feasibility of requiring any local government requirement that is inconsistent with the BCA to be approved by the responsible state minister (similar to the Victorian approach).<sup>11</sup>

#### **4.5.4 Fee setting by councils in relation to building and occupancy permits**

Schedule 2 of the Building Act sets out the procedures for applications for building permits and occupancy permits. Clause 1(c) of schedule 2 provides that an application must be accompanied by the fees ‘determined by the council in accordance with the Local Government Act’. Further, the Building Act provides in s188(1)(a) that the minister may issue guidelines on the fees to be charged for applications for permits and approvals, and any other fees to be charged under the Building Act and Regulations. The Act provides in s188(2) that the guidelines may specify the fees (or maximum or minimum fees) and that the fees may be different for different classes of case. The guidelines must be published in the *Victorian Government Gazette* (s188(3)).

The guidelines are not binding on councils when they set their fees. Section 188(4) of the Building Act states that a council or private building surveyor, in determining fees for permit applications, *may* have regard to fee guidelines issued by the minister. Section 188(6) provides that the Building Commission *must* have regard to fee guidelines issued by the minister. The use of ‘may’ rather than ‘must’ in relation to councils indicates that they are not obliged to follow the ministerial guidelines and, consequently, have discretion in setting fees.

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<sup>11</sup> Section 188A of the Building Act, discussed later, permits the minister to give directions to councils, but the Commission is not aware of any direction to the effect claimed by the Productivity Commission.

Section 113(1)(a) of the Local Government Act deals generally with fee setting by councils. It provides that a local law may provide that a council may determine a fee for any act, matter or thing—terms wide enough to include fees for issuing permits. The RIS process under the Subordinate Legislation Act does not apply to local laws made by councils, so there is no requirement for a council to undertake a cost–benefit scrutiny of proposed fees.

#### **4.5.5 Ministerial powers under the Building Act in relation to councils**

The Building Act provides in division 1 of part 12 that the minister administering the Act may issue guidelines to councils relating to fees (s188) and to the design and siting of single dwellings (s188A). (The effect of guidelines on fees has been discussed above.) Further, clause 4A of schedule 2 of the Building Act obliges a council to have regard to the minister’s guidelines when considering any permit application and to refuse to consent to any application that does not comply with the guidelines (c4A(2)(d)).

The current minister’s guidelines relate to street setback, building height, site coverage, permeability, car parking, walls on boundaries, daylight to existing habitable room windows, solar access, overshadowing, overlooking, daylight to new habitable room windows, private open space and front fence height. In several instances, the minister’s guidelines set out conditions under which a council may grant a permit notwithstanding non-compliance with particular Building Regulations.

The minister also has limited powers in relation to councils, as set out in division 1 of part 13 of the Building Act. The principal provision is s222(1), which provides as follows:

If, after due inquiry, the minister considers that a council or municipal building surveyor has not satisfactorily carried out any function given to the council or building surveyor under this Act or the regulations, the minister may, by order, direct the council—

- (a) to carry out the function within a specified time; or
- (b) to cause the building surveyor to carry out the function within a specified time, as the case requires.

Section 223 provides that the minister must give the council an opportunity to be heard before making an Order. Other sections in division 1 of part 13 give the minister power to enforce his or her Order or to engage another person to carry out the required function at the cost of the council. However, the minister does not have power under the Building Act to give a direction to councils regarding local laws that affect building. The minister is also unable to require reports from councils on their building regulation activity.

### **4.5.6 Summary**

Councils have a significant role in regulating housing construction in Victoria, through their powers to administer and enforce various parts of the Building Act, such as by granting or refusing building permits and prosecuting when building works are undertaken without a permit. But councils have only limited rule making powers. They have power to make local laws under the Local Government Act (such as requiring toilets to be installed on building sites) when those laws relate to council powers and functions under Acts. However, the local laws must not be inconsistent with any Act, Regulation or planning scheme.

Councils also have the power to impose additional requirements through their planning schemes. Under s11 of the Building Act, a provision of a planning scheme on the siting of buildings takes precedence over an inconsistent Building Regulation. However, there is no mandatory mechanism for subjecting local laws and planning scheme provisions that relate to housing construction to rigorous regulatory review, or for promoting consistency in this area across Victoria.

The minister may issue guidelines on fee setting by councils, but the guidelines are not binding. He or she may also issue guidelines to councils on the design and siting of single dwellings. In addition, the minister can act against councils if they fail to perform their functions in a timely manner, but the Building Act does not give the minister any power to require reporting by councils on their building regulation activities.

## **4.6 Processes for imposing new obligations**

This section describes the processes for imposing new legislative or regulatory obligations and guidelines on those involved in housing construction.

### **4.6.1 Legislation**

First, the legislation governing housing construction could be amended following debate and approval of an amending Bill by Parliament and assent by the Governor in Council. Where the responsible minister determines that proposed legislation ‘has potentially “significant effects” for business and/or competition in Victoria’, he or she will normally arrange for a business impact assessment (BIA) of the proposed legislation. The Commission reviews the BIA before it is submitted to Cabinet (State Government of Victoria 2005b, p. 4-6). The BIA must describe the legislative proposal and its expected effect on key stakeholders. It must also assess the costs and benefits of the proposal (including its impact on small business) and other practical alternative means of achieving the objective. A BIA is not ordinarily released to the public, but public consultation can occur



through exposure drafts of proposed legislation, which are sometimes used to seek feedback from stakeholders, test implementation and check any unanticipated impacts of proposed legislation.

None of the legislation described in this chapter has been exposed to the BIA process, which came into effect after the Building Act was enacted.

## **4.6.2 Regulations**

Second, the Building Regulations and other relevant Regulations may be amended by Regulations authorised by the responsible minister. Eighteen amendments have been made to the Regulations since 1994 (BRAC, sub. 57, p. 5).

The Building Commission coordinates the preparation of proposals for Building Regulations (s196(e)) for the minister to consider. The minister then obtains advice on the proposed Regulations from the Building Regulation Advisory Committee (s211) and consults with stakeholders according with the procedures required by the Subordinate Legislation Act.

Under that Act, proposed Regulations are ordinarily assessed in an RIS for their economic, social and environmental costs and benefits for affected groups. The Victorian Competition and Efficiency Commission reviews the RIS, which is then submitted along with the proposed Regulations to stakeholders to obtain their views. Following the consultation process, the proposed Regulations are submitted to the Governor in Council for approval and then placed before Parliament, where they may be disallowed in accordance with the Subordinate Legislation Act. A relevant exception to this procedure is the case of a Building Regulation that applies, adopts or incorporates any matter contained in a planning scheme approved under the Planning and Environment Act (Building Act, s9A).

## **4.6.3 Building Code of Australia**

Third, regulatory obligations governing housing construction can be altered by amendments to the BCA, the provisions of which are adopted by, and form part of, the Building Regulations (r1.7), except to the extent that the Regulations modify the BCA.

The BCA is amended every 12 months, with effect from 1 May each year. The primary responsibility for reaching agreement on the technical content of BCA amendments rests with the Building Codes Committee of the ABCB. The committee includes representatives of all state and territory building control administrations, building industry associations and specialist observers (ABCB 2005). The ABCB is required to undertake a regulatory analysis of all technical

changes proposed for the BCA and to invite public comment on its impact assessment. In addition, for more significant BCA amendments, an RIS on the financial and socioeconomic costs and benefits is prepared and released for circulation (PC 2004c, p. 245).

The BCA21 Committee, comprising members from industry, professional associations and state and territory governments, is analysing the broad framework of goals, objectives and structure of the BCA, including technical content. The analysis includes both policy and technical development phases and will consider research outcomes and any leading technology from international research on performance based building codes (ABCB 2005).

#### **4.6.4 State and territory amendments to the Building Code of Australia**

Fourth, states and territories can incorporate their own amendments into the BCA. The Building Codes Committee develops amendments to the BCA using a consensus approach. However, where an issue exists principally for geographic reasons that have implications for a state or territory, the state or territory can vary the BCA provisions. The Building Commission consults with the Building Regulations Advisory Committee about proposed Victorian amendments and, if set up, with specific interest groups relevant to the issue under review. The housing provisions of the BCA 2005 contain additions for all states and territories, apart from the Northern Territory and Western Australia.

#### **4.6.5 Ministerial guidelines and orders**

Fifth, the minister administering the Building Act can issue guidelines under ss188 and 188A relating to:

- fees charged under the Act and Regulations
- charges for services provided by the Building Commission
- the functions of municipal building surveyors and private building surveyors
- the circumstances under which building surveyors should seek help from the Chief Fire Officer of the Metropolitan Fire Brigade or Country Fire Authority
- the design and siting of single dwellings (including matters relating to neighbourhood character and amenity, overshadowing, building height, the preservation of trees, architectural or heritage features, energy efficiency, and fences and boundary walls).

The Act does not prescribe any consultation that must occur or any procedure that must be followed when guidelines are made, although guidelines must be published in the *Victorian Government Gazette*. Guidelines do not necessarily

impose binding obligations: building surveyors, the Building Commission and the BPB must have regard to certain guidelines, but building surveyors may have regard to guidelines on fees charged for permit applications, approvals and other matters. Under clause 4A of schedule 2 of the Act, a reporting authority such as a council must have regard to the guidelines made under s188A where relevant.

The guidelines sometimes vary the Building Regulations. The guidelines made under s188A on 24 November 2001, for example, permit a council to consent to a building permit for a single dwelling that does not comply with the Building Regulations relating to minimum street setback, building height, site coverage, permeability, car parking, boundary walls, daylight and other matters.

The minister may also publish orders under s135 requiring building practitioners to be covered by insurance. Before making orders, the minister must consult with the Building Practitioners Board (s135(5)).

Section 189 provides that the minister may delegate any of his or her functions under the Act to the Building Commission, including the function to make guidelines. The Building Commission has not made any guidelines under this provision.

#### **4.6.6 Local provisions in planning schemes**

Sixth, through local provisions in planning schemes, Victorian councils have the power to apply standards different from those in the Building Regulations. Before such standards are imposed, however, councils have to go through a process set out in the Building Act.

In preparing or amending a planning scheme, a council (called a planning authority) must have regard to the minister's directions, the Victorian Planning Provisions and other specified matters, such as environmental effects. A planning authority may also carry out studies, commission reports and consult with other persons (s12). Planning authorities must give notice of proposed amendments generally to persons who might be materially affected, and must also take reasonable steps to ensure public notice of the proposed amendments is given in the affected area. Further, they must submit planning scheme amendments for ministerial approval (s31), which may be granted in whole or part, or refused (s35).

#### **4.6.7 Local laws**

Seventh, councils can introduce local laws by following a procedure set out in s119 of the Local Government Act. A council is required to publish a notice in the *Victorian Government Gazette* stating that any person affected by a proposed local law may make a submission to the council. However, the council is not required to seek out the views of persons likely to be affected and is not expressly required to consider any submissions received, although such a requirement may be implied.

#### **Finding 4.1**

Additional regulatory obligations can be imposed on participants in housing construction in at least seven ways. In some cases, extra obligations can be imposed without any formal public process for analysing their costs and benefits.

# **Part B**

## **The instruments**



## 5 Regulation of housing design and construction

This chapter considers regulation that governs housing design and the choice of construction materials and building techniques. Its main focus is on State Government Regulations (including Regulations adopted via the Building Code of Australia), but it also discusses elements of local government regulation.

### 5.1 Introduction

A considerable body of Victoria's building regulation governing housing design, construction materials and building techniques is adopted via the Building Code of Australia (BCA), or variations to it. In reviewing Victoria's regulation of the housing construction sector, it is thus appropriate to consider the standards embodied in the BCA and ways to improve how they might apply in Victoria.

At the level of state-made regulation, inquiry participants were particularly concerned with regulation relating to energy and water efficiency, access for people with a disability, and health and safety. Accordingly, the Victorian Competition and Efficiency Commission has focused on these areas in its report. Inquiry participants also raised concerns about local government regulation (particularly by means of planning powers) and the costs it imposes on the housing construction sector. These concerns included the extent to which regulatory inconsistency across councils and poor notification procedures add to the regulatory burden for builders (and ultimately to the cost to consumers). Finally, because Victoria's regulatory framework confers on building surveyors a central role in ensuring the application of regulation governing building design and construction, it is important to review how well this approach is working.

### 5.2 Central role of building surveyors

As described in chapter 4, building surveyors have a central role in ensuring the application of the regulatory system in Victoria. They are responsible for issuing building permits and ensuring the minimum standards set out in building regulation are applied throughout the building process. Reddo Pty Ltd summarised the central role of building surveyors when it noted:

At the end of the day it is the relevant building surveyor that is administering regulation on behalf of the government. (sub. 70, p. 5)

The *Building Act 1993* (Vic.) provides for private (as well as municipal) building surveyors to approve building permits and certify compliance with building

regulation. The Department of Sustainability and Environment provided a measure of the extent to which private surveyors have been accepted by the industry:

In 1997 private building surveyors issued 57 per cent of the total number of building permits, which represented 73 per cent of the total value of building work approved. In 2004 these figures had risen to 73 per cent and 83 per cent respectively. (sub. 84, p. 54)

Where submissions commented on this change, they concluded that the advent of private building surveyors has worked well, particularly in reducing delays that were common when the system relied solely on council surveyors. The comments in box 5.1 are indicative of inquiry participants' views on this matter.

### **Box 5.1 Inquiry participants' views on allowing private building surveyors**

The Chairman of the Australian Building Codes Board (sub. 9, p. 3):

The introduction of private certification has significantly changed the landscape of building certification in Australia. ... To date, there have been clear advantages for the Victorian building industry and consumers. Generally private certification has resulted in streamlining the process of obtaining building approvals and inspections.

Plan Scan (Aust.) Pty Ltd (sub. 44, p. 1):

Prior to the introduction of this Act and Regulations all building permits were issued by local councils. Time delays were experienced by builders and in some instances building permits were taking up to three months to be issued. Delays of up to one week were being experienced getting on site building inspections.

With the introduction of competition into the system by way of private building permits these delays were reduced considerably and a time delay of probably no more than a week is now expected by the building industry for most project housing type permits.

The Department of Sustainability and Environment, too, noted that private certification has delivered benefits through faster approvals. It also noted other benefits, including:

- greater design freedom and use of innovation/technology
- improved dialogue between industry and building surveyors
- an expansion of the available specialist expertise
- increased upskilling of building surveyors
- the promotion of a more business-like approach among council building surveyors (sub. 84, p. 54).

These benefits mirror other jurisdictions' experience with private certification (PC 2004c, p. 55).



In issuing building permits and overseeing building standards, private building surveyors are, in effect, working for the consumer. Consumers may select the private building surveyor but the builder usually selects one on their behalf. However, some inquiry participants noted that this arrangement could lead to a potential conflict of interest. Reddo noted:

For whatever reason there is a perceived conflict of interest, the integrity of the building surveyor in this instance appears to be in question. Appointment by the owner is a process that would be supported and building application forms already identify owner/owners agent. Building surveyors can only assume the owner is informed by the person acting as the owners' agent of who the appointed building surveyor is. (sub. 70, p. 4)

The Australian Institute of Building Surveyors (Victorian chapter) (AIBS) stated it 'did not believe the integrity of private building surveyors is in question', but also noted:

Notwithstanding the above, the AIBS would support a change in legislation to require the 'owner' to appoint the 'building surveyor' directly and prohibit the novation or transfer of functions to builders or other practitioners without the written consent of the Building Commission ... (sub. 41, p. 7)

Robert Knott (an architect and a building and property dispute consultant) had a less sanguine view, noting that 'In many cases, in my experience, it has been alleged that building surveyors were not impartial, but favoured the builder because the builder employed them' (sub. 37, p. 1). He suggested that a solution to this potential problem would be for building law to prohibit engagement by other than the proprietor. However, Fagan and Fagan observed that such regulation might be justified if there were widespread evidence of unprofessional conduct, but this did not appear to be the case:

Published decisions of inquiries at the Building Practitioners Board or prosecutions at the Magistrates Court do not reflect problems with either a conflict of interest or attempts to influence the function of a registered building practitioner. Recent survey findings do not identify systemic problems. Results show that 78 per cent of consumers rated the independence of building surveyors as high to very high compared to 63 per cent in 2003. (sub. DR123, p. 4)

Information provided to the Commission suggests this potential conflict of interest is not a significant problem in practice. For this reason, prohibiting the current widespread practice of the builder engaging a building surveyor does not seem warranted. The comments noted above, however, suggest the consumer should be better informed about their right to choose a surveyor. This information would help to clarify that the surveyor is not working for, and on behalf of, the builder (as considered in more detail in section 6.4, as there is a suite of issues on which the consumer could be better informed).

### **Finding 5.1**

The evidence presented to the Victorian Competition and Efficiency Commission indicates that the privatised building surveyor/permit process is working well. There is a case, however, for consumers to be better informed that the building surveyor is working in their interest to ensure minimum building standards are met, and that they have a choice of surveyor at the inception of the project.

## **5.3 National regulation adopted in Victoria**

The BCA is a starting point for examining Victoria's regulation of the housing construction sector. As Stuart McLennan & Associates noted:

The Building Code of Australia ... is adopted by the Victorian Government to define minimum acceptable construction practice ... (sub. 65, p. 2)

The code—a nationally consistent set of minimum technical standards for the design and construction of buildings—occupies a central place in Victoria's building regulation governing housing design and construction.<sup>1</sup> Its operation was recently reviewed by the Productivity Commission, as part of a report on reform in building regulation (PC 2004c). The Productivity Commission found:

... reform of the building industry has delivered greater certainty and efficiency to the building industry as well as benefits to the broader community. The board has successfully reduced many regulatory differences across jurisdictions, especially those based on core elements of the code, and established the framework for a performance based regulatory regime. (PC 2004c, p. XXI)

### **5.3.1 Benefits of adopting the Building Code of Australia**

The inquiry heard that the current BCA model has served the building and construction industry and the Australian community very well (MBAV, sub. 49, p. 14) and that the adoption of the code 'has been a significant contributor to the moderation of housing construction costs' (City of Melbourne, sub. 45, p. 8). The National Association of Steel Framed Housing noted:

The introduction of the Building Code of Australia in 1996 was a major breakthrough in the development of efficient building regulations. The performance specification provided the basis of the 'deemed to satisfy' sections and also allowed the development of innovative new systems ... (sub. 35, p. 2)

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<sup>1</sup> Chapter 4 describes the nature of the BCA and its application in Victoria.

Benefits from the code derive particularly from the performance based nature and national consistency of regulation.

### **Performance based regulation and innovation**

Building regulations in the BCA can be either ‘deemed-to-satisfy’ solutions set out in prescriptive terms or ‘alternative solutions’ certified as meeting the relevant performance requirements. As the Chairman of the Australian Building Codes Board (ABCB) observed, a performance based code generates cost savings to developers and the community by:

- permitting the use of alternative or innovative materials and forms of construction or design
- allowing designs to be tailored to particular buildings
- providing guidance in a clear manner on what the BCA is trying to achieve
- allowing designers flexibility. (sub. 9, p. 7)

A growing body of literature supports the superiority of performance based regulation as a promoter of innovation over the industry’s traditional reliance on prescriptive regulations (Gann, Wang & Hawkins 1998).

The Productivity Commission, as part of its recent review of reform of building regulation, surveyed building surveyors regarding the impact of performance based regulation in the building industry. Eighty per cent of respondents thought that regulatory approach encouraged greater innovation in planning and building, and 70 per cent thought it encouraged the use of new technology (PC 2004c, p. 54).<sup>2</sup> Respondents were also asked whether, on balance, the introduction of performance based regulation had been beneficial or harmful to the overall performance of the industry.<sup>3</sup> Eighty per cent of respondents considered it had a positive impact on performance and 16 per cent considered the impact to be negative (PC 2004c, p. 55).

The inquiry has not been presented with evidence to suggest that Victoria’s adoption of the BCA has impeded innovation; rather, the evidence supports the view that the code has facilitated innovation. An example may be found in the operation of the Building Regulations Advisory Committee (BRAC), which has an accreditation and regulatory advice role as part of its functions under the Building Act:

Product accreditation is an essential element of the performance based regulatory system that supports innovation by dealing with solutions that are difficult for individual building surveyors to assess. ... Applications [for

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<sup>2</sup> The survey did not distinguish between the impact of regulation on housing and commercial building.

<sup>3</sup> Where performance was defined to include productivity, innovation, quality and efficiency.

accreditation to the BRAC] are assessed against performance requirements in the BCA. ... A certificate of accreditation [from the BRAC] is evidence that the product or system complies with the Regulations or the BCA. The register of accredited products is publicly available and accreditation approvals are published by the Building Commission in its quarterly magazine *Inform*. (sub. 57, p. 6)

The Building Appeals Board (BAB) performs a similar function, albeit more limited in scope. An owner (or their representative) can approach the board to seek a decision on whether a particular design or element of a building complies with the Building Act and the Building Regulations 1994. The board indicated that decisions (made by a panel of building experts) are made quickly and cost-effectively (sub. 74, p. 1).

### **National consistency**

The Productivity Commission's recent review of reform of building regulation looked at the benefits of national consistency arising from the BCA. Box 5.2 summarises the review findings. Evidence presented to this inquiry is consistent with the Productivity Commission findings in this regard.

#### **BOX 5.2 The benefits of national consistency in building regulation**

The Productivity Commission found that national consistency via the Building Code of Australia delivers substantial benefits:

- Builders and designers, especially those that operate across jurisdictional borders, can use and apply a single set of mandatory requirements, rather than having to be familiar with multiple codes. Further, building designs that comply in one jurisdiction do not have to be reworked or altered to comply in other jurisdictions.
- Manufacturers of building products strongly support a national scheme, because it allows them to manufacture a single product to meet demand across all jurisdictions, rather than having to develop different products for each jurisdiction.
- Tradespeople benefit from consistent building designs because they can apply their skills in any jurisdiction.
- The development of a national code is also likely to be significantly more cost-effective for government than would be the development of separate state and territory based codes.

Source: PC 2004c, p. XXX.

Based on the information presented to it, the Commission concludes that the adoption of the BCA as a central element of Victoria's building regulation is a sound approach. This approach has delivered a host of benefits derived from the

performance based nature of the code and from the national consistency it embodies. Moreover, it provides sufficient flexibility to cater for the specific needs of geographic areas within the framework of the national code.

### **Finding 5.2**

Victoria's adoption of the Building Code of Australia as a central element of its building regulation is generally a sound practice. It delivers significant benefits through performance based and nationally consistent building regulation.

Notwithstanding the apparent benefits from incorporating the BCA into Victoria's building regulation, the approach has shortcomings. Inquiry participants raised two general concerns. First, the process for developing standards to include in the code may not always incorporate a sufficiently rigorous analysis of their impact. (A related issue is the cost of obtaining these standards and the subsequent effect on their dissemination and application). Second, while the code allows for state variations to cater for specific needs of geographic areas, the process for assessing the merit of those variations might not incorporate a sufficiently rigorous analysis of their impact. These issues are discussed in the following sections.

### **5.3.2 Australian standards in the Building Code of Australia**

The BAB noted that the BCA calls up over 200 standards relating to building and construction. For each of these primary standards in the code, there are secondary and tertiary reference standards, increasing the number of codes in the BCA to over 1400 (sub. 74, p. 3). The fundamental and pervasive role of standards in building regulation raises two issues:

- (1) whether the process for developing national standards and adopting them into the BCA is adequate
- (2) whether Victoria has an adequate process to ensure standards adopted in the BCA will deliver net benefits for Victoria.

On the first of these issues, various inquiry participants were critical of the manner in which new standards are developed and incorporated into the code (and thus into Victoria's building regulation). The BRAC, for example:

... recognises that the adoption of national standards through reference in the [Building Code of Australia] provides an opportunity for uniformity and efficiency but often shares the concern expressed recently by the Productivity Commission about the standards setting process and continues to seek ways of addressing improvements. (sub. 57, p. 8)

The Housing Industry Association (HIA) expressed a similar view:

All Australian Standards should be subject to a rigorous cost benefit analysis prior to their referencing in the BCA. (sub. DR163, p. 7).

HIA is also concerned with the ‘best practice standards’ approach by Standards Australia. This is clearly inconsistent with the objectives of the BCA, which focuses on minimum effective standards. Unjustified and costly ‘best practice standards’ create an additional cost burden on homeowners and erode affordability. They are also inconsistent with Section 4 (d) of the Victorian Building Act which aims to ‘facilitate and promote cost effective construction of buildings’. (sub. DR163, p. 8)

Some inquiry participants also observed that major reform initiatives such as disability access and energy efficiency are subjected to an appropriate assessment process, yet lesser changes involving the inclusion of new standards are inadequately scrutinised. Moreover, as Stuart McLennan & Associates noted, the ABCB lacks the resources to properly evaluate new standards emerging from Standards Australia that enter the BCA and that might not have been subject to appropriate assessment (sub. 65, pp. 2–3).

The process of developing standards is a fundamental influence on whether new standards (regulation) will deliver net benefits for Victoria. But as the Property Council of Australia commented:

This issue [improving the process of developing standards] should be managed at a national level through the Australian Building Codes Board (of which state regulators are members), Standards Australia and industry groups. (sub. 69, p. 4)

Measures have been taken to address this concern. A memorandum of understanding between the ABCB and Standards Australia sets out the processes for developing primary BCA referenced standards (ABCB 2003). If considered necessary, the board will undertake a regulatory impact statement (RIS) for new standards (or new editions of standards) to be referenced in the code. Where possible, Standards Australia committees will identify the costs and benefits of developing or revising a standard, to assist the board with an RIS.

In addition, the board has developed a *Protocol for the Development of Building Code of Australia Referenced Documents* (ABCB 2004c) to improve transparency among bodies preparing documents for reference in the BCA. State and territory building control administrations require the protocol to be followed to ensure a document is properly considered before being referenced in the BCA.

However, the usefulness of these measures is questionable. In a recent review of reform of building regulation, the Productivity Commission was critical of them and recommended:

The memorandum of understanding between Standards Australia International (SAI) and the [Australian Building Codes Board] should be re-negotiated and the referenced documents protocol revised to provide for a clearer requirement for RIS-type analysis to be undertaken at an early stage in the development of standards that are expected to be referenced in the BCA and that are likely to have non-minor effects. (PC 2004c, p. 272)

The ABCB Chairman welcomed this recommendation, noting that it would improve the consultation and assessment process (sub. 9, p. 7).

The development and assessment of national standards for inclusion in the BCA are a matter beyond the scope of this inquiry. However, the Commission considers that the changes proposed by the Productivity Commission would improve the integrity of the process whereby standards are developed and incorporated into the BCA.

The proposed changes are also relevant to the second issue—whether Victoria has an adequate process to ensure standards adopted in the BCA will deliver net benefits for Victoria. But while they will increase the likelihood that standards (regulation) embodied in the code would deliver net benefits in aggregate, they will not necessarily ensure those standards would deliver net benefits to Victoria.

Stuart McLennan & Associates considered there is a fundamental conflict between Australian standards (which are typically best practice documents) and the objectives of Victoria’s Building Act (which aims ‘to facilitate and promote the cost-effective construction of buildings’—a role that suggests the development of minimum acceptable construction practices) (sub. 65, pp. 2–3). It noted that Standards Australia does not universally undertake independent and credible impact assessments that account for this potential conflict:

The failure to complete this process [of impact assessments] is significant for a number of reasons, not the least of which is the fundamental issue of whether the change is necessary and the potential economic implications if other alternatives are not explored—a process fundamental to regulation development. (sub. 65, p. 3)

The proposed changes to improve the process by which Australian standards are developed partly address these concerns. But the potential remains for Victoria to adopt national standards that do not deliver net benefits for the state. Stuart

McLennan & Associates suggested, in view of the potential net costs that even minor reforms to standards might impose on the community, that:

The Victorian Government should take a more responsible stance and not adopt standards that have not been independently proven as a net benefit for the Victorian community. (sub. 65, p. 7)

The Commission notes that the Victorian Government's principles for good regulation generally require that an RIS precede the introduction of a new regulation (which a new standard effectively represents). It also notes that when an amended standard is being developed, the ABCB sends the proposed amendment and reason for change to the relevant building control authority in each state for comments. The Building Commission would refer such proposals to the BRAC for their input, and provide comments where warranted to Standards Australia or the ABCB. However, the quote from Stuart McLennan & Associates suggests this is either not universally done or not accompanied by sufficient rigour. In response to a request in the draft inquiry report for suggested measures to improve the assessment process, the BRAC stated it 'would support stronger representation by Victoria in the initial stages of the development of standards rather than "after the event" through an RIS' (sub. DR142, p. 7).

### **Finding 5.3**

While Victoria's adoption of the Building Code of Australia as a central element of its building regulation is a sound practice, the approach has shortcomings, such as a lack of rigorous analysis of some standards at an early stage of their development. Additionally, there are legitimate concerns about the rigour generally applied to assessing the impact of standards that might subsequently be adopted into Victoria's building regulation.

In chapter 8, the Commission recommends that an RIS-type analysis of proposed standards be undertaken in certain circumstances.

### **Compliance costs**

Good regulatory practice is to enable the community to access information about regulatory responsibilities at low marginal cost. However, this appears not to be the case for aspects of the BCA. Several inquiry participants drew attention to the high cost of purchasing Australian Standards. Stuart McLennan & Associates noted that the BCA standards package (primary references only) is available at approximately \$1200 per year, and this cost could triple if the secondary and tertiary reference codes were included (sub. 65, p. 8). Plan Scan noted that access to the building codes and standards costs about \$1400 a year (sub. DR111, p. 1).



Although these costs are probably passed on to consumers, the initial expense of obtaining a copy of the regulations may dissuade some builders (particularly small builders) from purchasing the information. As a result, they would be unaware of their current obligations under the BCA. Stuart McLennan & Associates regarded the costs as excessive, impeding the accessibility of, and adherence to, the regulations:

It is important that Victorian legislation including reference codes be readily available to ensure the laws are understood and followed. (sub. 65, p. 7)

Stuart McLennan & Associates concluded that standards forming part of Victoria's building regulation should be available at production cost, and recommended:

- The BCA should be available free on the internet and on a cost recovery basis for hardcopies of the document under the revised Inter Government Agreement
- SAI [Standards Australia International] standards referenced in the [Building Code of Australia] should be sold at a fee limited to recover publication costs. (sub. 65, p. 8)

The Productivity Commission addressed the same issue in its recent review of reform of building regulation. That review found:

There is a strong argument for essential referenced standards to be made available free online with the BCA. However, the ABCB and governments have no direct control over the cost of Australian Standards. Pricing and distribution is determined by the commercial arm of Standards Australia (SAI Global). Charges represent a return on Standards Australia's intellectual property.

While there are clearly significant obstacles to the provision of free access to Australian Standards referenced in the BCA (including that SAI holds the copyright for their standards), various options may merit further examination. For example:

- the ABCB could pay SAI an appropriate royalty for the right to publish essential primary referenced standards online, linked to the BCA; or
- SAI could provide online access on a free subscription basis and then receive compensation from ABCB for revenue forgone (ie. based on the number of subscribers).

In either case the ABCB would, in turn, require a funding supplement from governments. ... More generally, there may be a case for establishing a freely accessible online register of all Standards referenced in legislation or regulation. (PC 2004c, pp. 296–7)

The issue of intellectual property rights arising from standards is not straightforward. As noted by Fagan & Fagan:

Standards are developed by working committees that constitute members representing such sectors as manufacturers, suppliers, regulators, building associations, special interest groups and individual experts. Having been a member of several such committees and travelled interstate to participate I can advise that there is no compensation for time or expenses. The success of the committees and ultimately the publication of a standard are solely reliant on the voluntary participation and goodwill expressed by members (and their employers). These members bring to the committee their collective expertise that is articulated both as tacit and explicit knowledge. Standards are developed on industry know how and as such, industry should be able to share in the results of their input, not as a payer but as a beneficiary.

Given the invaluable contribution of industry participants, free on line access to referenced standards is justifiable as it represents an appropriate level of compensation, not to the individual who resides on the committee, but to the whole industry that they ultimately represent. (sub. DR123, p. 5)

The Victorian Civil and Administrative Tribunal (VCAT) commented in a recent case:

The BCA is not freely available, in the same way that Acts and regulations are freely available. This is indefensible. (Hasan v Moreland CC [2005] VCAT 1931)

In view of the information provided in submissions and the findings of the Productivity Commission, the Commission considers that the Victorian Government should explore, through the ABCB, the options noted by the Productivity Commission to provide building standards electronically at zero cost. This lower cost of access would improve compliance by builders and advantage those prepared to use up-to-date systems.

As an example, the Australian Accounting Standards Board, in issuing the Australian Equivalent International Financial Reporting Standards, provides those standards online at its website free of charge. The hard copy service is charged at a cost recovery level. This access regime is based on Commonwealth Government policy for legislation and associated standards.

A number of submissions (for example, City of Moonee Valley, sub. DR99; BRAC, sub. DR142; HIA, sub. DR163), in responding to the draft inquiry report, acknowledged the high cost of access to standards and supported lowering this cost as a means of improving compliance while also providing a benefit to the industry. As the Master Builders Association of Victoria (MBAV) noted, 'This could lead to a greater update of standards, resulting in more informed practitioners, leading to better building quality, generating improved consumer outcomes' (sub. DR151, p. 5).

The City of Melbourne also supported lowering this cost, but questioned how such a reduction might be funded (sub. DR136, p. 5). In this regard, the ABCB noted the options in the draft inquiry report might be impractical:

The VCEC proposal for the ABCB to subsidise the availability of standards referenced in the BCA would require significant funds, estimated to be a minimum of \$26 million p.a. ... this compares to the current joint Commonwealth, state and territory funding of the ABCB which totals \$2 million p.a. Additional funding to support such a venture has not been addressed in the ABCB's new, draft inter-government agreement currently under consideration by ministers. (sub. DR113, p. 1)

The ABCB noted the Productivity Commission also recommended that the board continue to work towards minimising the number of referenced standards in the BCA. This would provide an avenue, albeit limited in scope, to reduce some costs of access. The ABCB is reviewing this issue (sub. DR113, p. 1).

While the cost of fully implementing the options proposed by the Productivity Commission and endorsed by the Victorian Competition and Efficiency Commission could be significant (for example, Victoria's share of \$26 million), there could also be scope for partial funding.

#### **Recommendation 5.1**

**That the Victorian Government test, through the Australian Building Codes Board, the merit of pursuing the following options to provide building standards electronically at zero cost:**

- **The Australian Building Codes Board pay Standards Australia an appropriate royalty for the right to publish essential primary referenced standards online, linked to the Building Code of Australia.**
- **Standards Australia provide online access on a free subscription basis and then receive compensation from the board for revenue forgone (that is, based on the number of subscribers).**

### 5.3.3 Varying the Building Code of Australia for Victoria

Stuart McLennan & Associates claimed that a major issue for domestic construction in Victoria is the potential for widely used sound practices to be deemed unacceptable through the adoption of code standards:

Victoria has a history of being progressive in its approach to regulation by recognising cost efficient design, many of which [that is, designs] have been acknowledged by the Building Appeals Board. However, such cost effective solutions will not be included in the BCA unless supported by the majority of

other states and territories. This means that Victorian innovation will continually be compromised by conservative approaches adopted in other states and territories. (sub. 65, p. 10)

It considered the adoption of standards within the BCA should allow for greater regional variation. As an example, it drew attention to timber framing requirements:

The Timber Framing Manual nominated in the BCA is AS 1684—1998. As part of a rationalisation of the framing industry, regional framing codes such as the Victorian Timber Framing Manual were removed and one national code was adopted. The national code was essentially prepared by the Queensland timber framing industry, and while it is a sound construction document for their industry, it does not reflect Victorian regional practices.

... Victorian builders have not adopted the latest ‘Queensland’ code and accordingly are building outside the prescribed standard. This exposes them to increased litigation. Alternatively, if they choose to comply with the ‘Queensland’ code there is an associated cost due to re-training, construction time and increased use of materials.

The solution to this problem would be for the Victorian Government to support regional construction practices and ensure that these methods are recognised in the BCA, especially as the housing provisions are structured to allow regional and traditional practices and where appropriate provide a range of options for compliance. It considered that the Victorian Government should endeavour to ensure that the Building Code of Australia is structured to provide a range of options for compliance that would include regional and traditional practices. (sub. 65, p. 10)

Plan Scan (sub. DR111) and the City of Moonee Valley also expressed support for retaining proven construction methods, with the latter noting that adopting standards that preclude previously satisfactory practices:

... has been an ongoing problem for building professionals in Victoria. New Australian Standards should recognise effective regional practices rather than adopting requirements that are mainly suitable for other terrains and weather conditions. (sub. DR99, p. 1)

The Commission notes that the performance basis of the BCA means that it should allow a number of possible solutions for complying with a code requirement, that these solutions may differ across jurisdictions, and that this is a strength of the code. (Taken to extremes, however, an excessive number of variations would compromise the benefits of a national code.) It notes that South Australia, for example, has its own regional housing code called up as a variation in the BCA. Building professionals in South Australia have the option of using the national provisions of the code or the South Australian housing code as necessary. Moreover, the Department of Sustainability and Environment advised the Commission that national standards potentially excluding sound Victorian building practices have arisen very infrequently (sub. DR172, p. 7).

The problem outlined by Stuart McLennan & Associates could probably be addressed routinely in any analysis of the impact of Victoria adopting a standard in the BCA. Assessing whether a new standard would (or should) preclude the retention of widely used practices would ensure any decision is mindful of the costs and benefits of that possible consequence. The MBAV noted that this approach would be valuable in terms of stopping the ‘back door’ introduction of regulation without any independent oversight (sub. DR151, p. 5).

#### **Recommendation 5.2**

**That regulatory impact analysis of a standard referenced in the Building Code of Australia consider (1) whether the standard would preclude retaining practices that have performed satisfactorily in Victoria in the past, and (2) the costs and benefits of that change.**

## **5.4 State level regulation in Victoria**

For state regulation, environmental and energy efficiency, disability access, and occupational health and safety (discussed below) were of most concern to inquiry participants. Other noted regulations of significance for the cost of housing construction were outside the scope of the inquiry. These included the impact of indigenous artefacts legislation (Civil Contractors Federation, sub. 47) and recent changes to the *Occupational Health and Safety Act 2004* (Vic.) that allow unions the right of access to construction sites (Property Council of Australia, sub. 69).

### 5.4.1 Environmental and energy efficiency

Inquiry participants drew attention to two elements of Victoria's environmental and energy efficiency regulation for the housing construction sector: those for 5 Star energy rating and those for mandatory water saving measures. Attention focused on these regulations because they have the potential to add significantly to housing costs and (with the 5 Star rating) adversely affect demand for some building materials.

#### Energy efficiency

As noted in chapter 4, one objective of the Building Act is 'To facilitate and promote ... the construction of environmentally and energy efficient buildings'. Consistent with this objective, Victoria introduced 5 Star energy efficiency standards for new class 1 and 2 buildings on 1 July 2004:

The state government is committed to introducing a range of measures to encourage more energy efficient and sustainable building practices and homes. As part of this, new houses in Victoria must feature a greater range of energy efficiency and water saving features. (Chant Link & Associates 2005, p. 11)

The industry was granted a 12 month transition period, giving it the opportunity to become familiar with the 5 Star standard.<sup>4</sup> That transition period ended on 30 June 2005. From 1 July 2005, it is compulsory for new houses to have:

- a 5 Star energy rating for building fabric (walls, ceilings, windows, floors and water saving measures)
- a rainwater tank for toilet flushing or solar hot water system (BC 2005e, p. 3).

Unless these requirements are met and certified by an appropriate assessor, a building permit for a new house will not be issued (box 5.3).<sup>5</sup> The energy rating for the standards is based on computer software packages.

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<sup>4</sup> The lightweight timber, mud brick and relocatable houses sectors raised concerns about their ability to meet the 1 July 2005 deadline. The transition period will extend until May 2006 for these types of construction (BC 2005e, p. 7).

<sup>5</sup> The standard applies to all new houses and apartments (class 1 and 2 buildings), with apartment buildings needing to achieve a 5 Star average for the whole building, with no individual dwelling rating less than 3 stars. If it is not practical to have a rainwater tank or solar water heater system, an application for a modification can be made to the BAB (BC 2003a, p. 4).

### **Box 5.3 Who provides the energy rating?**

Only a house energy rater accredited under a scheme administered by the Sustainable Energy Authority Victoria (SEAV) may assess building designs to provide an energy rating. A rater can assess a home for its energy rating using either the SEAV's FirstRate design software or its equivalent, the CSIRO's Nationwide House Energy Rating Scheme (NatHERS) package.

To become an accredited rater, a two day training course in the use of the FirstRate software must be completed, the associated assessments passed, a copy of the software must be purchased (\$300) and a code of conduct signed. Raters must pay an annual fee of \$275 (or \$400 if a take-home exam is completed instead of the two day training). Raters are also required to submit ratings for checking each year.

Source: SEAV 2004.

Victoria's 5 Star standards differ from the energy standards embodied in the BCA and operate as an addition to the code (ABCB 2004b, p. 611). Box 5.4 describes the BCA standards and their development.

### **Box 5.4 Housing energy efficiency measures in the Building Code of Australia**

Revised energy efficiency measures for housing were introduced in the Building Code of Australia (BCA) on 1 January 2003. The revisions mandated a 4 star standard for most new housing and were progressively adopted in the Northern Territory, Queensland, South Australia, Tasmania and Western Australia. The Australian Capital Territory already had an equivalent 4 star rating system in place. New South Wales chose to incorporate energy measures for residences into its Building Sustainability Index (BASIX). In 2003, Victoria announced that it intended to exceed the national 4 star standard with a two-step package—first, 4 stars with some plumbing features and, from 1 July 2005, 5 stars with the plumbing features.

The Australian Building Codes Board (ABCB) announced a review of the BCA housing energy measures in December 2003, reflecting the desire of some states and territories to increase the standard. The BCA energy provisions for class 2 (apartment) buildings were subsequently increased and implemented in May 2005. The whole apartment building is required to achieve a 5 star average rating, with no individual apartment rating less than 3 stars. There is no requirement to install a rainwater tank or solar water heater system in a class 2 building (BC 2005g, p. 2).

A document outlining revised BCA energy provisions for class 1 buildings (houses) is currently available for public comment. A draft regulatory impact statement on the costs and benefits of the proposed new regulation is being prepared and is expected to be available for public comment in 2005. The new measures for houses (for inclusion in the BCA in 2006) are scheduled for finalisation during 2005. The proposed changes are designed to increase the stringency of the provisions, preferably to the 5 stars of the NatHERS model (a software package that simulates the energy consumption implications of housing design attributes).

Under the 1995 Council of Australian Governments agreement on national standard setting, all technical changes in the BCA that apply nationally are subject to an RIS. Amendments to the state appendixes of the code, however, are not captured in this process. Instead, they must meet the regulatory requirements in the particular state. Given that 5 Star standards are not embodied in primary legislation or Regulations, a formal RIS was not prepared for their introduction in Victoria.<sup>6</sup> Instead, the Building Commission prepared a regulatory information bulletin (BC 2002d).

The bulletin described why standards were needed, what the proposal required, and the costs and benefits of the proposal (drawn from consultants' reports). It also invited public participation and sought comments on issues such as the appropriate timing for implementing the standards and draft clauses for inclusion in the BCA. The bulletin did not, however, explore alternatives such as smart metering, encouraging the use of gas (rather than electrical) hot water systems and changing the pricing regime for energy and water to achieve reduced greenhouse gas emissions.

The regulatory information bulletin outlined three types of market failure as the rationale for regulatory intervention:

- (1) The environment is a public good—its value is difficult to quantify and thus it is poorly treated by the market.
- (2) Greenhouse gas emissions are an unpriced externality—the lack of market signals means that homeowners ignore environmental costs and the planet's finite capacity to absorb greenhouse gases.
- (3) Information asymmetries occur—builders and homeowners are unaware of the cost-effectiveness of better energy performance over the life of a home.

The bulletin summarised the results of two cost–benefit studies (one with a technical perspective focusing on energy and environmental outcomes, the other with an economic perspective). The first, by Energy Efficient Strategies, analysed the proposal's resulting energy savings and estimated cost, finding that a 5 Star rating would deliver a greater reduction in greenhouse gas emissions than would a 4 star rating (BC 2002d, p. 14). However:

... in all cases [different scenarios] the 4 star options provide a better benefit to cost ratio and a better compliance rate than the 5 Star options. (BC 2002d p. 11).

The second study, by The Allen Consulting Group, used a general equilibrium model to evaluate the impact of increasing energy efficiency from a 4 to 5 Star rating for all new houses and major renovations. Using data from the SEAV, the

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<sup>6</sup> At the time, a business impact assessment was not required for primary legislation.



study showed net benefits (moving from the standards prevailing in the late 1990s to a 5 Star standard) of \$1.8 million in Melbourne (a \$9.1 million reduction in energy costs—in net present value terms—less a \$7.3 million increase in capital costs). The study concluded that the benefits of moving to a 4 or 5 Star energy standard outweigh the costs, whether measured in economic, social or environmental terms (The Allen Consulting Group 2002, p. 35).

The Commission received information that was critical of 5 Star regulation on two counts. The first criticism was about targeting housing to achieve energy efficiency goals rather than taking an economy wide approach. The second criticism was about specific aspects of the 5 Star scheme, such as its failure to acknowledge life cycle energy costs and to recognise alternative energy saving measures, and the cost it would impose on new housing.

On the first of these criticisms, the Royal Australian Institute of Architects (RAIA) and Archicentre Limited summed up the incongruity of focusing on energy saving in housing:

Archicentre sent a team of people to New Mexico in 2004 to explore energy and water saving devices. What the team found was a classic anomaly: energy efficient homes with double glazed, totally sealed windows that can't be opened, alongside three-car garages housing V8 cars. ... It seems Australia is going in the same direction, but the overall cost effectiveness is questioned. (sub. 40, p. 12)

Elsewhere, the HIA has stated that 'Housing, and households, should not be considered to be an easier target for government to tackle than other sectors' (HIA 2004b, p. 5). More comprehensively, a recent Productivity Commission report on energy efficiency was critical of the piecemeal approach to energy efficiency (such as that targeting housing):

... the objectives of energy efficiency policy need to be clarified and private cost effectiveness placed in a more realistic light. ... piecemeal responses to greenhouse gas externalities have the potential to be costly and ineffective. A coherent, soundly based national response is required. (PC 2005b, p. XLIV)

However, the Commission has not been asked to assess the merit of the selective targeting of residential energy efficiency. The Victorian Government has made a policy decision to this effect, which the Commission has taken as given. Instead, the Commission has focused on whether the regulation to effect this policy is adequate and what might be done to improve it. As noted, the process preceding the introduction of 5 Star regulation appears to have been less rigorous than an RIS process. It is possible, therefore, that the regulation could be improved. Inquiry participants' comments and the Productivity Commission report on

energy efficiency identify two main areas where this improvement might occur: first, shortcomings in the process of assessing whether (and what) regulation is warranted; and second, where the current 5 Star regulation is deficient in meeting its objective and needs change.

Information reviewed by the Commission highlighted five potential deficiencies in the assessment process:

- (1) inappropriate discount rates in assessing benefits and costs
- (2) a disregard for consumer preferences
- (3) constraint on consumer access to capital
- (4) failure to consider alternative means of achieving energy efficiency objectives
- (5) failure to consider the impact of energy efficiency standards on less affluent groups.

#### *The use of inappropriately low discount rates*

The criterion used to determine the cost-effectiveness of standards is that the expected present value of benefits exceeds the expected present value of costs. Present values are determined by applying a discount rate to future costs and benefits. The Allen Consulting Group used a 3.5 per cent real discount rate, for example, to evaluate the impact of the standards on the Victorian economy. The ABCB used a real discount rate of 5 per cent to evaluate the current BCA energy efficiency standard for housing. In many cases, however, homebuyers have to finance the added cost of satisfying building standards by taking a larger loan. The average interest rate on a standard variable rate home loan is around 7 per cent (or about 4–5 per cent real), which is historically low. The discount rates used to assess new regulation thus appear to be at or below the historically low interest rates that householders are now paying to fund mandated energy efficiency requirements. This suggests that ‘the cost-effectiveness of energy efficiency improvements is overstated from the perspective of householders’ (PC 2005b, p. 152). On the other hand, some economic literature argues in favour of lower discount rates for longer term benefits and costs (Weitzman 2001).

#### *Disregard for consumers’ preferences*

The Productivity Commission found some homebuyers prefer a less energy efficient home to obtain certain highly valued characteristics (PC 2005b, p. 153). This inquiry heard that consumers in Victoria’s coastal areas, for example, often wish to have windows facing south to capture views, which makes it more difficult to achieve the 5 Star standard. The Insulation Council of Australia & New Zealand (ICANZ) considered it is not appropriate for governments to fail to act to reduce greenhouse gas emissions simply because a small number of consumers want to buy inefficient products (sub. DR124, p. 20). The Commission acknowledges that the whole area of regulation abounds with

measures designed to curtail consumer choice in the interests of society more generally. The costs of removing highly valued options do not generally figure in assessments.

*Constraint on consumer access to capital*

The Productivity Commission noted the common assumption that homebuyers face no constraint on their access to capital. Yet households are often capital constrained and may prefer to allocate available capital to what they consider to be the most highly valued uses for that capital. This allocation may involve investment in cheaper and less efficient building methods and materials. However, as the Australian Business Council for Sustainable Energy noted, the absolute amounts involved are likely to be small (sub. DR119, p. 7). If the average increase in construction cost amounted to the \$3300 indicated in the Building Commission's regulatory information bulletin, the increased outlay on a 10 per cent deposit would amount to only \$330 (sub. DR119, p. 7). Nevertheless, some homebuyers may not agree that \$330 is a 'small' amount, and eventually the whole additional cost (which may be greater than the RIB estimate) must be paid.

*Failure to consider alternative means of achieving energy efficiency in housing*

The regulatory information bulletin did not address alternative approaches to managing energy that might either complement or provide a substitute for elements of the 5 Star standard. In Tasmania, for example, about 10 per cent of consumers are using pre-payment meters (Energy and Water Ombudsman NSW 2004). Consumers are provided with a card that they 'top up' at an outlet such as a convenience store. The card is inserted into the meter, the amount downloaded and the electricity paid for. This system provides customers with immediate information about the cost of their electricity use, which they can and do adjust accordingly. The Australian Business Council for Sustainable Energy (BCSE) also suggested the use of more sophisticated meters (sub. 32, p. 6). Some inquiry submissions, such as that from the Australian Conservation Foundation, argued that these alternatives should be viewed not as a substitute for 5 Star, but as separate, justified options that could be pursued in their own right (sub. DR137, p. 6). While the regulatory information bulletin did not address alternative approaches, the performance based nature of the BCA means that such alternatives could possibly be considered as a means of meeting the standard required under the 5 Star scheme.

*Failure to consider the impact of energy efficiency standards on less affluent groups*

The Productivity Commission noted the potential for standards to be regressive if the proportionate increase in costs is greatest for cheaper homes, which are typically purchased by the less affluent. The inquiry received some evidence that this was the case. Langford Jones Homes estimated that a 5 Star energy rating

requirement could add \$10 000 to the company's standard \$90 000 house (sub. 14, p. 5). ICANZ argued that this should not be an issue with 5 Star:

Those on low incomes typically devote a much higher proportion of their income to energy bills. Efficient housing will help to alleviate this. In addition the rating requirements have been significantly relaxed for smaller housing which is more likely to be occupied by lower income households. (sub. DR124, p. 20)

Information presented to the Commission highlighted the following six (in some cases, interrelated) aspects of the regulation need consideration:

- (1) the validity and flexibility of the underpinning software
- (2) failure to account for embodied energy and lifecycle costs
- (3) the adverse effect of energy efficiency standards on the health of building occupants
- (4) the monitoring of compliance with the standards
- (5) the excessive costs of achieving 5 Star energy rating
- (6) the confusion of means and ends in pursuing policy objectives.

*The validity and flexibility of the underpinning software*

This aspect of the energy efficiency regulation attracted the most comment. The regulation information bulletin did not consider the validity of using software to provide an energy use rating. This validity was considered by the Productivity Commission, however, which doubted that software could accurately predict energy consumption. While the energy efficiency of appliances and motor vehicles is measured in terms of their energy consumption, this is not the case for the BCA standards (PC 2005b, p. 144). Instead, energy efficiency under the BCA is:

- simulated, rather than measured directly
- defined in terms of heating and cooling loads.<sup>7</sup>

Because it is impractical to directly measure the energy efficiency of every building, standards are based on simulated efficiency determined by a computer software package (in Victoria, the FirstRate software package).

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<sup>7</sup> Cooling (heating) load means the calculated amount of energy removed from (delivered to) the cooled (heated) spaces of the building annually by artificial means to maintain the desired temperatures in those spaces (ABCB 2004b, p. 75).

The Productivity Commission considered that reliance on simulations is problematic, in that:

... regardless of whether the simulation packages are accurate or not, a more fundamental issue is whether the variable being simulated is a useful indicator of energy efficiency. (PC 2005b, p. 146)

It found that computer simulation models exclude many of the determinants (particularly behavioural determinants) of a building's actual energy efficiency from consideration. It noted:

In essence, policy makers have sought to isolate the impact of a building's design and physical location from the many other factors that affect its energy efficiency, such as householder behaviour, appliance efficiency, whether heating and cooling equipment are installed, and inter-year variability in climate. As a result, building energy efficiency standards do not target many of the determinants of a building's actual energy efficiency. (PC 2005b, p. 147)

After examining case studies, the Productivity Commission found that energy rating and actual energy consumption are not strongly correlated, and concluded:

A ranking of residential buildings by star rating (using energy rating software such as Nationwide House Energy Rating Scheme) may be very different from a subsequent ranking based on actual energy consumption or efficiency. (PC 2005b, p. 149)

A similar concern led the Australian Wood Panels Association Incorporated to argue that 5 Star is fundamentally inappropriate because it does not address the most important factor affecting energy use in the home: the behaviour of the occupants (sub. DR120, p. 3).

The current rating software penalises the use of some products, such as suspended timber floors and mud bricks.<sup>8</sup> The Timber Promotion Council noted that existing energy design software (FirstRate/NatHERS) uses a thermal mass philosophy that does not accurately model the performance of suspended lightweight floors (sub. 52, p. 2). It noted that the Commonwealth Department of the Environment and Heritage stated that the 'the actual measurements necessary to prove the validity of NatHERS modelling for a single house would cost hundreds of thousands of dollars ... and have not been undertaken' (sub. 52, p. 5).<sup>9</sup> The Timber Promotion Council claimed this bias against the use

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<sup>8</sup> The corollary is that other industries are advantaged. The Australian Glass and Glazing Association, for example, noted that 5 Star legislation has led the glass and window industry to embark on significant capacity expansion that will improve production efficiencies and create significant employment (sub. 77, p. 4).

<sup>9</sup> This seems a trivial amount compared with the overall costs and benefits.

of suspended timber flooring was having adverse consequences for Victoria's timber industry, with significant regional implications:

... major coastal builders are currently walking away from this market citing that it's 'just now too hard' to achieve 5 Star with light-weight structures ... major timber merchants are advising of a significant drop in sales of sub-floor materials (solid timber and panel products). (sub 52, p. 3)

How 5 Star might affect regional Victoria is not clear. Cement Concrete and Aggregates Australia noted, for example, that the concrete industry too is a significant employer and maintains a significant regional network of operations (sub. DR110, p. 5).

The Timber Promotion Council drew attention to a new software package—AccuRate—that has been developed with improved sub-floor modelling and new ventilation algorithms and occupancy behaviour inputs:

Preliminary results suggest that AccuRate will demonstrate that insulated lightweight timber floors perform to an equivalent standard as mass slab construction during the winter cycle. (sub. 52, p. 4)

The Insulation Council of Australia and New Zealand also noted the shortcomings of the existing software in certain applications and, together with the BCSE, noted that these have been overcome by elements within the updated AccuRate software (sub. 28, p. 3; sub. DR119, p. 2). In particular, AccuRate will better accommodate sub-floor ventilation and will assist timber-floored construction to achieve energy ratings of around one third to half a star higher (sub. DR124, p. 17). The use of AccuRate should thus be able:

... to lower the performance requirement for houses on timber floors without air leakage between subfloor and attic. As the last half a star is generally the most expensive this should allow a considerable reduction in compliance costs for houses with timber floors. (sub. DR124, p. 17)

Moreover, 5 Star allows for design strategies such as the use of attached verandahs that can reduce the cost of compliance for timber floored houses (sub. DR124, p. 17).

The Department of Sustainability and Environment acknowledged that the NatHERS scheme is being updated to incorporate AccuRate. Once approved for use nationally, AccuRate will thus be an acceptable software package to use in Victoria for 5 Star rating (sub. DR172, p. 8). In addition, the FirstRate package is also undergoing similar revision to better incorporate a variety of building types. The Commission considers these changes will add flexibility to the scheme and help answer criticism of the current arrangements. However, the history of the software to date suggests that on-going monitoring of its relevance would be

desirable, to take account of changes in technology and increasing information about the behavioural aspects of energy use.

Another aspect of the validity of using software is the flexibility it allows for attaining the 5 Star standard. Langford Jones Homes raised this issue, maintaining that the use of LP gas hot water systems should, under the software algorithm, contribute 1 star towards a 5 Star rating. In its view, a 3 star rating for the fabric of the building plus a gas hot water system would show a greater reduction in greenhouse gas emissions than would homes fitted with either the solar (electric boosted) or electric hot water systems (sub. 14, p. 6). The Australian Business Council for Sustainable Energy (sub. 32, p. 4) also recommended that installation of a high performance solar hot water service should receive recognition in the regulation.

*Failure to account for the embodied energy and lifecycle costs in construction materials*

The Timber Promotion Council (sub. 52, pp. 2–3) argued that the objective of reducing greenhouse emissions should not be confined to the ongoing energy consumption of a house. Energy embodied in the construction materials and their sustainability is also relevant. The council noted that the Energy Efficiency Strategies study found annual greenhouse gas saving of about 1.05 tonnes for a 4 star house and 1.45 tonnes for a 5 Star house. This implies that a 4 star house with a suspended timber floor would generate 0.4 tonnes of additional greenhouse gas emissions each year compared with a similar 5 Star house on a concrete slab. However, because a concrete slab produces around 15 tonnes of carbon dioxide in its manufacture, it would take about 37.5 years of operational energy use before a 5 Star home provided any net environmental benefit (sub. 52, p. 3). Nevertheless, Cement Concrete and Aggregates Australia argued that the embodied carbon dioxide of a timber floor is not dissimilar to that of a concrete slab, when all the processes employed to produce a functional timber floor system are considered (sub. DR110, p. 5).

The Building Products Innovation Council also argued that the pursuit of energy efficiency is sensible only from the perspective of the full life cycle analysis of a particular building and building applications:

Full life cycle analysis has the significant advantage of being based on scientific evidence and research and an internationally accepted methodology. ... Clauses which try to restrict the use of a specific material may in fact lead to the use of alternative products which are less sustainable over their life time, than a product made from the restricted material. (sub. 46, p. 2)

In response to the draft inquiry report, various submissions (BlueScope Steel, sub. DR107, p. 4; Cement and Concrete Aggregates Australia, sub. DR 110, pp. 2–3; National Association of Steel Framed Housing, sub. DR122, p. 2) noted that an approach based on embodied energy alone would be too limited in scope,

and that full life cycle assessment should be the basis for assessing energy efficiency. Moreover, there are accepted methods for applying the latter approach.

In considering whether improvements to achieve Victoria's 5 Star objectives are warranted, the Commission is mindful that the scheme is based on the principles underlying the development of a national BCA 5 Star standard, albeit introduced in advance of the national standard. That national standard is to be introduced in May 2006. The Department of Sustainability and Environment noted that 'The ABCB took a policy decision early in the process of developing building energy efficiency measures in the BCA to focus on operational energy, and not address embodied energy' (sub. DR172, p. 10). It considered that issues associated with embodied energy are likely to be best addressed through the prices of building material (p. 10).

As noted, the Commission recognises the value of nationally consistent regulation, and thus it is sensible to have Victoria's 5 Star regulation based on the same principles that underpin the national scheme (that is, a focus on governing the building fabric). Mindful that the existence of 5 Star does not preclude other regulation to reduce greenhouse emissions, it considers the current basis for 5 Star (with its focus on the building fabric) is warranted at present, provided it is implemented with appropriate flexibility.

*Potential adverse impacts of energy standards on the health of building occupants*

The Commission's attention was also drawn to the apparent conflict between the pursuit of energy efficiency and the objectives of the Building Act, 'To enhance the amenity of buildings and to protect the safety and health of people who use buildings'. On this issue, the RAlA and Archicentre Limited noted that sealing a building to meet 5 Star requirements tends to create microclimates that can cause serious illness (sub. 40, p. 12).

However, the Australian Business Council for Sustainable Energy stated that the concerns identified by the RAlA would not be created or exacerbated by the 5 Star regulations, which 'still maintain minimum requirements for openable window area and, with the introduction of AccuRate, will provide encouragement for properly designed natural ventilation' (sub. DR119, p. 10). In addition, it noted that 5 Star requirements would lessen problems of moisture and mould in medium density housing, and thus deliver improved health outcomes (sub. DR119, p. 10). ICANZ also noted that 'There is no evidence that houses which are weather sealed to the extent required to achieve 5 stars in Victoria have indoor air quality problems' (sub. DR124, p. 21).



*Problems in ensuring compliance with the standards*

The BCSE expressed concern that a lack of enforcement is undermining the credibility of 5 Star and its benefits:

It has been a concern for BCSE that there seems to have been little effort by Victorian Government agencies to closely monitor the quality of installation of energy features, and to ensure that products used, such as insulation materials, meet appropriate standards and comply with marketing claims regarding performance and durability. This weakness has undermined the credibility of the government's measures, and seems likely to have led to smaller benefits than should have been gained. (sub. 32, pp. 5–6)

The RAlA and Archicentre Limited also made this criticism, claiming that energy efficiency elements that might be specified in a design—such as sealing and glazing—are not being checked to ensure they are implemented (sub. 40, p. 13). ICANZ, too, expressed concern that a light handed approach to compliance checking could allow unscrupulous builders to avoid meeting the regulations (sub. DR124, p. 21). Accordingly, it argued there should be appropriate monitoring of construction and installation practices to ensure compliance (sub. DR124, p. 21). The Commission's view of whether building regulations in general are adequately monitored and enforced, and what action might be needed to address concerns in this area, is discussed in chapter 6.

*Excessive costs of achieving 5 Star*

Prior to the start of this inquiry, key industry bodies such as the HIA and the MBAV were critical of the cost of achieving 5 Star in terms of the absolute cost relative to expected benefits. Early estimates by the HIA claimed 5 Star would add \$3300 to the cost of an average \$150 000 house, or about 2.2 per cent. This contrasted with the assumption in the regulatory information bulletin that 5 Star would add around 0.7–1.9 per cent to the cost of a new house (BC 2002d, p. 20).

Results of a survey of 601 Victorian builders conducted in February 2005 for the Building Commission suggest the bulletin's cost assumption was a significant underestimate. The report on the survey noted:

The data suggests that residential building costs have increased as a result of builders achieving standards in this area, with the median estimate of such a cost increase in the range of 3 to 5 per cent. Excluding those that answered 'don't know', the mean additional cost incurred was 6.04 per cent. (Chant Link & Associates 2005, pp. 9 and 50)

Some inquiry participants questioned the validity of this survey. The Australian Conservation Foundation, for example, argued the survey method was not robust (sub. DR137, p. 4). The Commission acknowledges that the survey results should be viewed as indicative rather than definitive, despite the report disclaimer that the costs are unlikely to be overestimated. However, information

from inquiry submissions and the Commission's own survey do not provide a clear alternative picture of the cost.<sup>10</sup> For example, the Department of Sustainability and Environment noted that 'Henley Homes, which serves the lower cost end of the new house market, claims that the company has been building 5 Star energy efficient homes, at little or no additional cost, since 2002' (sub. DR172, p. 5). Against this claim are contrary examples, such as those from Langford Jones Homes and the Australian Wood Panels Association Incorporated:

We had one case where, in addition to the cut and fill required to facilitate a slab, a retaining wall was needed. It was to cost \$25 000. ... In this case it was cheaper to redesign the house at a cost of \$8000 ... (LJH, sub. DR126, p. 3)

... the use of high mass construction is not always suitable, resulting in 'cut and fill' and other high energy inputs in the construction phase further increasing the use of energy and negatively impacting on the environment. There is also a significant cost increase using these methods ... (AWPAI, sub. DR120, p. 4)

The Commission acknowledges that as the industry becomes more familiar with 5 Star, costs could be expected to decline. In its submission to the Productivity Commission inquiry, ICANZ highlighted how the price of insulation fell following the introduction of insulation requirements in Victoria in 1990. Similarly, in its submission to this inquiry, it noted that the added cost of this regulation will lessen as builders and designers become more familiar with 5 Star:

The higher costs quoted by industry ... may indicate that designers have not yet come to grips with the techniques needed to achieve the required rating in the most cost effective manner. ... As designers gain experience with the energy rating the costs reported by industry may well fall. A number of the cost problems industry is reported to have may be resolved through better training and information. (sub. DR124, p. 6)

A more recent survey for the Building Commission—of volume builders—found average incremental costs to achieve a 5 Star rating across a range of house types were:

- \$2841 for homes 100m<sup>2</sup> to 160m<sup>2</sup> (single-storey)
- \$3448 for homes 160m<sup>2</sup> to 250m<sup>2</sup> (single-storey)
- \$3946 for homes 250m<sup>2</sup> to 380m<sup>2</sup> (single-storey)
- \$5908 for homes 250m<sup>2</sup> to 380 m<sup>2</sup> (double-storey)

These costs represent an average percentage increase in cost across the range of homes of 2.4–2.1 per cent for the best case orientation, and 3.0–2.4 per cent for

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<sup>10</sup> Appendix C discusses the likely costs of 5 Star in more detail.

the worst case orientation (Jettaree 2005). These costs are substantially below those reported in its March survey. Quantity surveyors reviewed data submitted by builders to confirm that it reflected incremental costs, current market rates and realistic quantities. Accordingly, the reported costs may be viewed with more confidence than those from the February 2005 survey.

Despite doubts about the validity of the data showing mean costs almost three times above those used in the regulatory information bulletin,<sup>11</sup> that data and inquiry submissions raise concerns about the extent to which the currently configured 5 Star regulations can deliver net benefits to Victoria. The more recent survey data gives better information, but does not entirely dispel those concerns.

The information provided suggests the need for an ongoing robust monitoring of the costs and benefits of the 5 Star regulations. (Such monitoring could form part of the regular reporting of the cost of regulation suggested by the Commission in chapter 9). This would support performance based adjustments to meeting 5 Star objectives over time, in the face of technological change and better information.

*A confusion of means and ends in pursuing policy objectives*

The Australian Business Council for Sustainable Energy (sub. 32) and the HIA (sub. DR163) questioned the sense of combining water and energy efficiency regulation under 5 Star:

The option offered under the 5 Star scheme of either a solar hot water service or a rainwater tank is problematic. It involves a trade off between apples and oranges. It is more appropriate to set separate performance targets for energy/greenhouse and water, but to allow flexibility based on a performance approach within each area. This is the approach taken by the New South Wales BASIX scheme, the structure of which BCSE considers to be preferable to the Victorian approach. (BCSE, sub. 32, p. 4)

The MBAV and Rinnai Australia also highlighted the conflicting objectives:

Water saving measures should be removed from the 5 Star system, as they have nothing to do with greenhouse emissions. In fact, rainwater tanks in many instances add to greenhouse emissions [from the pump needed to operate the flushing facility] ... (MBAV, sub. DR151, p. 8)

... we must also work towards energy efficient products on one platform and water conservation on a separate platform (Rinnai, sub. DR109, p. 2)

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<sup>11</sup> For the purpose of the survey, the costs of achieving the 5 Star standard may incorporate the installation of a rainwater tank (Chant Link & Associates 2005, p. 34).

The 5 Star regulation clearly derives from the Victorian Government’s broader policy objective of improved energy efficiency. The Department of Sustainability and Environment and the BCSE, for example, noted that the 5 Star standard was introduced as a key element of the Victorian Greenhouse Strategy (sub. DR172, p. 8; sub. DR119, p. 2), while the Australian Conservation Foundation noted:

The Victorian Government’s public commitment to the National Framework for Energy Efficiency provides a clear statement of objectives in delivering energy efficiency outcomes through the introduction of mandatory standards for all classes of buildings. (sub. DR137, p. 5)

However, it seems anomalous that within 5 Star, a measure for improved energy efficiency—solar water heating—should be set against a measure for improved water efficiency. (This leaves aside the question of whether the rainwater tank option is sensible from a cost–benefit perspective, which is discussed in the following section). An approach more consistent with energy efficiency objectives would be to offer energy related alternatives. Langford Jones Homes noted that ‘many consumers are sceptical about the efficiency of solar hot water services’ and that the government should consider the use of gas hot water systems (sub. DR126, p. 3). Similarly, LPG Australia argued that solar hot water systems are an expensive way to reduce greenhouse emissions (sub. DR156, p. 2) and suggested high efficiency gas water heating and space heating would better achieve the objective of improved energy efficiency in homes.

The Commission considers that the current mandatory choice between a solar hot water system and a rainwater tank in 5 Star is not appropriate. The policy objective of improved energy efficiency would be better served if the choice were between a solar hot water heating system and an alternative high efficiency hot water system.

Based on the above discussion, the Commission considers Victoria’s 5 Star regulation could be improved to better deliver least cost pursuit of objectives. An improvement that should be considered is to link 5 Star to the government’s energy efficiency objectives more clearly by removing the choice of a rainwater tank in lieu of a solar water heating system and substituting the choice of an alternative high efficiency water heating system. Another is the accreditation and use of more contemporary software packages.

Many submissions were critical of the scheme’s flexibility in accommodating alternative means of achieving improved energy efficiency (and thus a 5 star rating). But there is intended to be flexibility under 5 Star because building regulations embody a performance based approach. A building surveyor can attest, for example, that a measure such as a gas hot water service will deliver improved energy efficiency performance, and recommend that a commensurate

rating credit be awarded.<sup>12</sup> As the BCSE noted, ‘the building regulations offer an alternative pathway for compliance via “expert opinion”’ (sub. DR119, p. 2). The Commission considers this approach is a strength of building regulation. In the context of 5 Star, the Australian Conservation Foundation noted this approach imbues a high degree of flexibility in how current energy efficiency standards may be met:

The performance based approach of energy efficiency standards at the national and Victorian level means that there is a high degree of flexibility in how current energy efficiency standards can be met. Several options have been developed to assist builders to comply with the standard (deemed to comply provisions) however the standards themselves are not prescriptive. This allows for alternate approaches to delivering energy efficiency outcomes and encourages innovation. (sub. DR137, p. 5)

It is possible, however, that the actions of local councils are thwarting the inherent flexibility in the scheme (from the performance based nature of the BCA):

Although alternative methods to meet performance test are now allowed within the 5 Star standard, the reality is that local council planning officers will demand that builders comply with the standard State Government policy. Innovation will be curtailed ... (MBAV, sub. DR151, p. 6)

This particular concern is addressed in chapter 8, which discusses the overlap of building and planning regulation at the local government level.

The criticism received in inquiry submissions about the flexibility of 5 Star suggest a considerable lack of awareness of what is possible, despite the extensive efforts to date aimed at informing practitioners. The risk is that the first round prescription of means has been embedded by practice to be an end. Whereas a least cost approach to the objective of reducing greenhouse gas emissions through building specifications should allow adaptation over time. This points to a need to improve awareness of the scope for performance based solutions to deliver alternative ways of achieving a 5 star rating.

#### **Finding 5.4**

There is a considerable lack of awareness of the flexibility available under 5 Star, despite extensive efforts to date aimed at informing practitioners of this flexibility. This points to a need to improve awareness of the scope for performance based solutions to deliver least cost ways of achieving a 5 star rating.

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<sup>12</sup> Moreover, if achieving the required energy rating proves impractical, the requirements of the BCA can be waived, modified or varied by the Building Appeals Board (see BC 2005g).

### **Recommendation 5.3**

**That the implementation of the 5 Star scheme be more clearly related to the Victorian Government's energy efficiency objectives. The choice of a rainwater tank in lieu of a solar water heating system should be removed and substituted with the choice of an alternative high efficiency water heating system. In addition, the scheme should incorporate more flexibility through the accreditation and use of more contemporary software packages.**

### **Mandatory water saving measures**

As part of the 5 Star reforms described, water saving measures were introduced on 1 July 2004, requiring that all new houses:

- install water saving tapware and flow reducing showerheads (flow rates to be 7.5–9 litres per minute)
- reduce water pressure to 500 kilopascals at outlets within buildings
- install either an approved solar water heater or rainwater tank for toilet flushing. (PIC 2004c, p. 3)

Licensed plumbers are required to install 5 Star appliances and fittings. These water saving measures were complemented by broader changes to Victoria's plumbing Regulations aimed at reducing total energy and water consumption, some of which came into effect on 1 July 2005.

The reforms were introduced via the Plumbing (Water and Energy Savings) Regulations 2004 and, therefore, were subject to the RIS process. (Plumbing Regulations are made under part 12A of the *Building Act 1993*.) The RIS draws on The Allen Consulting Group's (2004a) report *Enhancing 5 Star home energy standards in Victoria* for analysis of costs and benefits.

The Commission considers the RIS exhibited shortcomings. The RIS listed additional costs and benefits identified by the Plumbing Industry Commission, including the cost of purchasing new standards for plumbers. In concluding that the Regulations have a net benefit, however, the RIS did not articulate how these additional costs and benefits reconcile with the results of The Allen Consulting Group 2004 report. The RIS also contained only a limited consideration of alternatives.

The approach used in The Allen Consulting Group's cost–benefit analysis was similar to the one it used in its 2002 analysis of 4 star versus 5 Star. The study measured the impact of moving beyond a 5 Star standard for building materials to incorporate water saving measures (such as reduced water pressure and tap flow), solar water heating and a rainwater tank. The study found that the benefits

provided by the rainwater tank are not sufficient to justify the added investment costs:

... in the long run, Victoria is better off in economic welfare and [gross state product] terms under the 5 Star housing standard alone than a regulatory option that requires investment in rainwater tank equipment. (The Allen Consulting Group 2004a, p. 5)

Despite these findings, Regulations were introduced to mandate either an approved solar water heater or rainwater tank for toilet flushing. As with the 5 Star energy requirements, the HIA and the MBAV were critical of the cost of mandatory water saving measures. Early estimates by the HIA claimed mandatory water saving measures would add about \$2500 to the cost of an average \$150 000 house (equal to about 1.7 per cent) but comprehensive data are not available to assess how closely actual costs correspond to those assumed in the RIS.

Inquiry participants provided little information quantifying the costs and benefits of the total water saving measures forming part of the 5 Star regulation.<sup>13</sup> For some measures—water saving tapware, flow reducing showerheads and reduced water pressure at outlets within buildings—the Commission accepts that the additional costs are insignificant while benefits are likely to be substantial and ongoing. However, this would not appear to be the case for the rainwater tank option. For this measure, the HIA noted the added cost is substantial yet delivers no net benefits (sub. DR163, pp. 10–11); thus, The Allen Consulting Group’s conclusion in 2004 appears just as valid today. The Plumbing Industry Advisory Council effectively corroborated this view:

The rainwater tank option, while able to be criticised on cost–benefit grounds if seen in isolation, was a practical solution needed to achieve the overall 5 Star package with wide stakeholder support. (sub. DR132, p. 10)

As the Australian Conservation Foundation noted, the Victorian Government has clearly stated its commitment to water efficiency objectives in the *Our water, our future* policy (sub. DR137, p. 6). However, and consistent with the previous discussion of energy efficiency objectives in 5 Star, the Commission perceives benefit in linking water saving measures more clearly with the government’s water efficiency objectives. A better linking of objectives would be achieved by removing the current choice between a solar hot water system and a rainwater tank (contained in recommendation 5.3).

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<sup>13</sup> Appendix C contains more discussion of the potential costs.

VCAT considered in a recent case:

According to the VCEC [Victorian Competition and Efficiency Commission], the process leading to the requirement to install either a solar water heater or a rainwater tank in new dwellings also had shortcomings. We share the concern of the VCEC that the building regulations make solar water heating an alternative to a rainwater tank. The connection is tenuous and incongruous. It is almost as if a decision maker was half hearted about each requirement. For our part, we also think that there should only be a requirement to install such capital items if the benefits clearly outweigh the costs. What this means is that regulator must focus on costs (and who pays) and not just benefits. (Hasan v Moreland CC [2005] VCAT 1931)

### **Box 5.5 Cost–benefit of rainwater tank for toilet flushing**

To meet the new 5 Star energy requirements, a new home must have either a solar hot water system or a rainwater tank for toilet flushing installed. The slow voluntary uptake of these items by households raises the question of whether their benefits outweigh their costs. If the private costs outweigh private benefits, the public costs and benefits should also be considered when assessing whether installation of these systems is desirable from society's standpoint.

A study conducted for Yarra Valley Water by the Centre for Design at RMIT completed a detailed life cycle costing of installing rainwater tanks. The study found for the average Melbourne household that a 2250 litre tank used for both toilet flushing and garden watering would not pay for itself within its expected 30 year life.

Since that study, the water pricing structure has changed. Further, the study assumed that the rainwater collected would be used for garden watering and toilet flushing. The new 5 Star standards, however, require only that the rainwater be used for toilet flushing. Given these differences, the Commission adapted the study conducted by the Centre for Design to analyse the economic efficiency of installing a rainwater tank for only toilet flushing under the current water pricing arrangements.

The Centre for Design study found that the average Melbourne household with a 2250 litre rainwater tank can save 61 931 litres of mains water in a year of average rainfall if it uses the water collected to both flush the toilet and water the garden. Based on this, and its own analysis, the Commission has assumed in its cost–benefit analysis that (in a year of average rainfall) the rainwater tank will not run dry if just used for toilet flushing and no mains water will be required for toilet flushing.

The current pricing structure of mains water consists of three rising block tariffs. For the three retail water companies in Melbourne, the prices are similar. For Yarra Valley Water customers, the first 40 kilolitres of water in each quarter are priced at \$0.7822 for 2005-06. The second 40 kilolitres are priced at \$0.9177 and any further water used is priced at \$1.3588 a kilolitre. These prices will increase by 1.6 per cent per year in real terms over the following two years, as outlined in the Essential Services Commission's water price review determination. For the Commission's cost–benefit analysis, the price of water is assumed to increase at this rate over the life of the tank.

(continued next page)



### Box 5.5 **Cost–benefit of rainwater tank for toilet flushing** (continued)

Given the three block pricing structure, water saved from a rainwater tank will be of greater value for the typical household in summer (when it hits the highest tariff block) than in winter (when all water used is in the cheapest block). Under this pricing structure, the Commission estimated that an average household, in an average year, would save \$35.39 on its water bill if tank water is used to flush the toilet.

Using the tank cost estimates from the Centre for Design study (\$1268.50 for the tank, pump and installation, and a further \$350 to replace the pump after 15 years), and assuming it costs \$3.50 each year for the electricity to operate the pump, the net present value of installing a rainwater tank for flushing the toilet will be negative \$808 over the 30 year life of the tank (using a 5 per cent real discount rate).

Considering only private economic costs, this suggests that it is inefficient to install a rainwater tank to supply just water for toilet flushing. Instead of using the collected water just for toilet flushing, however, the rainwater could be used to also reduce mains water use on the garden. If used just for toilet flushing, a considerable amount of collected rainwater that could be used on the garden would be lost as overflow down stormwater drains. The Commission estimated that if the collected water were used on the garden too, the net present value would be negative \$459. While this improves the economic efficiency of installing a rainwater tank, it still is less efficient than relying on mains water.

While it appears inefficient on private economic grounds to install a rainwater tank, there are also public costs to consider in determining whether it is socially preferable for households to install rainwater tanks. The Centre for Design estimated environmental costs of manufacturing of rainwater tanks, as well as the benefits of reduced stormwater flows and reduced demand for mains water infrastructure. It found that the energy and material impacts of water tank manufacture and operation are higher than for the equivalent mains water supply, and that the overall additional energy and greenhouse impacts of having a water tank installed are roughly equivalent to driving a car an extra 60 kilometres each year.

The Centre for Design study identified the reduced load on the stormwater system as the most significant environmental benefit of installing a rainwater tank. The rain diverted from stormwater into tanks results in a significantly reduced nutrient load to local rivers and Port Phillip Bay and reduced eutrophication.

A further public benefit of rainwater tank installation is the reduced demand placed on water storage infrastructure. However, the Centre for Design study found that ‘avoided water storage infrastructure is not insignificant but not nearly large enough to offset the impacts of the water tank construction and operation’.

Evidence thus suggests that the private and public costs of rainwater tank installation outweigh the benefits, and that both the individual household and society would be better off relying on mains water under the current water pricing structure.

*Sources:* ESC 2005; Hallman et al. 2003; Yarra Valley Water 2005.

A separate issue is the worth of mandating a rainwater tank as a water saving option. Information from inquiry participants and the Commission's own cost-benefit analysis of this option (box 5.5) supports the conclusion that the mandate is likely to deliver negative returns to both individual consumers and society more generally. Accordingly, the Commission considers this option should not be mandated; rather, individual consumers should be left to decide whether they would invest in this facility on its own merits as a water saving measure.

In the draft inquiry report, the Commission perceived benefit in allowing for greater flexibility in how improved water efficiency might be achieved. Various inquiry participants, such as the Plumbing Industry Advisory Council, noted that the performance basis of the BCA already allows other options—for example, a third pipe can be approved in lieu of the rainwater tank if a property developer prefers that option (sub. DR132, p. 10). Other participants suggested that an estate development level rating might add flexibility to the rating scheme. Such an addition would provide an incentive for developers to build water saving features into their projects (Villa World, sub. DR115, p. 3).

At present, attaining water and energy efficiency objectives has involved tradeoffs between the two. The Commission considers it inappropriate to retain such tradeoffs. Under current regulation, and in view of the Commission's view that rainwater tanks not be included in any mandated choice, the scope for flexibility in achieving water efficiency objectives in a least cost manner appears limited unless alternatives are allowed to substitute for mandatory inputs such as water saving tapware, and reduced outlet pressure. If the government considers this flexibility is warranted, the current Regulations would need to be amended to allow for this substitution. As with energy efficiency, a registered building surveyor would need to endorse any alternative measures for delivering improved water efficiency.

#### **Finding 5.5**

Achieving flexibility in achieving water efficiency objectives is likely to require amending current Regulations to allow alternatives to otherwise specified mandatory requirements such as water saving tapware.

#### **Recommendation 5.4**

**That the water saving regulation in the 5 Star scheme be more clearly related to the Victorian Government's water efficiency objectives via the removal of the tradeoff between water saving and energy saving measures. Further, rainwater tanks should not be included in any mandated choice. Rather, individual consumers should be left to decide whether they would invest in this facility on its own merits as a water saving measure.**

#### **5.4.2 Access for people with a disability**

Inquiry participants highlighted the lack of accessible or visitable housing for people with disabilities. This, they argued, should be corrected by building regulation to deliver accessibility features or to require dwellings to be built so they could be easily adapted to achieve accessibility. (Box 5.6 provides a definition of these terms). The Disability Support and Housing Alliance (DSHA), for example, considered such regulation was needed:

... to achieve a more inclusive built environment, to promote greater participation by people with mobility impairments in social and economic life, and to prevent a critical shortage of housing and other accommodation in the coming years due to our ageing population and allowing people to live as independently as possible for as long as possible. (sub. 59, p. 2)

#### **Box 5.6 Definitions of visitable, adaptable and accessible dwellings**

*Accessible dwellings* allow full access and use for all occupants and visitors.

*Visitable dwellings* allow everyone (including wheelchair users) to visit with dignity, including overnight, and for an occupant with a disability to reside temporarily. It would be expected, therefore, to have a no-step entry, wide doors and a wheelchair friendly toilet on the ground floor.

*Adaptable dwellings* should be visitable, but with additional provisions that enable the dwelling to be altered without major structural works and at a much lower cost to make it fully accessible and useable in the future.

Source: Derived from Robert Knott, architect, building and property dispute consultant (sub. 37, p. 5).

There appears to be little effective regulation to deliver accessible, visitable or adaptable private housing in Victoria. The Commonwealth *Disability Discrimination Act 1992* prohibits a range of areas of discrimination against people with a disability, including accommodation and public premises. Under this Act, public premises include buildings to which the public has access, but not private

premises such as private housing. Victoria's *Equal Opportunity Act 1995* prohibits discrimination in terms similar to the Disability Act, although it does not deal with access to private housing by those with disabilities, other than their right to make alterations.

Similarly, the current access provisions of the BCA do not apply to class 1 (detached houses, terrace houses, row houses) and class 2 buildings (apartments). The Equal Opportunity Commission Victoria (EOCV) noted:

Technical requirements which prescribe for disability access can be found in building regulations incorporating the Building Code of Australia and Australian Standards. However, these requirements primarily deal with public premises—not housing. The omission of housing access regulations in the current regulatory framework excludes and isolates people with a disability from full participation in the community. (sub. 75, p. 6)

This situation also led the Yarra City Council Disability Advisory Committee and Chris Stewart to note the existing BCA and Victorian building regulation would not ensure housing is built to be accessible and adaptable (sub. 36, p. 1; sub. 68, p. 1).

Some BCA provisions are under review. The ABCB released draft disability standards for access to premises for public comment in February 2004. Under the draft, access requirements will apply to the entrance and specified common areas of apartment buildings, but none is mandated for class 1 buildings. Public consultation closed on 30 April 2004. The ABCB subsequently consulted with respondents to address issues raised and strike a balance between access and cost. It expects to make recommendations to ministers in 2005, although any premises standards are unlikely to be introduced before May 2006 (PC 2004c, p. 128).

Victoria's ResCode addresses the issue of accessibility under clause 55.05, the objective of which is 'To encourage the consideration of the needs of people with limited mobility in the design of developments'. The standard associated with the objective requires that 'The dwelling entry of ground floor dwellings and the ground floor of dwellings and residential buildings should be accessible or able to be easily made accessible to people with limited mobility'. The standard does not, however, prescribe minimum door widths, ramp gradient and dimensions for bathrooms or toilets. The DSHA considered the lack of such specific requirements renders the standard ineffective (sub. DR149, p. 2).

The Building Commission has also taken steps to promote more functional and more accessible housing design through its *Welcome* publication. However, as the EOCV noted:

The [Building] Commission's experience indicates that reliance upon information and education alone is insufficient to facilitate attitudinal change towards eliminating discrimination in the absence of any regulatory incentives or enforcement. Relying on non-regulatory alternatives such as moral suasion and education is unlikely to be as effective as regulation in this area. (sub. 75, p. 9)

Inquiry participants noted that the market has not delivered housing stock with these features. The DSHA noted:

- the market is failing to provide choice of suitable rental and purchase housing options for a large segment of the population presently
- there is no indication that the market will adequately and economically cater for people's desire to 'age in place' and the clearly foreseeable rise in the older population
- the market offers little in the way of even basic 'visitability' features, such as 'no step' entries and wider doorways. (sub. 59, p. 2)

Similarly, the EOCV noted:

To date the housing construction market has responded unsatisfactorily to accommodate the needs of individuals with a disability or providing independent living solutions for the ageing population. Given the absence of market driven solutions we need regulation to facilitate attitudinal change and sustainable inclusive growth in housing. (sub. 75, p. 7)

There is some evidence that the market is moving to incorporate accessibility in new housing. The Australian Network for Universal Housing Design 'has witnessed an increased interest in universal housing design by housing industry leaders' (ANUHD 2005, p. 13).<sup>14</sup> And the HIA noted that Australand's Parkville Gardens estate has included accessibility measures in about 170 villas and homes (HIA 2005b, p. 4).

However, the EOCV noted that a Productivity Commission report on reform of building regulation found that certain building qualities, such as access for people with disabilities, are unlikely to be delivered widely without government intervention (PC 2004c, p. XXIII). The DSHA emphasised the same point:

It is quite clear that without government intervention, the needs of people with mobility impairments are likely to continue to be largely ignored in the commissioning, design and construction of homes. (sub. DR149, p. 3)

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<sup>14</sup> Universal housing design means designing buildings and exterior spaces to allow the maximum number of people to use them without the need for adaptation or specialised design.

Inquiry participants noted that the scale of the problem would grow in line with Victoria's ageing population, increasing the number and proportion of people with chronic illnesses and various levels of disability requiring accessible and visitable dwellings. The DSHA and the Victorian Council of Social Services provided data showing that the incidence of disability is about 20 per cent for the whole population but exceeds 50 per cent for people aged 60 years or over (sub. 59, pp. 4–5; sub. 29, p. 2). However, not all disabilities, including those associated with ageing, would necessarily be relevant to the issue of accessible housing and, as the Productivity Commission noted, declining age-specific disability rates could lower the level of disability among young and old (PC 2005a, p. 187).

Inquiry participants drew attention to the substantial social and economic benefits of more accessible, visitable and adaptable housing, including the greater independence, inclusion and choice for people with disabilities, and the lower costs of health care derived from ageing in place (DSHA, sub. 59, pp. 7–16; sub. DR149, p. 3). They also noted the potential savings in adaptation costs by providing for such changes in the initial design of a building. The Victorian Council of Social Services (sub. 29, pp. 4–5) and the City of Melbourne (sub. 45, p. 6) drew attention to an Australian study (Hill PDA et al 1999) that supports this claim. This study found that the initial cost to make a townhouse compliant with AS4299 class C<sup>15</sup> is 0.5–1.0 per cent of the total cost, and that it would cost an additional 5.7–6.7 per cent to adapt the dwelling if the need arose. This compares with costs of 19–24 per cent if no prior adaptive features are included in a dwelling. The City of Melbourne also referred to evidence from the Victorian Office of Housing that it costs about \$2000–3000 to adapt a dwelling during construction, compared with about \$25 000 to retrofit a standard dwelling to be adaptable/accessible (sub. 45, p. 6). The EOCV also noted that building regulation to improve accessibility would benefit a wider group of people than just those with a disability—for example, young families with prams and strollers, and victims of workplace accidents with temporary restrictive injuries (sub. DR102, p. 2).

Most submissions on this issue of access to private housing argued for Victoria to implement regulation in advance of national standards. A common theme was:

That the State Government amend the Victorian Building Regulations to include standards for the accessibility and adaptability of dwellings. (Valerie Johnstone, sub. 55, p. 2)

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<sup>15</sup> An Australian Standard specifying certain minimum levels of accessibility.

However, the Commission notes that if Victoria were to introduce such change unilaterally, it would risk introducing requirements not subsequently replicated in the other jurisdictions. This has a high risk of the state forgoing the benefits of a national approach, including economies of scale in materials and standardised designs, and the development of knowledge and skills. Such economies are likely to be substantial given the scale of costs and benefits involved. The DSHA presented an opposing view, arguing that some features of accessible housing impose no additional cost (for example, no steps and wider doors). Such features, it claimed, would deliver substantial benefits at no cost (sub. DR149, p. 3).

Where there is no effective regulation to establish standards for accessible or visitable private dwellings in Victoria, or where there is no prospect of any imminent improvement, some local governments have sought to introduce planning scheme amendments that reference Australian Standards on accessibility to housing (DSHA, sub. 59, pp. 18–9; VCOSS, sub. 29, p. 5).<sup>16</sup> The City of Melbourne noted:

[It] is cognisant of the work that is being undertaken in the area of accessibility but is of the opinion that mandatory requirements for accessible housing, in addition to the requirements for publicly accessible buildings, should be put in place as soon as possible. (sub. 45, p. 5)

The EOCV noted that such actions are consistent with councils' role in planning for and managing sustainable and adequate housing for all members of their community:

The Victorian Government has acknowledged that local government authorities will have a major responsibility in implementing Melbourne 2030 and that local councils have a legitimate role and scope in tailoring housing regulation to their local circumstances. Waiting for statewide or national regulation may not adequately and timely address the current challenge facing local government in planning for affordable and accessible housing ... (sub. 75, p. 10)

VCAT, however, has noted in a recent case that it is not appropriate for a local council to seek to achieve building outcomes through planning powers where those outcomes are covered by building regulations (*Hasan v Moreland CC* [2005] VCAT 1931).

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<sup>16</sup> The EOCV stated that the City of Melbourne, City of Manningham, Moonee Valley City Council and Yarra City Council have introduced such planning scheme amendments (sub. 75, p. 10). Other municipalities, such as Stonnington, Bundoora and Glen Eira, have taken similar but limited action (Robert Knott, sub. 37, p. 3).

Inquiry participants argued that available evidence suggests that markets are not providing a level of accessible or visitable private housing commensurate with community expectations. Government intervention might be warranted, therefore, although this situation might also reflect the level of ‘effective demand’ for those features.<sup>17</sup>

Even if government intervention were warranted, it does not necessarily follow that building regulation is the most effective or efficient way to proceed. Such regulation would impose upfront costs on all new buildings, even though only some would be used or visited by those with disabilities. It would also affect only the marginal addition to the housing stock (leaving most dwellings unaffected), so do nothing to make the existing stock more accessible or visitable. Further, the HIA questioned the merit of targeting new housing, given that most is located in outer urban areas, with limited suitable infrastructure and accessible transport (HIA 2005b, p. 4). The DSHA also recognised this issue:

It is true that some cheaper new homes are available at the metropolitan fringes, but people with disabilities will tend to avoid these areas because of lack of accessible public transport, distance between services and to shops, etc. (sub. DR149, p. 3)

Against this background, a targeted intervention is likely to be more effective in achieving improved accessibility and visitability outcomes:

Alternatives to the increased use of regulatory standards include funding disadvantaged groups directly or subsidising buildings with specified characteristics. (PC 2004c, p. 33)

The scale of the costs and benefits associated with regulation of this type is not trivial. Information from the DSHA, drawing on a 1999 study for New South Wales,<sup>18</sup> suggested the cost to construct an adaptable single dwelling or townhouse could initially add 1–3.6 per cent (depending on the extent of items incorporated). For mid-rise dwellings, the cost could initially add 0.3–8 per cent (sub. 59, pp. 10–11). One scenario presented in that study suggested:

On a per annum basis the adoption of adaptable design standards will cost the residential housing sector [in New South Wales] an additional \$286 m in building costs. To the beneficiaries of these standards, \$338 m will be saved in major adaptation costs per annum. (sub. 59, p. 13)

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<sup>17</sup> ‘Effective demand’ is a term indicating demand backed by the purchasing power to satisfy that demand.

<sup>18</sup> Information derived from Hill PDA et al 1999, pp. 9–15 and 18–27.



Moreover, the size of the associated costs and benefits (and the net outcome) will differ depending on the assumptions used in deriving them. Accordingly, the consequences of introducing ineffective or inefficient regulation are significant to all Victorians and warrant extensive analysis. Estimates of the initial cost to make a new house compliant with the relevant standards are at least comparable to (and may be considerably greater than) the cost of some other regulatory requirements, such as meeting energy efficiency goals. (Unlike energy regulation that delivers improved efficiency in all new dwellings, however, the distribution of benefits from improved access would apply to only a proportion of all new dwellings with improved access).

The rise of local government regulation in this area, therefore, is a cause for concern. The issues involved are not specific to local government areas; the costs and benefits of such regulation go beyond their boundaries. Piecemeal change is unlikely to deliver the most efficient outcome for the state or the nation. Robert Knott noted:

These well-intentioned efforts [by local governments] are to be commended but are, by their nature, parochial and disparate in content. These matters should more appropriately be addressed by the state government to achieve statewide consistency of policy. (sub. 37, p. 2)

Initiatives in place could, in time, take full account of these benefits and costs, and deliver a consistent approach to improving the level of accessible, visitable and adaptable housing in Victoria. The EOCV drew attention to research by the ABCB and the Building Commission into accessible housing. The research began in January 2004 and intends to report on the supply of accessible housing and the range of interventions the government could consider if the current supply is considered insufficient (sub. 75, p. 8). The EOCV also noted that the Victorian Parliamentary Outer Suburban Interface Services Development Committee recently completed its inquiry into sustainable urban design for new communities in outer suburban areas, and recommended that the government:

- give consideration to inclusive and accessible design to bring Victorian housing regulation standards in line with UK standards in relation to visitability; and
- investigate the economic and social viability of incorporating Australian Standard 4299—Adaptable Housing into the Building Regulations as a requirement for all new homes in Victoria; and
- determine the economic and social viability of making future public housing stock accessible and adaptable. (sub. 75, p. 8)

These initiatives, coupled with the access-to-premises standard being developed by the Commonwealth Government and the associated protocol for administering building access (box 5.7), provide a basis for the Victorian

Government to consider how to respond to this important issue. (A comprehensive RIS-type analysis of the issue is likely to precede any final decision).

The Commission considers it is inappropriate to introduce specific Victorian Building Regulations in this area at present. This is not because it believes that government intervention could not be warranted, or because it doubts that such regulation would deliver benefits for some people with some disabilities. Rather, it is because it is not clear that government intervention in this form is the most cost-effective manner of delivering improved accessibility and, thus, in the best interests of the community generally. Moreover, the Commission doubts that the piecemeal approach by local government regulation is an efficient or effective path for improving the level of accessible, visitable and adaptable private housing, and thus the approach is unlikely to be in the best interests of Victoria.

### **Box 5.7      Implementing an access-to-premises standard at state level**

The Commonwealth Government is developing a draft protocol for administering building access (as provided for in s31 of the *Disability Discrimination Act 1992*) to ensure a consistent approach to implementing the access requirements for specific buildings. Under the protocol, each state and territory building control administration would set up or designate a method for determining whether a proposed alternative solution meets the performance requirements of the revised Building Code of Australia, and whether a provision in the revised BCA applied to a certain design would result in unjustifiable hardship for a development in an existing building.

The protocol will not form part of the premises standard, but it will be open to state and territory governments to use the protocol or develop their own mechanisms for determining access related issues.

Nonetheless, pending these broader developments, there may be a case to develop options for targeted intervention and ‘market promoting’ information. The Commission is not aware of broad evidence of the extent and success of information efforts to date. But it would seem that with the generally elevated seriousness of disability and ageing trends, further useful progress could be achieved with an information plan coordinated by the Building Commission. VicUrban noted it would support action to achieve demonstration projects and market promotion of material that will improve industry and public awareness of the value of accessibility or adaptability features in new homes (sub. DR129, p. 3). This information could assist in promoting the value of accessibility or adaptability features, and thus provide an incentive to include these features in a dwelling. With extra demand arising from population ageing, the market might be expected to develop such informational characteristics in time. The government’s efforts would thus be intended to bring forwards this response.

### **Finding 5.6**

Victoria should continue to support national progress on access to premises. However, it is inappropriate at this time to introduce specific regulation for accessible housing in the Victorian Building Regulations. Further, it is doubtful that the piecemeal approach by local government regulation is an efficient or effective path for improving the level of accessible, visitable and adaptable private housing. There may be scope to develop better insights into the capacity of targeted, market related interventions to address the issue.

## **5.4.3 Occupational health and safety**

### **Scaffolding**

The Victorian Government introduced new Regulations in March 2004 governing work performed at a height of more than 2 metres.<sup>19</sup> The Regulations are intended to reduce the risk of fatalities and injuries from falls across a broad range of activities, the housing construction sector being one of many. The MBAV and the HIA support the initiative from a work safety perspective, but expressed concern that it will add substantially to the cost of a new house and thus adversely affect housing affordability. The HIA estimated that perimeter scaffolding requirements could add about \$10 000–12 000 to the cost of a \$150 000 two-storey house (HIA 2003b). Those costs represent an impost of 6.7–8.0 per cent on the construction value of an average house.

The Commission is aware of the substantial cost that this regulation can impose on individual construction projects and on the whole housing construction sector. Its preliminary estimates from a survey of industry participants suggest the early HIA values were upper bound estimates, and that the average cost where scaffolding is required is considerably lower. The Commission's survey identified, for a two-storey house, that scaffolding costs alone can range between \$2000 and \$15 000, or 0.3–5.1 per cent of the average project value. The wide range of these estimates reflects differences in the size and nature of each house, and differences in the total cost of construction of each house. Langford Jones Homes considered this added cost would disproportionately disadvantage the lower end of the housing construction market, where first home buyers are prevalent (sub. DR126, pp. 3–4).

All inquiry participants surveyed by the Commission indicated that they would use some means to prevent falls even if not required by regulation to do so. Some indicated that they would incur these costs regardless of regulation, to

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<sup>19</sup> The Occupational Health and Safety (Prevention of Falls) Regulations 2003.

provide a safe working environment. These comments suggest that the added expense attributable to this regulation is materially less than the total reported cost. (Appendix C discusses these costs in more detail.)

While the falls prevention regulation has added to the cost of housing (substantially in some cases), the Commission can not usefully comment on this area because that regulation is part of a much broader body of regulation (that is, occupational health and safety). Sensible comment is possible only in the context of a full consideration of that body of regulation—a task outside the scope of this inquiry.

The Commission notes, however, that under the *Occupational Health and Safety Act 2004* (Vic.), 12 sets of Regulations made under the former Act (including the Occupational Health and Safety (Prevention of Falls) Regulations 2003) sunset two years after the new Act comes into operation on 1 July 2005, unless the Regulations are earlier revoked. This provides an opportunity for the Victorian Workcover Authority to collect information on the effectiveness of the falls prevention Regulations (and associated guidance materials that affect compliance) and the costs they impose, before reassessing the manner of their continuation when they sunset.

### **Checking and tagging power tools**

Another area of safety regulation noted by the HIA (because it has potential to impose unwarranted costs on the housing construction sector) is the requirement to check and tag power tools. Prior to the inquiry, the HIA had estimated that this requirement adds an average \$260 to the cost of a house (HIA 2003b). The Commission's analysis generally confirms this estimate.

Clark Homes commented on the requirement that power tools be checked and tagged (at a cost of \$7.50 per tool) every three months. It maintained that the cost was excessive when accounting for the time taken for workers to deliver tools for tagging. It considered it is ludicrous that new power tools too need to be checked and tagged. Moreover, it expressed scepticism about the effectiveness of the regulation, noting that a tool's lead could be damaged a day after tagging, yet the tool would still carry a current tag (sub. 6, p. 1).

The Commission understands that the standard was not introduced in the form of a regulation, so has not been the subject of an RIS.<sup>20</sup> According to the Victorian Workcover Authority (VWA 2002), the Victorian code of practice for

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<sup>20</sup> The requirement was introduced under the Industry Standard for Electrical Installations on Construction Sites.

temporary electrical installations on building and construction sites was published in 1988. The code was revoked, and the responsible ministers launched a new industry standard in March 2002.

The Commission notes that TAFE providers offer a course in testing and tagging portable electrical appliances, which typically can be completed in two four hour sessions outside work hours, at a cost of \$275. This does not seem a significant imposition, but the Commission doubts whether the industry standard is achieving its objective efficiently or effectively. As Villa World Limited noted, this issue ‘has been raised by many builders as highly over regulated. Surely a higher quality control measure on the point of electrical supply would improve safety’ (sub. DR115, p. 4). Analysing the requirement to check and tag power tools along the lines of regulatory impact analysis would identify the costs and benefits of achieving electrical safety on building sites (and those of alternative approaches, such as breaker circuits).

### **Recommendation 5.5**

**That the requirement relating to the checking and tagging of power tools be subject to a regulatory impact analysis, with particular attention given to identifying alternative means of delivering the implicit objective of safer use of electrical tools on building sites.**

## **5.5 Local level regulation in Victoria**

Local government has the power to impose regulation governing housing construction. It may do so through its power to make regulation and to decide whether to apply state regulation in its areas (such as designating areas as being prone to termite infestation, bushfires or flood, or as being alpine). Most of the comments from inquiry participants regarding local government concerned councils’ power to make regulation.

### **5.5.1 Planning and building regulation**

Chapter 4 noted that local councils have limited powers to impose building controls that are unique to a municipality. As the Australian Institute of Building Surveyors noted:

Local government has the ability to make local laws pursuant to the Local Government Act. Some local governments impose requirements on the approval process which whilst a legitimate law, can be conflicting, duplicating and/or more onerous than the provision of Building Regulation or Building Code of Australia. These laws include building site access, rubbish bin and tipping fees, fences, site management and in particular specific planning provisions or variations. (sub. 41, p. 9)

The City of Boroondara gave a local government perspective:

Before a local law can be introduced, it must go through a process of public notice requirements, which makes the process sufficiently transparent and gives opportunity for submissions to be lodged. ... Councils would prefer not to have to introduce local laws, but a failure by the industry to regulate sections of their own members forces councils to introduce local laws such as asset protection, public protection, site security and litter control. (sub. 66, p. 4)

The City of Melbourne generally endorsed this view, noting that it is using its planning power to affect building design so to facilitate improved access for people with disabilities because other avenues have failed to do so (sub. 45, p. 5). Similarly, the City of Moonee Valley argued that it used this power only when necessary:

Local laws are a tool that has long been used to assist councils in the conduct of their responsibilities under the provisions of the Local Government Act. It is considered that councils pursue the introduction of local laws responsibly and do not abuse their use. In the event that a council does seek to use a local law to deal with a development or building matter it will be in response to the deficiency in the current regulatory controls at the state level. (sub. DR99, p. 2)

Many inquiry participants were critical of local government involvement in the regulation of housing construction, citing the excessive costs they considered this involvement imposed on the sector. They attributed these costs to both the proliferation of such regulation and its inconsistency (with the BCA and across council areas). The MBAV and the BAB, while noting that local regulation attempts to address genuine concerns of councils and ratepayers, nonetheless observed:

[The] MBAV understands that council areas are unique. However there ought to be a degree of commonality throughout Victoria, which would develop consistency, transparency and better outcomes for builders. (MBAV, sub. 49, p. 13)

... each council establishing its own requirements and setting its own fees results in regulation which is expensive, inconsistent, confusing and time consuming for builders, building owners, building surveyors and other industry practitioners. (BAB, sub. 74, p. 2)

Similarly, the Property Council of Australia noted it is concerned:

... about the incidence of local governments introducing their own building regulations. It undermines the objectives of the Building Code of Australia, and lacks the rigour associated with introducing regulations at the state or national level. (sub. 69, p. 3)

### **Box 5.8 Examples of costly local ‘building’ regulation**

‘The company is often asked to install a range of design and non-design features at the request of council staff. These features (for example, a Colorbond roof) are “over and above any regulation or local law” and become, in effect, a set of conditions for obtaining a planning permit.’ (Langford Jones Homes, sub. 14, pp. 5–6)

‘The significant benefits of the [Building Code of Australia] can and are being eroded by the activities of local government where the planning provisions of the state legislation are apparently applied to impact on the technical aspects of a particular building.’ (Building Products Innovation Council, sub. 46, p. 1)

Beston noted that temporary fencing requirements make it difficult (and more costly) for them to access sites (sub. 7, p. 2). On the same issue, the Master Builders Association of Victoria (MBAV) cited Cardinia draft local law no. 9, which sets dimensions for building site fences that impede deliveries to the site (sub. 49, p. 13).

The MBAV noted that local governments also set starting times on building sites (sub. 49, p. 14). It noted that later start times on weekends raise costs because those times do not correspond with industrial relations practices within Victoria. Workers are idle from 7.00 am until the local government approved start time at 9.00 am while being paid at time and a half or double time. The MBAV maintained that this regulation is causing employers to shift away from Saturday work, so projects take increased time to complete. It provided this as yet another example of local regulation being introduced without a full assessment of its possible costs and benefits.

‘[HIA members] have experienced a growing number of councils introducing sustainable building elements into planning schemes that include current building regulation. These inclusions are not subjected to the regulatory impact statement (RIS) process that is required for amendments to the building regulations. Therefore, there is potential for new and unnecessary costs to be added to [the] construction process simply due to the ability of state and local governments to unilaterally introduce building regulation.’ (HIA, sub. 58, p. 35)

‘Members in Victoria have experienced difficulty in understanding and complying with the increasing complexity and prevalence of building regulations introduced by individual local councils.’ (Roofing Tile Association of Australia Inc., sub. 60, p. 1)

Moreover, many inquiry participants expressed the view that local government involvement is increasing. RAlA and Archicentre Limited noted ‘a burgeoning trend towards local councils imposing and enforcing what amount to construction regulations at the planning phase of a housing project’ (sub. DR164, p. 3). Box 5.8 contains examples of added costs that inquiry participants provided to the Commission in support of their criticism of local ‘building’ regulation. The numerous examples provided of local regulation that adds to the

cost of a house attest the scale of the problem. Some examples indicated that particular costs are substantial. The HIA noted:

A number of councils, including Wyndham, Melton, Casey and Hume, require temporary fencing around an allotment prior to commencing work. Typically, the cost to erect a fence is between \$1500 and \$2000 per house site.

Non-compliance can result in an 'on the spot' fine of between \$200 and \$1000, in respect of numerous matters, including fencing, stormwater, builder's refuse, sanitary facilities and site identification. (sub. DR163, p. 13)

However, the Commission received little quantification on an average house or total industry basis. Only the MBAV provided costs in this form. It claimed that the cost of local government variations to Building Regulations added an average of around \$1700 per construction project in Victoria (sub. 49, p. 15). Appendix C contains additional information of the likely level of these costs in aggregate.

This issue of local government imposing building regulation is not unique to Victoria. The Productivity Commission report on reform in building regulations (PC 2004c) identified local governments' increasing use of their planning processes to extend or alter building requirements as a nation-wide issue. It noted that this situation creates inconsistencies in building regulation across jurisdictions and undermines gains from national consistency. It further noted that local governments usually do not conduct an adequate impact analysis of their regulation. As a result, new regulation may be introduced that imposes extra requirements on business, with increased costs, for uncertain benefit (PC 2004c, p. XXXVII). The Productivity Commission made recommendations for improving regulatory outcomes, including:

- subjecting changes [to council building requirements] to a suitably rigorous justification process involving impact analysis ...
- maintaining a register of state RISs undertaken for local government building regulations, to help inform [ABCB] discussions
- facilitating interjurisdictional discussions, with the objective of establishing national agreement over a delineation between regulation making powers relating to planning and building
- assessing the feasibility of requiring any local government requirement that is inconsistent with the BCA to be approved by the responsible state minister ... (PC 2004c, p. XXXVII)

A number of inquiry participants endorsed these recommendations. They noted that the recommendations, if followed, would reduce the odds of local governments subverting the national framework through local by-laws or planning approval processes.



The issue of local government imposing regulation without adequate assessment is not new for Victoria. The Scrutiny of Acts and Regulations Committee (SARC) recently investigated this matter as part of a broader review. It acknowledged that local government is a separate tier of government and thus should be exempt from the State Government's RIS process. However, it recommended that the Minister for Local Government, in consultation with councils, consider establishing an appropriate scrutiny process for local laws (SARC 2002). The government supported this recommendation, and the Department for Victorian Communities advised the Commission that this matter is under consideration.

### **Recommendation 5.6**

**That the Department for Victorian Communities report within six months on a timetable for implementing the Victorian Government's intention to consider an appropriate scrutiny process for local laws.**

As noted, VCAT commented on where local government intervention was not appropriate. Inquiry participants had their own views on how to resolve this issue of inappropriate and excessive local regulation, in addition to possible solutions arising from the Productivity Commission or SARC reviews. The BAB noted that standard local law across all local governments would reduce much of the confusion and introduce welcome efficiencies. It suggested that the Building Commission could take responsibility for creating and standardising regulation across Victoria, using the objectives of the Building Act to do so (sub. 74, p. 2). The Australian Institute of Building Surveyors and the MBAV also considered this to be a solution to the plethora of local regulation and the regulatory differences across councils:

The AIBS consider that to ensure for an efficient and effective permit process the duplication of controls e.g. matters related to planning, public protection, infrastructure, site access and facilities, bushfire prone areas and termite areas should not be duplicated by legislation outside the Building Act and Regulations. The AIBS recommend consideration of a 'model local law' which includes provision for the above to be developed as a consistent model across Victoria. (AIBS, sub. 41, p. 10)

Much to the dismay of the building industry, councils throughout Victoria have not adopted the model local law developed by the Building Commission. This is unfortunate, as the model would have reduced significantly the divergence among municipalities in local laws. (MBAV, sub. 49, p. 13)

The MBAV noted that this model local law offers the ‘potential benefits of generating simple, easy-to-understand and consistent local laws throughout Victoria’ (sub. DR151, p. 9). It considered:

With stronger leadership from State Government, it is expected that many local councils would accept the merits of consistency in respect of a stronger local law. (sub. DR151, p. 9)

Evidence presented to the Commission highlighted the growing local regulation affecting housing construction. It also indicated the substantial costs this regulation adds to housing construction (with a corresponding adverse effect on affordability). That evidence is consistent with the findings of the Productivity Commission review of reform of building regulation.

The Commission endorses the Productivity Commission’s recommendations (noted above) as a way of addressing these problems on a national systemic level. It also supports the action recommended by the SARC review—that is, that the Minister for Local Government, in consultation with councils, consider establishing an appropriate scrutiny process for local laws. However, mindful of the view of inquiry participants, the Commission suggests that a model law approach be part of the scrutiny process—for example, departures from the ‘model law’, while not ruled out, could be subjected to RIS-type scrutiny. Alternatively, for planning changes that include Building Regulations, the minister might require the costs and benefits of the regulatory changes to be explicitly identified.

The machinery of change at the national and state level will not deliver immediate results, although establishing a timetable would seem appropriate. Accordingly, in the interim, the Commission considers the Building Commission should, as part of its information provision role, establish a web link to list selected requirements of each local council, to provide a central reference point for building practitioners. The candidates for inclusion on the web link could be determined in consultation with industry groups to determine which would be most useful to identify.

A broad range of inquiry participants endorsed the worth of such an initiative—for example, the Macedon Ranges Shire Council (sub. DR146, p. 3), the City of Melbourne (sub. DR136, p. 7), the Civil Contractors Federation (sub. DR108, p. 1), the MBAV (sub. DR151, p. 10), the Australian Conservation Foundation

(sub DR137, pp. 5–6); and the BRAC (sub. DR142, p. 8). The submission from Fagan and Fagan generally summarised participants' views:

The establishment of a central web link would be a welcome development in containing and disseminating local laws. It is suggested that this notion be extended to the listing of proposed new local laws, or amendments to current local laws as well as mapping of designated areas.<sup>21</sup>

Notification of local laws to the building industry is usually a limited process by way of public notices in local papers, advisory correspondence to stakeholders who undertake work in the municipal area, notification on the municipal website and through the gazettal process. Providing notification on a central website in a timely manner would enable all parties to easily monitor local law development and be sufficiently informed to prepare submissions as required. (sub. DR123, p. 6)

This task might involve only limited effort. The Department of Sustainability and Environment advised the Commission that the portal provided by the department to the websites of local councils<sup>22</sup> provides details about local laws and planning schemes, and that those sites have been developed using a standard template. Moreover, it advised that the Building Commission has held discussions with the Municipal Association of Victoria about the potential means to better inform building practitioners and consumers of local council variations to building requirements. However, many submissions' general criticism of the lack of a central source of information suggests current arrangements are not working and an effective centralised web link needs more attention.

#### **Recommendation 5.7**

**That, to restrain the cost of inappropriate local government variations to building regulation, the Building Commission establish—as an interim measure pending changes arising from reviews—a web link listing selected 'building' requirements of each local council to provide a central reference point for building practitioners.**

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<sup>21</sup> Plan Scan argued that a number of councils have not complied with the Building Regulations requirement that they submit hazard maps to the Building Commission, and that there is no way of compelling them to do so (sub. DR111, p. 1).

<sup>22</sup> [www.dse.vic.gov.au/planning](http://www.dse.vic.gov.au/planning)

## 5.5.2 Termite declaration

During the inquiry, a question raised was how councils might implement regulation via their power to designate areas as termite zones. This issue was deemed significant because it could add substantially to the cost of a new house. As the AIBS noted:

... the hot topic at the moment is termite areas and designation of termite control between councils ... (transcript , 7 March 2005, p. 99)

The RAlA and Archicentre Limited highlighted what they considered to be an alarming incidence of termite attacks in Victoria and the apparent escalation of infestations (partly due to phasing out effective, but environmentally unfriendly, chemical treatments). They recommended:

That local councils be encouraged through regulation to declare areas which are demonstrably termite prone so that the prevention requirements under building regulations can be enforced. (sub. 40, p. 10)

Requirements for termite control are set by the Building Regulations 1994, which adopt the BCA requirements for termite risk management. Those requirements apply only to primary building elements<sup>23</sup> of class 1 and 10 buildings ‘considered susceptible to termite attack’. The BCA provides two compliance alternatives:

- (1) construction of the primary building elements from termite resistant materials, or
- (2) installation of a termite management system in accordance with the referenced Standard. (National Association of Steel Framed Housing, sub. DR122, p. 5)

Because current regulation provides a choice of potential treatments for the risk of termite infestation, the Department of Sustainability and Environment noted that:

... the potential for the existing regulations to impose costs, by requiring a treatment which is not least cost, is small or non-existent. (sub. DR172, p. 4)

Victoria’s Building Regulations allow local governments to designate the areas within their municipal district in which buildings are likely to be subject to infestation by termites. Following such designation, the termite risk management requirements of the BCA then apply for that area, but only to a building being constructed (r6.3(2)(a)). Existing buildings are not subject to the termite

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<sup>23</sup> Regulation 803(2)(a) of the Building (Interim) Regulations states that: ‘A primary building element is only required to be protected against attack by termites if it is part of a building being constructed’. A primary building element is defined under the BCA as ‘a member of a building designed specifically to take part of the building loads ... and wall framing members’.

management requirements of the BCA. As of 13 January 2005, 48 of Victoria's 78 municipalities were designated as being subject to termite infestation.

A council's decision to designate an area as a termite zone has a substantial cost for new building. The BRAC estimated the average cost of termite protection for new homes at \$1500–3000 (sub. 57, p. 8).<sup>24</sup> The Commission's own survey of building practitioners identified absolute costs of termite protection for new houses of \$490–4240 and proportionate costs of 0.1–1.6 per cent. For alterations and extensions, the respective costs were \$400–4500 and 0.1–3.1 per cent. Appendix C contains further details. Conversely, there are potential costs if termite protection is not installed in a new house, although estimates provided to the Commission varied considerably. The RAIA and Archicentre Limited indicated that the average repair cost, should a house become infested, is \$4500 (sub. 40, p. 10). The National Association of Steel-framed Housing provided an independent study (Jeary 2003) that reported the average cost of each attack to timber framed housing (for New South Wales in 2003) to be a little over \$2300 (sub. DR122, p. 12 of appendix).

One issue is whether the designation of an area as a termite zone is being decided after sufficient consideration of the costs and benefits. There is some evidence that decisions to declare termite zones, and thus impose costs on consumers, is not being done in a sufficiently rigorous manner. In 2004, for example, the municipalities of Monash, Knox, Wyndham and Hume declared their districts to be 'likely to be subject to termite infestation'. Termite Action Victoria played a significant role in their decision, as the minutes from the 20 December 2004 council meeting of the Wyndham City Council indicate:

Termite Action Victoria provided a presentation to council highlighting the seriousness of the termite problem throughout the state and the possible consequences of future litigation, cost to ratepayers and the methods of protection available. (Wyndham City Council 2004, p. 241)

Concerns over potential litigation appear to have been a factor in these municipalities' decision to declare their districts at risk of termite infestation. The Hume City Council concluded:

... the prudent and appropriate action for council is to declare the Hume City municipal district as an area in which buildings are likely to be subject to termite infestation. By taking this action council is protecting the interests of building owners and the integrity and value of the built environment of Hume City. In

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<sup>24</sup> The use of termite management systems does not prevent a termite infestation. Rather, it reduces the likelihood of an infestation and makes for easier detection, with the result that any damage is likely to be less than if no system were in place.

addition, by taking this decision, council is exercising its powers in an informed and responsible manner, thereby mitigating future liability and risks of litigation. (Hume City Council 2004, p. 31)

The Commission is unable to comment on the rigour underlying councils' cost–benefit assessment. However, in light of the information presented above, it has concerns that councils do not, as a matter of course, conduct a full assessment of the benefits and costs and of the minimum regulation necessary (including alternatives, such as providing relevant information to homeowners or requiring a termite inspection report when a property is sold).

Related issues are whether the regulation confers benefits equally on new house construction and on alterations and additions, and thus whether councils are making decisions on an accurate assessment of net benefits. The regulation invokes termite control measures for new alterations or additions, even where the main building may not be protected. In such cases, the cost of control may not confer the expected benefit—termites could circumvent the protection on new construction by entering via the older unprotected building. Thus, the net benefits assumed to accrue from declaring a local government area termite prone would be overstated (to the extent that extensions and alterations do not benefit, and in proportion to their share of new construction).

The Commission did not receive sufficient information to fully assess this issue. However, in view of the significant cost involved and the possibility that no aggregate net benefit accrues for alterations and additions, it considers any future consideration of whether to declare an area termite prone needs to identify whether such a net benefit is likely. The Building Commission could consider facilitating the availability of good methodology for this purpose, through consultation with local councils and through a consultancy project. Similarly, in view of this concern that a net benefit is unlikely where the main building is not protected, the Building Commission should consider regulation that allows an exemption for such construction—for example, allowing owners, after being informed of the risks they face, to opt out of applying control measures.

#### **Recommendation 5.8**

**That the Building Commission assess whether regulation is warranted to allow an exemption for alterations and additions from r803(2)(a) of the Building (Interim) Regulations 2005 (concerning termites). The exemption would allow owners, after being informed of the risks they face, to opt out of applying control measures where the main building is not protected.**

### 5.5.3 Bushfire prone declaration

Local councils are able to declare their area as bushfire prone in accordance with the Building Regulations. The Metropolitan Fire and Emergency Services Board and the Country Fire Authority noted that the majority of Victorian municipalities that have urban/rural interfaces, or are mainly rural environments, have designated their areas as bushfire prone (sub. 53, p. 9). The BCA specifies Australian Standard AS3959 (Construction of Dwellings in Bushfire Prone Areas) when designing dwellings in these areas.

The Metropolitan Fire and Emergency Services Board and the Country Fire Authority claimed that there has been a poor record of compliance with the AS3959 standard (sub. 53, p. 9). To support this claim, their submission referred to an audit by the Building Commission in Victoria in 2003. That audit found that a significant proportion of working drawings prepared for dwelling construction, and of the number of building sites inspected, did not comply with the Regulations (table 5.1).

Table 5.1 **Compliance at document audit stage**

<i>Shire</i>	<i>Compliant (no.)</i>	<i>Non-compliant (no.)</i>	<i>Proportion compliant (%)</i>
Bass Coast	20	8	71
Hepburn	19	1	95
Latrobe	21	21	50
Macedon Ranges	25	14	64
Mitchell	0	15	0
South Gippsland	41	61	40
Yarra Ranges	51	14	78

Source: BC 2003b, slide 23.

The Country Fire Authority noted that greater monitoring and enforcement of this regulation is required to ensure compliance with the BCA and AS3959 (sub. 53, p. 9). It also noted that a recent Council of Australian Governments (COAG) report into bushfire mitigation and management highlighted the poor application of both planning and building construction controls in areas prone to bushfire (sub. 53, p. 9). It pointed out that the BRAC has acknowledged construction in bushfire prone areas is an issue and is being addressed through added research. However, this research was due for completion in 2004, yet the authority had seen no evidence of this activity at July 2005 (sub. DR148, p. 3).

The standard governing construction in bushfire prone areas was revised in 1999. The revised standard provides for protection from burning debris, radiant heat and direct flame, where the previous standard considered only attack from burning debris (ABCB 1999, p. 2). The RIS preceding the revised standard suggested the additional cost of the higher hazard protection would affect a relatively small number of new houses each year and that the additional cost was likely to be modest:

The average construction cost resulting from measures contained in this proposal (\$907 for level 1 protection and \$1157 for level 2 protection) is not significantly different from the costs of the current standard (\$932). (ABCB 1999, p. 3)

However, the BRAC noted that the proposed bushfire standard ‘is raising serious concerns regarding the potential cost impact and non-compliance implications’ (sub. DR142, p. 7). Anecdotal evidence suggests that the cost per new house of the higher hazard protection standard is significant, and that homeowners are baulking at incurring those costs. Thus, while monitoring and enforcement of protection standards appear to be an ongoing and unresolved issue, the appropriateness of those standards for Victoria appears still unresolved.

At the least, the above discussion suggests that the BRAC or the Building Commission should publicly report on the status of the research to which the Country Fire Authority referred. Further, and consistent with the Commission’s comments in section 5.3, the proposed standards governing construction in bushfire prone areas should be adopted in Victoria only if a cost–benefit assessment indicates they are appropriate for Victoria’s circumstances.



## 6 Permits and registration

This chapter describes the operation of two elements of Victoria’s regulatory regime intended to help achieve building standards—the building permit and building practitioner registration systems. It considers the rationale for these regulatory systems and identifies issues with their operation. Where shortcomings are identified, the chapter discusses arrangements that might address them.

### 6.1 Introduction

Victoria’s building permit and practitioner registration systems are regulatory instruments designed to counteract information problems that consumers may face (chapter 3) and to achieve building standards.<sup>1</sup> Practitioner registration operates as an input check, signalling that registered building practitioners have the required qualifications. The permit system operates as an output check, with inspections verifying—before building work commences, and at prescribed stages in the building process—that the building design and building work comply with regulated standards.

The effectiveness and efficiency of this ‘dual system’ depend on the set parameters of the permit and registration systems. That is, they depend on the size and type of jobs requiring a building permit (section 6.2), the coverage of practitioner registration and the required qualifications (section 6.3), and how the dual system (permits and registration) is monitored and enforced (section 6.4). Section 6.5 discusses the competition impacts of the dual permit and registration system.

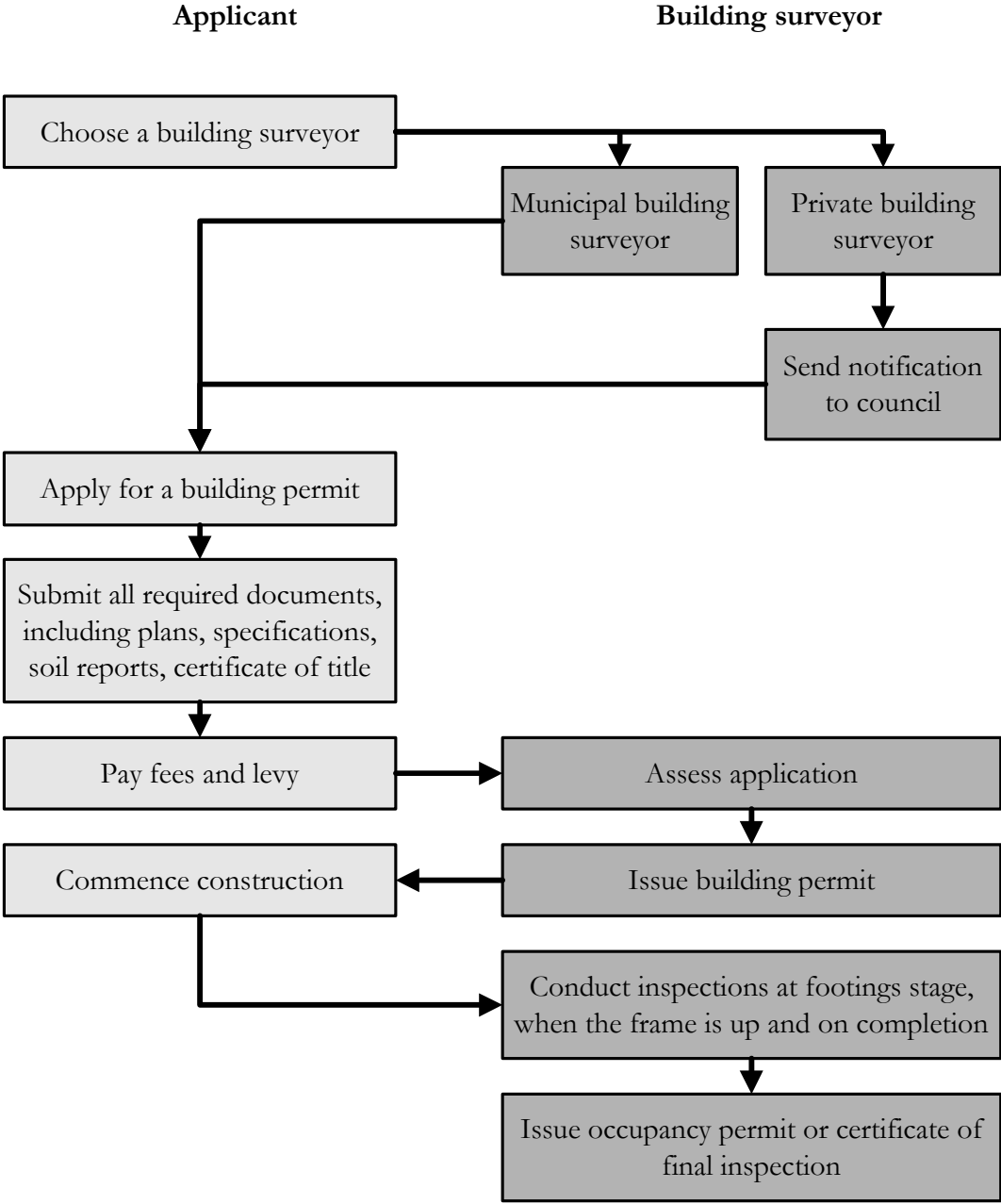
### 6.2 Building permits

Figure 6.1 summarises the building permit process, which is described in more detail in chapter 4. All building work, unless specifically exempted under the Building Regulations, requires a building permit.

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<sup>1</sup> The regulatory system for housing construction includes some components that operate together to achieve building standards. Other components include regulation of the content of contracts, mandatory insurance, assistance with dispute resolution and rights of appeal. It is arguable, however, that the permit and registration systems are at the heart of the regulatory system.

Figure 6.1 The building permit process



Source: Based on BC 2005a, p. 4.

**6.2.1 Previous reviews of the building permit process**

Two reviews have commented on the building permit process. First, the National Competition Policy review of architects and building legislation concluded that the building permit system does not unduly restrict competition (Freehills Regulatory Group 1999, p. 73). Section 6.5 discusses the impact on competition of the building permit and registration systems.

The second review, which reported on the building permit and occupancy permit process to the Building Commission in 2003, concluded that:

It can be broadly stated that the overall results of the survey, focus groups and industry consultation is that the existing building and occupancy permit process is operating at a significantly efficient and effective level. At the macro view the principles of a ‘command and control’ legislative approach (that is, requiring a building and occupancy permit) [are] considered necessary, effective and relatively well understood. (Warrington Fire Research (Aust.) & Pitt and Sherry 2004, p. 16)

Nonetheless, the report made 19 recommendations for change or further review (box 6.1). Some recommendations have been implemented (for example, changes to the exemptions from the requirement to obtain a building permit, as discussed in the next section); some are being implemented; and others are still being considered.

### **BOX 6.1      Review recommendations on the building and occupancy permit process**

Themes to emerge from the recommendations included:

- streamlining administrative processes—for example, using standardised forms, fees and processes for interaction between key parties
- improving information provision—for example, creating a central database and information centre, providing guidance material and requiring greater disclosure on permit documentation
- clarifying relationships—for example, proposing that the owner appoint a building surveyor
- strengthening compliance—for example, auditing selected building permits and issuing pro-forma notices and orders
- reviewing aspects of the building and occupancy permit process—for example, changing the exemptions from the requirement to obtain building and occupancy permits, and the report and consent process. The report also recommended removing the \$5000 cost threshold for building permit exemptions.

Source: Warrington Fire Research (Aust.) & Pitt and Sherry 2004, pp. 16–21.

## **6.2.2      Issues arising from the building permit process**

The efficiency and effectiveness of the permit system are influenced by the threshold at which a permit is required (discussed in this section) and how the system is monitored and enforced (discussed in section 6.4).

## The permit threshold: exemptions from the permit requirement

The building permit system applies to all building work unless exempted under the Building Regulations. Until recently, table 1.6 of the Building Regulations 1994 outlined building work not requiring a building (and occupancy) permit. The exemptions related to specific types of building work, such as temporary buildings, fences, masts and (some) building work costing less than \$5000 (including all labour and materials), where the work would not affect the structural soundness of the building and public safety, among other things.

These exemptions changed following the introduction of the Building (Interim) Regulations 2005 on 14 June 2005. Building permit requirements are now based solely on the scope of building work (defined in terms of physical characteristics of the building and/or building work and their impact on structural soundness and safety), rather than a combination of the work's physical characteristics and the previous \$5000 threshold. (The exemptions are outlined in schedule 8 of the interim Regulations).<sup>2</sup> Renewal, repair or alteration of part of a building (up to any value) now appears to be exempt from requiring a permit if the work does not affect safety or breach other conditions.

Consumers are responsible for determining, or seeking advice to assist them in determining, whether building work will require a building permit. The Commission understands that consumers normally gain advice or other assistance from a builder, a building professional (such as a designer, building inspector, building surveyor or architect), a building tradesperson (a licensed/registered plumber or electrician or unregistered tradesperson), or from the building section of their local council.

In addition, the Building Commission provides information to consumers and building practitioners—printed, online and in response to questions—about building permit requirements and exemptions. It does not, however, issue formal exemptions from the requirement to obtain a building permit, or record exemption decisions. If a consumer makes an incorrect judgment, or obtains incorrect advice, on the need to obtain a building permit, then the resulting building work undertaken without a building permit would be illegal, and the consumer would be subject to enforcement or other sanctioning. In practice, this would normally occur through a complaint from a neighbour to a council, or a

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<sup>2</sup> The changes include:

- narrowing the class 10a buildings that are exempt
- changing fence height exemptions
- narrowing exemptions for pergolas
- specifying more closely the exemptions for building repair work
- basing building permit requirements on the scope of building work rather than the previous \$5000 limit, implying the need for some garages, carports and pergolas to have a permit.

council officer otherwise becoming aware of the illegal building work (such as the periodic pool fence compliance inspection by councils) or as a result of purchase inspections in a sale process.

The recent removal of the \$5000 threshold is consistent with the review of the building and occupancy permit process, which commented that:

... some exemptions (most notably the \$5000 exemption) were poorly understood and applied and required too much interpretation. Additionally it was commented that exemptions should be based on size and/or complexity or public risk, not simplistic measures such as cost. (Warrington Fire Research (Aust.) & Pitt and Sherry 2004, p. 14)

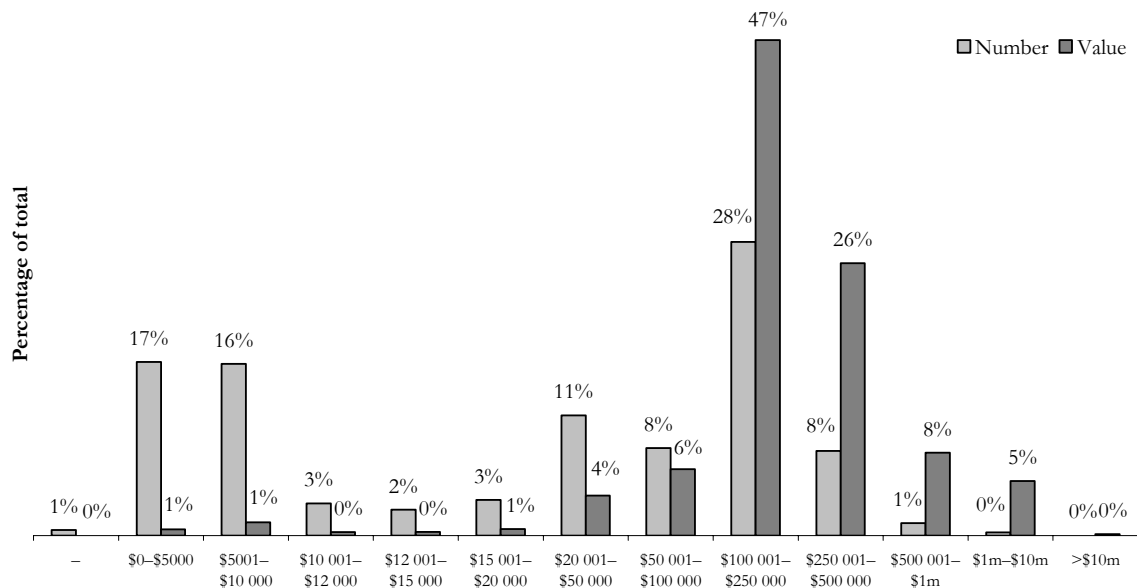
Some inquiry participants agreed that the former exemptions were difficult to understand. The Royal Australian Institute of Architects (RAIA) and Archicentre Limited commented that:

Effective understanding in the community of the regulatory requirements for building permits (building approvals) appears to be an issue. Archicentre's feedback indicates uncertainty among the consumer public about when a building approval is or is not needed where the regulations are variable with the particular circumstances. (sub. 40, p. 7)

The Master Builders Association of Victoria suggested that specifying 'a series of exemptions from the requirement for [a] building permit, based on a mixture of size, function and value criteria' created 'unintended pitfalls and opportunities for abuse' (sub. 49, p. 21).

It is difficult to assess the impact that removing the monetary threshold will have on the costs and benefits of regulation. There may be cost savings if the number of building permits issued falls. In 2004-05, 19 per cent of permits were in the \$5000–12 000 value range, but accounted for less than 1 per cent of the value of all building permits (figure 6.2). Less costly jobs may be less likely to have an impact on the structural soundness of buildings. If so, removing the monetary threshold could significantly reduce the number of building permits, with a consequent fall in the costs of regulation.

Figure 6.2 Number and value of building permits, 2004-05



Source: Data provided by the Building Commission, 4 August 2005.

Whether the health and safety benefits of regulation will be compromised will depend on whether the removal of the \$5000 threshold results in any building work with a structural impact proceeding without a permit. This could happen, for example, if consumers (who previously would have sought a permit because they recognised the \$5000 threshold under the former approach) now undertake work without a permit, not recognising that the work has a structural impact. This possibility does not seem far fetched, given that the case for regulation is built on consumers' poor knowledge of building processes.

In its draft inquiry report, the Victorian Competition and Efficiency Commission requested information about the advantages and disadvantages of defining exemptions based on the type of building work, compared with the previous combined approach of using monetary cost and the physical characteristics of the building work.

The Australian Institute of Building Surveyors argued that removing the \$5000 threshold is a backwards step:

The AIBS believe that the real reason why the \$5000 cap for not requiring a building permit never really worked, was due to the regulations being open to interpretation. If the regulation wording stated that the requirement for a Building Permit was as 'determined by the relevant building surveyor' then there may not have been so much confusion in the community ... The removal of the \$5000 has once again created confusion in the community, placing more cost on consumers, and more cost and onus on councils and their building control staff

who [are] required to administer the building regulations for once exempted building works. (sub. DR130, p. 7)

Fagan and Fagan, on the other hand, claimed that removing the \$5000 threshold will reduce confusion and subsequent illegal building works (sub. DR123, p. 6). Nevertheless, they noted that guidance material would help consumers to interpret the exemptions:

Description of the building works as a means to determine exemption status relies on sufficient and comprehensive information. Case studies [are] one such means, however there still exists an area of doubt in respect to kitchen and bathroom alterations, improvements or renovations which comprise a significant proportion of domestic building work. The issue is partially resolved with enhanced guidance stating that the replacement of an existing kitchen that does not involve structural work would not require a building permit. Expansion of the case studies to cover various types of kitchen alterations and inclusion of bathroom case studies would provide practitioners (including building surveyors) [with] more certainty. (sub. DR123, p. 7)

Moreland City Council also supported the removal of cost based exemptions and the need for clear guidance on the exemptions (sub. DR158, p. 11).

The Department of Sustainability and Environment indicated that building permit exemptions will be considered in the regulatory impact statement (RIS) for the Building Regulations 2006:

The RIS will review the current definition for building permit exemptions, evaluate the purpose and rationale of this regulation and propose a list of alternatives to achieve the purpose. The RIS process will identify the best regulatory approach for this issue. The underlying principle for changing the building permit exemptions from a monetary threshold to definitions of building work was to ensure that safety is maintained despite the cost of the building work. The BRAC [Building Regulations Advisory Committee] considers that there is a need for tighter definitions of exemptions in order to achieve desired regulatory outcomes. (sub. DR172, p. 27)

This RIS could consider many options, including:

- retaining the current arrangements, whereby there is no monetary threshold and consumers assess whether a building permit is required, but with the Building Commission providing more information, as Fagan and Fagan suggested, to help consumers to interpret the exemptions
- retaining the current arrangements, but more tightly defining the exemptions, as the BRAC proposed, to reduce the difficulties that consumers may face in interpreting the exemptions
- re-introducing a monetary threshold, at either \$5000 or a higher level, along with the other exemptions

- requiring a building surveyor to assess whether a building permit is required, in order to reduce the risk that consumers make errors, as the Australian Institute of Building Surveyors (AIBS) proposed. This could apply to all jobs, as the AIBS propose, or above a monetary threshold of \$5000 or more, to reduce the cost of securing an exemption
- requiring either a registered building practitioner or building surveyor to assess whether a building permit is required.

Exemptions define the coverage of the regulatory framework and are therefore one of its most important features. Hence, this issue is likely to be a significant aspect of the forthcoming review of the building regulations. If, as seems possible, there will be little information to quantify the costs and benefits of the options, the exemptions and effectiveness with which they are administered should be periodically reviewed after the regulations are re-made. Such monitoring needs to take into account that the permit system is part of an integrated regulatory system, the other principal parts being registration and insurance. Adjustments in the permit system may affect other regulatory efforts.

#### **Recommendation 6.1**

**That the regulatory impact statement for the Building Regulations 2006 consider the most appropriate options for making exemptions from building permits, and the process through which these exemptions are administered, to achieve an appropriate balance between health and safety objectives and regulatory intervention and cost.**

The removal of a value based threshold for building permits—and the consequent building inspections—suggests that building permits focus on safety issues more than financial protection. Protection against financial risks is more the role of the contractual safeguards and insurance arrangements implemented through the *Domestic Building Contracts Act 1995* (Vic.) (discussed in section 6.3.1).<sup>3</sup>

### **6.3 Practitioner registration and licensing**

Along with the building permit and inspection system, practitioner registration<sup>4</sup> and licensing are intended to help achieve good building outcomes and to strengthen consumer confidence in the building industry. The system seeks to do

<sup>3</sup> Insurance arrangements are discussed in chapter 7.

<sup>4</sup> The *Building Act 1993* (Vic.) contains provisions for the registration of building practitioners and the licensing and registration of plumbers. The principal difference between licensed and registered plumbers is that only licensed plumbers can purchase and sign certificates of compliance. A licensed plumber must also demonstrate competence in both the practical and theoretical aspects of plumbing and hold appropriate insurance cover; these are not requirements of registered plumbers (PIC 2005).



this by ensuring a practitioner is appropriately qualified to perform specified building tasks and by requiring practitioners to demonstrate eligibility for insurance, thereby providing consumers with access to insurance cover for a range of adverse events. (Chapter 7 considers issues related to insurance requirements.)

As the Department of Sustainability and Environment noted, registration and licensing, by requiring that practitioners have relevant capabilities, should reduce the costs to consumers of locating a competent service provider and reduce the need for other more stringent regulation (sub. 84, p. 25). Lower search costs should expand the number of market transactions, although registration can reduce competition by acting as a barrier to entry to building trades. These impacts on competition are discussed in section 6.5.

### **6.3.1 Operation of the practitioner registration and licensing system in Victoria**

#### **Regulatory framework for practitioner registration and licensing**

Chapter 4 described the legislative and regulatory basis for practitioner registration and licensing, and the responsible bodies. Box 6.2 summarises the arrangements.

#### **Box 6.2 Regulatory framework for practitioner registration and licensing in Victoria**

The Building Practitioners Board registers building practitioners—including builders, draftspersons, building surveyors, building inspectors and engineers—under part 11 of the *Building Act 1993* (Vic.).

The Plumbing Industry Commission registers and licenses plumbers under part 12A of the Building Act.

Energy Safe Victoria<sup>5</sup> registers electrical contractors and licenses electricians, supervised workers and electrical inspectors under the Electricity Safety (Installations) Regulations 1999.

The Architects Registration Board of Victoria registers architects under the *Architects Act 1991* (Vic.). An architect registered under this Act may use the title ‘building practitioner’ or ‘registered building practitioner’ under part 11 (s176(6)) of the Building Act.

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<sup>5</sup> On 10 August 2005, the Office of the Chief Electrical Inspector was amalgamated with the Office of Gas Safety and the pipelines safety functions of the Department of Primary Industries, to form Energy Safe Victoria.

## Practitioner coverage

Housing construction involves practitioners from many trades and professions, including builders, building surveyors, engineers, architects, plumbers and electricians. Most practitioners are required to be registered and/or licensed to undertake work relating to housing construction in Victoria. The Building Practitioners Board is responsible for registering most building practitioners in Victoria, registering approximately 16 000 in 2004 (BC undated E). Some practitioners have multiple registrations, so the number of registrations exceeds the number of individuals registered. The board issued a total of 19 560 building practitioner registrations in 2003-04, including 10 757 domestic builder registrations (table 6.1).

**Table 6.1 Building Practitioner Board registrations**

<i>Category</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>
Domestic builder—limited	597	643	800
Domestic builder—unlimited	10 283	9 948	9 753
Domestic builder—manager	245	218	204
<i>Subtotal</i>	<i>11 125</i>	<i>10 809</i>	<i>10 757</i>
Commercial builder	4 047	4 075	3 910
Demolisher	190	195	198
Building inspector	399	389	387
Building surveyor	477	477	463
Draftsperson	2 001	1 958	1 989
Engineer	1 682	1 637	1 640
Quantity surveyor	101	101	100
Temporary structure	122	123	116
<i>Subtotal</i>	<i>9 019</i>	<i>8 955</i>	<i>8 803</i>
<b>TOTAL</b>	<b>20 144</b>	<b>19 764</b>	<b>19 560</b>

Source: BPB, sub. 26, p. 4.

The Plumbing Industry Commission registers and licenses plumbers. There were 19 361 plumbers registered and/or licensed with the commission in 2003-04 (PIC 2004a, p. 22). Energy Safe Victoria<sup>6</sup> registers and licenses electrical trades. It

<sup>6</sup> Energy Safe Victoria assumed this responsibility from the Office of the Chief Electrical Inspector.

licenses over 33 000 licence holders (including 24 000 licensed electricians), over 320 licensed electrical inspectors and more than 8400 registered electrical contractors (sub. 18, p. 7).

## Qualifications

The registration and licensing bodies assess applications against a set of competencies, with most bodies requiring some form of insurance as a condition of registration or licensing. Box 6.3 summarises the qualification requirements and chapter 7 discusses the insurance market and the requirements of insurers.

### Box 6.3 Qualifications

**Registered building practitioners**—The Building Practitioners Board assesses applications for registration against the qualifications prescribed in the Building Regulations and against a set of competencies designed to determine the suitability of an applicant seeking registration (sub. 26, p. 4). Successful applicants are required to provide proof of insurance, or eligibility for insurance, to be registered.

The Building (Interim) Regulations 2005 (schedule 7) prescribe that:

- **a domestic builder (unlimited)** has a degree, diploma or associate diploma from a university or TAFE college and three years practical experience to the satisfaction of the board
- **a domestic builder (limited)** has a certificate issued by the board certifying that the applicant has adequate knowledge and experience to carry out, manage or arrange to carry out the components of domestic building work specified in the certificate
- **a building surveyor** has a university degree in building surveying, and three years practical experience, to the satisfaction of the board.

**Plumbers**—The Plumbing Regulations 1998 outline the qualifications and experience required for obtaining a licence or registration. Applicants for a licence or registration are required to have completed and passed specific courses relevant to the class of licence or registration held, and to have completed a four year plumbing apprenticeship or four years relevant employment experience (except for draining work, for which a two year apprenticeship or two years work experience is required). A licensed plumber must also have appropriate insurance cover.

Sources: Building (Interim) Regulations 2005; Plumbing Regulations 1998 (part 3); BPB, sub. 26.

### **6.3.2 Issues related to practitioner registration**

Inquiry participants and the Commission's research highlighted issues regarding practitioner registration:

- the threshold value of building work, above which a builder undertaking the work must be registered, and the relationship between this value and other thresholds
- continuing professional development requirements for registered practitioners
- competency requirements for registered practitioners
- the process for changing the building practitioner categories that require registration
- registration fees
- part time registration
- whether companies should be required to register as building practitioners
- owner–builder legislation, which is aimed at reducing evasion of the registration system
- other unregistered builders.

#### **The registration threshold**

A building practitioner must be registered to undertake domestic building work in excess of \$5000, even for work for which a building permit is not required. (box 6.4). Registration is also required for any building work involving the reblocking, restumping or demolition of a home, irrespective of the work's value. To be registered, the practitioner must have skills and qualifications such as those listed in box 6.3, and pay fees to cover the costs of registration.

The levels at which the registration threshold and associated skill requirements are set will affect the cost and effectiveness of the registration system. If the skill requirements are excessive relative to the characteristics of the job for which registration is required, for example, then registration may unduly restrict competition. On the other hand, if the threshold requirements are set too low, registration may not ensure that practitioners have the requisite skills, experience and qualifications to achieve desired outcomes, and practitioners without these attributes may enter the market. The extent of this problem depends on the potential adverse consequences of practice by an unregistered person. Society would expect a medical practitioner, for example, to be subject to more stringent registration requirements than apply to a building practitioner. Overall, the costs and benefits of restricting competition versus protecting consumers from incompetent practitioners should be balanced when the registration threshold is

set. Other ways to achieve the same outcomes (such as more rigorous auditing arrangements or higher penalties for faulty work) should also be considered (PC 2004c, p. 207).

## **Box 6.4 Cost thresholds in the housing construction regulatory framework**

### **Practitioner registration**

The Building (Interim) Regulations 2005 (r1810) state that a builder engaged solely in domestic building work is not required to be registered if the cost of that work is \$5000 or less. A builder engaged in restumping or demolition work, however, must be registered regardless of the cost of that work.

### **Major domestic building contract**

Domestic building work over \$5000 also requires the builder and consumer to enter a major domestic building contract under the *Domestic Building Contracts Act 1995* (s3), which requires that the builder entering the contract be a registered builder (s29).

### **Insurance**

Domestic building contracts where the contract price for carrying out the domestic building work is more than \$12 000 require the builder to provide insurance (Domestic Building Insurance Ministerial Order, *Victorian Government Gazette* no. S98, Friday 23 May 2003).

### **Building permits**

Following the introduction of the Building (Interim) Regulations 2005 on 14 June 2005, there is no longer a cost threshold for the requirement to obtain a building permit. Exemptions from the requirement to obtain a building permit are now defined in terms of physical characteristics of the building and/or building work (schedule 8).

### **Building permit levies**

The *Building Act 1993* (s201) imposes building permit levies that are payable for applications for building permits where the cost of the building work exceeds \$10 000.

### **Owner-builders**

The Building Act (s25B) states that owner-builders must obtain a Certificate of Consent from the Building Practitioners Board to obtain a building permit to carry out domestic building work valued over \$12 000.

### **Lodgment fee**

The Building (Interim) Regulations 2005 (r321) state that a fee on lodgment of a building permit is payable where the cost of the building work is \$5000 or more.

Setting an appropriate threshold combination of competencies and size or type of building work is complicated. Relevant factors include the skills required for the job; the adverse consequences if a job is done by a person without the necessary skills; the extent to which consumers can assess practitioners' capabilities; the costs of the registration system; and consumers' willingness to

take on risk. While consumers' ability to assess practitioners and appetite for risk vary, it is not practical to have multiple thresholds. The current approach—requiring builders to be registered for all work valued above a specified monetary threshold (except restumping and demolition work, which must be undertaken by registered practitioners)—avoids universal registration coverage except for relatively high risk jobs.

Is \$5000 the appropriate level for the registration threshold for most work? This value has not changed since 1993, even though prices (as measured by the consumer price index or the index of building material prices) have since risen by about 30 per cent.<sup>7</sup> The threshold has thus fallen considerably in real terms. An increase to \$6500 would return the threshold to its original value in real terms.

A \$6500 threshold for registration would remain, however, below the thresholds above which the building permit levies are payable (\$10 000) and domestic builders warranty insurance becomes mandatory (\$12 000), but above the threshold requiring a major domestic building contract (\$5000) and payment of a lodgment fee (also \$5000) (box 6.4). It is not clear why the insurance and building practitioner registration thresholds need to be set at different levels, because the intent of both registration and insurance is to protect consumers.<sup>8</sup> The insurance threshold was previously set at \$5000 (chapter 7).

Setting all cost based thresholds at the same level would reduce the complexity of the regulatory arrangements. In the draft inquiry report, the Commission sought information on impediments to it recommending that all cost based regulatory thresholds be aligned, initially at \$12 000 in line with the current insurance (and owner–builder) thresholds, but with provision to increase this threshold over time in response to further information.<sup>9</sup>

In response to this request for information, Fagan and Fagan stated:

Raising the thresholds to a common alignment once more will assist in compliance and understanding by all stakeholders. ... Compliance with the registration provisions of the Building Act 1993 would, in all likelihood, be strengthened given the current low level of compliance with the \$5000 threshold for limited domestic builders. The higher threshold would potentially legitimise the operation of many practitioners who either through ignorance or indifference elect not to be registered. (sub. DR123, p. 9)

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<sup>7</sup> The consumer price index (for Melbourne) increased by 31 per cent between 1993 and 2004, while the index of materials used in house construction (for Melbourne) increased by 24 per cent over the same period (ABS 2005d, 2005g).

<sup>8</sup> Builders warranty insurance also provides protection against the cost of non-completion of a contract.

<sup>9</sup> This would leave the zero dollar threshold in place for reblockers, restumpers and demolishers.

Competition for work between registered and unregistered builders would seem strongest for small jobs. Raising the threshold would increase the number of builders who could bid for work, although, as Fagan and Fagan suggested, some unregistered builders may (illegally) be doing so already. Access to a larger number of builders could increase the choice available to consumers and reduce delays.

Consumer Affairs Victoria, on the other hand, argued that consumers would be less well protected if the thresholds were increased:

Consumers may be adversely affected by this proposal, particularly those who are renovating their existing homes where the costs are more likely to be less than \$12 000. Any consumer who engages a builder for works below \$12 000 under this model would have reduced consumer protection given current requirements that apply to major domestic building contracts (contracts exceeding \$5000) under the DBCA [Domestic Building Contracts Act]. There would be no requirement for a builder to be registered or enter into a major domestic building contract (for example, stage payments and specification of what must be contained in a contract).

Further, an increase in the registration threshold may lead to practices in the industry where a domestic building project is split into two or more projects each valued at less than \$12 000. This practice is known as contract splitting. Contract splitting to avoid registration is more difficult for higher value projects where the registration threshold is \$5000. (sub. DR166, p. 10)

The Commission accepts that consumer protection could fall if the thresholds for registration and major domestic building contracts were increased. However, the Domestic Building Contracts Act implies warranties for *all* domestic building work, covering, for example, that work is carried out in a proper and workmanlike manner, is done using suitable materials, complies with the Building Act and Regulations, and is completed by the date specified in the contract. Moreover, it limits the size of deposits and restricts cost plus contracts and cost escalation clauses. A major domestic building contract has additional safeguards for consumers, including that the builder be registered and must obtain information concerning foundations under certain circumstances. It specifies exclusions and inclusions and limits progress payments.

While consumer protection would fall somewhat if the threshold at which a major domestic contract were required were increased to \$12 000, it is not an ‘all or nothing’ situation. Moreover, consumers could be given a choice of entering a major domestic building contract for work below \$12 000 if the threshold were increased to that level. (Although it may be difficult to provide some safeguards—such as cooling off periods—in voluntary contracts.)

A further consideration is that the \$12 000 threshold for insurance indicates that the government accepts that consumers can be exposed to financial risk for non-completion or defective work up to this value. It is not clear why different values would be set for exposure to different types of risk. Moreover, the steps involved in stage payments under a major domestic building contract are set in percentage terms, and the absolute dollar value of the steps is often much higher than \$5000 or even \$12 000.

If the thresholds for major domestic building contracts and for practitioner registration were increased to \$12 000, unregistered builders could undertake projects below this value that require building permits. This would mean that builders who have not met the competency requirements of the Builders Practitioners Board would be able to undertake work that affects the structural soundness of a building, up to a value of \$12 000. This may not be a concern, given that the work would be subject to the building inspections required for building permits. If these inspections were considered to provide inadequate safeguards, then one solution would be to require registered builders to undertake work requiring a building permit. But this approach would reduce the scope for competition between registered and unregistered practitioners for some smaller jobs (although it would ensure qualified practitioners undertake these jobs).

On balance, the Commission considers that:

- a major domestic building contract should be required only for work valued above \$12 000, although consumers could choose to have a major domestic building contract for work valued below \$12 000
- the Building (Interim) Regulations should state that a builder engaged solely in domestic building work is not required to be registered if the cost of the work is \$12 000 or less and a building permit is not required.

Implementation of these proposals would mean that practitioners undertaking jobs not requiring building permits would need to be registered only if the value of the work exceeded \$12 000 (unless it involved reblocking, restumping or demolition work, which would continue to require a registered practitioner irrespective of the cost of the work).<sup>10</sup>

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<sup>10</sup> One consequence of the proposal (and of the current arrangement) is that a major domestic building contract may be required for work that does not require a building permit. Yet, the final payment under a major domestic contract has to be made only when the final inspection has occurred, even though no inspection occurs if a permit is not required. To correct this situation, the final payment should be contingent on a final inspection only when a building permit is required (see chapter 8).



This leaves two other thresholds: the thresholds above which the building permit levies and lodgment fees are payable. The former is set at \$10 000 and the latter at \$5000. Unlike the other thresholds, they appear to have been set at their current levels to influence the revenue raised more than to achieve regulatory outcomes.

Based on the current value of building work, increasing the threshold for the building permit levies to \$12 000 would reduce revenue raised from the levies by about \$48 000 per year.<sup>11</sup> This suggests that the benefits of uniformity could be achieved with little reduction in revenue. Moreland City Council (sub. DR158, p. 11) supported aligning the thresholds for practitioner registration, major domestic building contracts, payment of the building permit levies and builders warranty insurance, but suggested that the lodgment fee threshold should be reduced to zero. The Commission supports this view, given that the costs of lodging and processing building permits appear unrelated to the value of a permit, and that, on the Commission's current understanding, lodgment is only a byproduct of other requirements that have thresholds.

#### **Recommendation 6.2**

**That cost based thresholds be aligned for building practitioner registration, major domestic building contracts, the payment of the building permit levies, and owner-builders having to obtain a certificate of consent, initially at \$12 000 but with provision to increase over time in response to further information. The threshold for the payment of lodgment fees for building permits should be removed.**

#### **Continuing professional development**

The benefits of a well-trained workforce include higher productivity, improved workmanship and enhanced consumer protection. But should continuing professional development be compulsory for all registered building practitioners? The Building Commission recently introduced voluntary continuing professional development (CPD) for registered practitioners (box 6.5), to give the industry the opportunity to adjust and to resolve operational issues before a compulsory CPD program commences (BC 2002b, p. 9). Although the Victorian Government has

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<sup>11</sup> The building permit levies are equivalent to 0.16 per cent of the value of the building work. Based on 2004-05 data, increasing the threshold for payment from \$10 000 to \$12 000 would reduce the value of building work covered by approximately \$30 million, and hence levy payments by approximately \$48 000 (0.16 per cent of \$30 million). The reduction in levy payments will be lower if the June 2005 changes to building permit exemptions decrease the number of building permits issued in this value range.

yet to decide on compulsory CPD, the Building Commission reinforced the possible introduction of a compulsory program in recent CPD promotional material:

Participation in the CPD program is voluntary, at least for the time being. However, it is worth noting that compulsory CPD was introduced in [New South Wales] from 1 March 2004. There is a trend towards the introduction of compulsory CPD in many industry sectors across Australia, which is being driven by the demands of consumers and the insurance industry. (BC 2005b, p. 4)

### **Box 6.5 Arrangements for the continued professional development of registered building practitioners in Victoria**

Registered building practitioners are encouraged to earn a specified number of points a year (12 months from the commencement or renewal of registration):

- Builders, demolishers and erectors of temporary structures need to gain 12 points a year.
- Engineers, building surveyors, building inspectors, draftspersons and quantity surveyors need to gain 15 points a year.

They earn points by participating in activities (offered by providers approved and accredited by the Building Practitioners Board) that are categorised into two groups:

- (1) Group one involves 'structured' learning activities, such as structured on-the-job training, industry based education, short courses, university education, vocational education, information sessions, trade sessions and conferences.
- (2) Group two consists of 'interactive' learning activities, such as participation in meetings and discussion groups, subscription to trade and technical publications and the Building Code of Australia, membership of an industry association and professional institute, mentoring and private/individual studies.

One point is equivalent to an hour of activity, and only group one points can be carried over to the following year if excess points are accrued. Registered building practitioners can choose activities that suit their own professional development and business needs from group one and two activities. However, builders, demolishers and erectors of temporary structures need to accrue a minimum of nine points from group one activities, while engineers, surveyors, building inspectors, draftspersons and quantity surveyors need to accrue a minimum of 10 points from group one activities. Further, some activities are 'capped' to encourage practitioners to undertake a range of different learning activities. Proof of completion of each activity is required upon registration (or renewal of registration).

Source: BC 2005b.

The following are possible rationales for making CPD compulsory:

- It may provide a signal to consumers about builders' capabilities, which they might otherwise be unable to assess.
- Building practitioners may be unaware of the benefits of CPD.
- Employers may underinvest in training their employees, because they bear the cost of providing training for employees who may then leave for another job.
- It may help builders to keep up with changing technology, and safety and environmental developments and requirements.

These arguments are not, however, decisive:

- Making CPD compulsory may dampen market signals, because consumers would be less able to distinguish between builders on the basis of training they have undertaken (except to the extent that builders do more than the compulsory minimum).
- Information could be provided to builders about the benefits of CPD.
- The CPD requirement falls on registered practitioners, many of whom are self-employed with less capacity to undertake additional curriculum activities.
- Many of the benefits can be achieved through voluntary CPD.
- Training does not guarantee competence, and focusing on compulsory training may be less useful than ongoing assessment of the competence of registered practitioners.

The cost of introducing a compulsory CPD program has been estimated at \$5.2–5.9 million per annum<sup>12</sup> (The Allen Consulting Group 2004b, p. 37). Some inquiry participants (Builders Collective of Australia, sub. 38, p. 10; MR Construction, sub. 78; Colmac Homes, sub. 80) were concerned that the costs could fall disproportionately on small businesses, given that 99 per cent of businesses in the Victorian construction industry have fewer than 20 employees (BC undated A). The Builders Collective of Australia considered that:

This individual [smaller builder] is responsible and accountable for the day to day running of the job, often including the physical construction with their own hands. In addition, they [are] also responsible for managing accounts, sales, quoting and estimating, human resources, purchasing and general office management. Add to this the additional impost of accruing CPD points and the time burden for these builders is beyond what is reasonable. (sub. 38, p. 10)

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<sup>12</sup> The cost estimate includes: administration cost (\$200 000 per annum); direct cost to builders (\$1.9–2.8 million per annum); indirect cost to builders (approximately \$2.6 million per annum); and indirect cost to the community (\$0.3 million per annum) (The Allen Consulting Group 2004b, p. 37).

Other inquiry participants preferred to emphasise the benefits of CPD, including:

- improved knowledge and skills, whereby practitioners must keep up to date with the changes in their profession (City of Boroondara, sub. 66, p. 9; Vero Warranty, sub. 71, p. 11)
- maintaining skills in declining trades (The ArchiTeam Cooperative Ltd, sub. 39, p. 4).

A survey of architects by The Allen Consulting Group (2004b, p. 33) estimated a 3.7 per cent reduction in housing faults if domestic building practitioners undertook compulsory CPD.<sup>13</sup> This reduction equates to benefits of \$5.8 million per year in the first five years of introducing compulsory CPD, increasing to \$7.6 million per year in year five and rising to \$8.3 million per year after 10 years (The Allen Consulting Group 2004b, p. 38).<sup>14</sup> Considerable uncertainty is attached to these estimates, however, given that they are based on architects' judgment of both the percentage of housing faults caused by building practitioners and the extent to which the faults would be reduced if building practitioners undertook CPD. The Housing Industry Association considered that the net benefits of a reduction in faults per house are insignificant (for an average house cost of \$366 000 in Victoria, \$108 per house in the first five years, rising to \$155 per house in 10–20 years) (sub. 58, p. 19).

#### *The Commission's view*

CPD is likely to contribute to the productivity of the building industry. The arguments for making CPD compulsory are not convincing, however, and quantitative assessments of the costs and benefits are not compelling. Further, there are market drivers for CPD—such as insurance premium discounts—and a voluntary approach already exists. There are also other options for reducing the incidence of faults—for example, more rigorous inspections or performance monitoring (discussed later in this chapter). If the government decides that more CPD is needed, another option would be for the government or Building Commission to subsidise training courses. Reporting subsidies would make the costs of intervention transparent, rather than disguising them as would occur if CPD were made compulsory. It would also require the Building Commission to balance the costs and benefits of this form of intervention against other ways of improving building outcomes.

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<sup>13</sup> The Allen Consulting Group considered architects to be unbiased (with no direct interest in whether builders undertake CPD) and well placed to comment on builder competency and the cost of building faults.

<sup>14</sup> An implicit assumption in the analysis is that compulsory CPD reduces faults only in new houses.

### Recommendation 6.3

**That continuing professional development (CPD) not be made compulsory until rigorous cost–benefit analysis shows it is warranted. In the meantime, the Building Practitioners Board should facilitate voluntary CPD, including as a tool for marketing the skills of registered building practitioners to consumers.**

### Competency requirements for practitioners

In addition to proposing to extend coverage of the registration system to new trades, inquiry participants raised concerns about the extent to which competency requirements for some trades already requiring registration may contribute to labour shortages.

#### *Metal roofing*

Under current regulatory arrangements, persons must be registered or licensed by the Plumbing Industry Commission to install metal roofs (sheeting, gutters and drainage). In comparison, roof tilers are not required to be registered or licensed with the commission (although registered or licensed plumbers are required to perform work associated with gutters, flashings, downpipes and the like). Roof tilers are required to be registered with the Building Practitioners Board only where they are working directly for an owner (that is, they are a principal contractor). Inquiry participants noted that Victoria is the only state to require a full plumbing qualification to install metal roofing (sub. 23, appendix 1; sub. 46, p. 4).

Some inquiry participants, including the Residential Metal Roofing Industry Association of Victoria Limited (RMRIAV) (sub. 23), BlueScope Steel Limited (sub. 48), Bruce Harmer Homes (sub. 20) and the Master Builders Association of Victoria (sub. 88), identified the installation of metal roofing as an area experiencing skill shortages that lead to installation delays and higher costs. They considered that the requirement for installers to be qualified plumbers contributes to the shortages, particularly in regional areas where plumbers are in relatively short supply (transcript, 9 March 2005, pp. 197–8). Further, inquiry participants noted that only a small proportion of plumbers and plumbing apprentices choose to specialise in metal roofing (sub. 23, p. 4).

Several inquiry participants commented on the merits of a proposal to remove the regulatory requirement that only those with a full plumbing qualification can install metal roofing. They argued that removing this requirement would:

- facilitate an increase in the supply of building workers able to install metal roofing

- reduce costs and delays, particularly in regional Victoria (transcript, 9 March 2005, pp. 197–8)
- address inconsistencies in the regulatory treatment of different roofing types (sub. 23, p. 4; sub. DR151, p. 11)
- be consistent with previous reviews recommending that the licensing of metal roofing workers be discontinued (sub. 88, p. 10).

On the other hand, members of the plumbing industry—including the Plumbing Division of the Communications, Electrical and Plumbing Union (sub. DR125), the Master Plumbers and Mechanical Services Association of Australia (sub. DR159), Arrow (sub. DR116) and BMG Plumbing (sub. DR121)—argued against removing the requirement that only registered or licensed plumbers be able to install metal roofing. Their arguments included the following:

- **Evidence of a skills shortage is uncertain.** The Master Plumbers and Mechanical Services Association of Australia noted that ‘the plumbing metal roofing industry in Victoria has responded to the growth of Victoria’s large steel roofing market’ (sub. DR100, p. 10), while the Plumbing Industry Advisory Council noted that plumbing apprentice commencements in Victoria has increased in recent years (sub. DR132, p. 7).
- **Evidence of installation delays is uncertain.** Plumbers Choice stated that a number of Melbourne roofing companies indicated that delays in installing metal roofs are ‘generally less than a week’ (sub. DR105, p. 2), other inquiry participants suggested installation delays are more likely due to weather, framing issues and possibly scaffolding delays (sub. DR116, p. 3; sub. DR121, p. 2).
- **Reported cost differences are overstated.**
  - Plumbers Choice stated that the ‘cost of having a metal roof fitted includes the installation of valley gutters, box gutters and flashings, all are important parts of plumbers’ knowledge and skill level. On a tile roof the valleys, gutters and flashing are equally important and are currently done by plumbers but this is not mentioned by those that argue that a tile roof is cheaper’ (sub. DR105 p. 2).
  - An indicative cost comparison prepared by Construction and Planning Economics (sub. DR141) estimated it costs approximately \$2000 more to install a metal roof relative to an equivalent concrete tile roof, but found this cost difference is driven largely by metal roofs requiring more labour (at a slightly higher hourly rate) and, to a lesser extent, higher material prices. The Master Plumbers and Mechanical Services Association of Australia, on the other hand, provided a cost comparison that showed that the cost of a corrugated steel roof for a single storey house of approximately 213 square metres was \$2435 less than for a concrete tile roof. While there are substantially different estimates of the

costs of different types of roofs, the estimates do not indicate how much regulation adds to the cost of installing metal roofs.

- **There is already some flexibility within the system.**
  - The Plumbing Industry Commission can issue Restricted Roofing Class 10 registration to non-plumbers, which would allow the holder to install metal roof sheeting, gutters and drainage to class 10 buildings (non-habitable buildings, including private garages, carports and sheds) (sub. DR125, p. 5). This flexibility does not, however, extend beyond class 10 buildings.
  - People who have not completed a plumbing apprenticeship but have four years practical experience may obtain a provisional registration,<sup>15</sup> full registration or licence following successful completion of a practical skills test, competency based examination and theoretical examination respectively. In 2003-04, 73 non-apprentice candidates attempted a roofing practical skills test and 66 (90 per cent) were successful. A further 77 non-apprentice candidates attempted a roofing competency-based examination and 35 (45 per cent) were successful (PIC 2004a, p. 32).
  - Although licensed plumbers are ultimately responsible for the work, registered plumbers and apprentices are also able to install metal roofing (sub. DR125, p. 6).
- **Consumer protection would be compromised.** The protection of plumbing industry insurance warranties and Plumbing Industry Commission enforcement and sanctions would be removed if metal roof installation were extended to non-plumbing trades (sub. DR159, p. 3; sub. DR125, p. 6).
- **The ability to achieve environmental objectives would be compromised.** Inquiry participants argued that the introduction of 5 Star energy efficiency and other environmental sustainability initiatives is increasing the focus on recycling rainwater. Training in plumbing systems is necessary and reduced reliance on plumbing skills may limit the scope to exploit water conservation opportunities (transcript, 7 March 2005, pp. 144–8). The strength of this argument depends on the scope of the changes considered. If only the requirements for the installation of metal roof sheeting are removed, for instance, plumbers will have processes in place to address these issues with other trades where houses have tile roofs. It is not clear why metal roofs would, or should, be different.
- **Efficiencies in installing metal roofing would be compromised.** Inquiry participants argued there are efficiencies (and, consequently, cost savings) in

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<sup>15</sup> The Plumbing Industry Commission issues provision registration for 12 months in which time the holder is expected to obtain full registration.

the installation of metal roof sheeting, gutters and drainage that could be lost if requirements regarding the installation of metal roof sheeting (but not gutters and drainage) were relaxed (sub. DR125, p. 7).

Members of the metal roofing industry (including the Residential Metal Roofing Industry Association of Victoria, BlueScope Steel, Stoddart Victoria, the Australian Steel Institute and the Building Products Innovation Council) called for the introduction of a specific roof plumbing qualification (as offered in other jurisdictions) to address skill shortages. Inquiry participants commented that the Australian National Training Authority and key industry stakeholders developed and endorsed a specific roof plumbing qualification—Certificate III in Roof Plumbing (BCP 30303), as part of the new Plumbing and Services Training Package on 15 October 2003 (sub. 23, p. 5). They argued that the introduction of a specific roof plumbing qualification would:

- increase the supply of appropriately skilled labour and reduce installation delays and costs. They suggested that skill shortages and the resultant cost increases and delays are less in other jurisdictions that have a specific roofing qualification (sub. 23, p. 5; sub. 46, p. 4; sub. 21, p. 4; transcript, 9 March 2005, p. 195; sub. DR121, p. 1).
- provide a greater component of roofing-specific training (comparable with the current plumbing qualification) (sub. 23, p. 7)
- improve the quality of metal roofing installations and reduce demand for follow-up work (sub. 23, p. 5)
- support existing initiatives to promote the metal roof industry and thereby address issues with the industry's attractiveness (sub. 72, p. 3).<sup>16</sup>

In noting their support for the introduction of a specific roof plumbing apprenticeship, Arrow stated:

I have been in discussion with TAFE colleges (plumbing dept. heads) and they are in agreement that a more specific roofing plumbing apprenticeship of four years should be introduced. (sub. DR116, p. 3)

On the other hand, members of the plumbing industry commented that the building industry is cyclical and that a broader plumbing qualification provides greater flexibility to pursue other work opportunities when demand for metal roofing is subdued (transcript 7 March 2005, p. 89). The Plumbing Industry Advisory Council (sub. DR132, p. 8) also observed that 'the concept of increasing the supply of labour for metal roofing through training courses

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<sup>16</sup> Inquiry participants also suggested that a specific roof plumbing qualification may overcome the observed high attrition rate among metal roofing apprentices, which has been attributed to the need for apprentices to undertake training in other plumbing modules for which they do not get practical, on-the-job experience (sub. 23, p. 4).



focused strictly on roofing has been attempted in Victoria previously’, but noted that the training had to be abandoned, largely because ‘too many of the course participants were unhappy with the narrowness of the course content and their consequent job prospects’.

Inquiry participants have thus expressed differing views on the need for, and merits of, removing the current regulatory restrictions on metal roof installation. Current arrangements provide limited flexibility, including the scope for non-plumbers to obtain a restricted licence from the Plumbing Industry Commission to install roofs (and associated gutters and drainage) on class 10 buildings, and for persons who have not completed a plumbing apprenticeship (but who are able to demonstrate required skills and competencies) to obtain provisional and full registration and/or a plumbing licence. While the extent to which the current arrangements are leading to skill shortages in metal roofing is not clear, no evidence has been provided that the current arrangements are leading to better health, safety and consumer protection outcomes than is being achieved in other jurisdictions where roof installation is not restricted to licensed plumbers. This suggests that there would be merit in considering ways to provide additional flexibility without compromising health, safety and consumer protection outcomes.

Options include the following:

- (1) Remove restrictions on the installation of metal sheeting, gutters and drainage for all roof types (metal and tile) on domestic buildings (class 1 and class 10).
- (2) Allow any person to install metal sheeting, while plumbers continue to install gutters and drainage. This would be achieved by providing a narrower definition of plumbing (roofing (stormwater)) work in part 2 of the Plumbing Regulations 1998.
- (3) Introduce a roof plumbing qualification that is less costly to obtain, and permit any person with this qualification to install the entire roof for all roof types (metal or tile), including gutters and downpipes and the like. This less comprehensive qualification would be limited to roof installation (that is, it would not be linked to general plumbing qualifications) and would increase the pathways for demonstrating competence in roof installation. The Plumbing Industry Commission seems best placed to judge the adequacy of any new roof plumbing qualifications. Consultation with the Building Practitioners Board would help to ensure a wider building perspective informs these judgments.

The first option would remove licensing and registration requirements for roof installation. It would increase competition and the number of people able to install metal roofs, but could result in some roofs being installed by people

without the relevant competencies. Although safeguards would still exist under the *Fair Trading Act 1999* (Vic.) and Domestic Building Contracts Act, risks to consumer protection and the achievement of health and safety regulatory objectives under this option would need to be evaluated. The implications of this option for the water industry, whose assets connect to gutters and downpipes, would also need to be considered.

The second option would lead to a consistent regulatory approach to roofing types (metal and tile). This option would not preclude licensed or registered plumbers or people with provisional registration from undertaking complete metal roofing installation, but would allow other tradespeople to install metal sheeting. The extent to which this would reduce costs and delays will depend on factors such as the extent of current skill shortages and the existence of any synergies between installation of the sheeting and of valleys, gutters and down pipes, which would still be undertaken by licensed plumbers. If there are strong synergies, the increase in labour supply may be more limited as plumbers undertaking the entire roofing job may be able to outbid competitors offering separate provision of sheet installation and work reserved for plumbers. The costs and benefits of this option may also differ according to whether the change applied to only domestic buildings or all buildings (domestic and commercial).

The third option would create additional pathways into metal roofing as happens in New South Wales, Queensland, South Australia and the Northern Territory. It would not preclude registered or licensed plumbers from installing metal roofing but could increase the supply of skilled labour and assist in addressing future demand for metal roofing, while ensuring that suitably qualified people undertake the work. For this option to succeed, however, new training courses would need to be introduced and the evidence about whether this is feasible appears mixed. The Commission notes, however, that some industry participants support the development of such courses. Such courses will not, however, develop, if regulation precludes people with such a qualification from installing roofs.

The choice from the three options and the status quo will be influenced by their cost and contribution to consumer protection. A combination may be appropriate—for example, removing restrictions on who may install metal sheeting (as in option 2), while allowing people who can demonstrate sufficient competency from a new training course to undertake roof installation (as in option 3).

All options would appear to require changes to the Plumbing Regulations. The Regulations will sunset in 2008 and this will provide an opportunity for public scrutiny of the costs and benefits of these options in the regulatory impact statement that will then be required. However, delaying the review until 2008 would also delay securing any benefits from more flexible arrangements for three

years. The Regulations have been amended seven times since 1998, suggesting that it is common for changes to be made when needed.

The Commission's view is that the government should prepare draft regulations for inclusion in the Plumbing Regulations, which would involve narrower definitions of 'plumbing (roofing (stormwater))' work and more focussed and flexible competency requirements for aspects of this work that continue to require registration and licensing. As these regulations reduce the burden of regulation, an RIS would not need to be prepared. The government could, of course, choose to prepare an RIS if the proponents of restrictions on competition provided additional information that relaxing the current regulations would compromise health and safety; for example, compared with the outcomes achieved in other jurisdictions without Victorian-style restrictions.

Such a review should be guided by the principles that underpin the Competition Principles Agreement, namely that legislation should not restrict competition unless it can be shown that the benefits of the restriction to the community outweigh the costs and that the objectives of the legislation can be achieved only by restricting competition. That is, the onus should be on those seeking to retain restrictions on competition to demonstrate that removal would not be in the interests of the broader community.

#### **Finding 6.1**

The net benefit in continuing to restrict the installation of metal roofing to licensed plumbers is questionable. The present arrangements are inconsistent across different roofing types and disadvantage metal roofing in competing with other roofing types.

#### **Recommendation 6.4**

**That in order to create less restrictive pathways into the installation of metal roofing, the Victorian Government prepare draft Regulations for inclusion in the Plumbing Regulations 1998, which would more narrowly define 'plumbing (roofing (stormwater))' work and contain more focussed and flexible competency requirements for aspects of this work that continue to require registration and licensing. These draft Regulations could be subject to the regulatory impact statement process.**

### *Other trades*

The Housing Industry Association commented on observed skill shortages in the building industry, and stated that the narrow range of training options available and the requirement to commit to three or four years of training discouraged prospective entrants to the industry (sub. 58, pp. 28–9). It suggested that more people would be attracted to the industry if training were more relevant to their needs and the needs of their employers. It suggested, for example, that a person seeking a career as a paver should not be obliged to undertake a full bricklayer's apprenticeship (where much of the course would be irrelevant to paving work).

#### **Box 6.6 Review of building practitioner categories**

The review of building practitioner categories was initiated to 'ensure that practitioner registration categories and classes are consistent with the long term needs of the building industry and reflect both the requirement for practitioners to be appropriately skilled and changes in the industry environment, such as the recent development in professional insurance' (BC & BAC 2003, p. 1).

The Building Commission and the Building Advisory Committee released a discussion paper in September 2003, drawing on consultation with industry stakeholders. Issues considered were grouped into three categories: industry direction and refocus (reflecting a shift in industry focus towards issues such as practitioner competency, continuing professional development and insurance); amendments to existing categories for consideration; and new categories for consideration.

The Building Commission advised that potential projects were identified in the review. Seven are planned to be underway during 2005-06, with the remainder reserved for future consideration. Three (of the seven) projects have commenced:

- (1) key tradespersons' registration—that is, investigating whether the benefits of registering bricklayers, carpenters, concreters and plasterers would outweigh any associated costs
- (2) registration effectiveness measurement—that is, developing a framework to measure the effectiveness of Victoria's building practitioner registration system
- (3) practitioner attribution (energy and accessible design)—that is, investigating the feasibility of attributing energy rater/designer and accessible building designer competencies to existing registered practitioners.

Sources: BC & BAC 2003; BC (pers. comm., 15 June 2005).

### **Changes to building practitioner registration categories**

Altering the trades that are required to be registered changes the scope of the regulatory framework and its costs and benefits. The Building Commission and the Building Advisory Council are reviewing the categories of building practitioner registration (box 6.6). The discussion paper for this review states that consulted parties suggested increasing the scope of registration but not reducing it. Brickwork, carpentry and concreting (identified by the Building Commission

and Building Appeals Board as having high defect levels) were suggested additions. The Master Builders Association of Victoria (sub. 49) supported this proposal and the registration of plasterers, principally on the grounds of consumer protection and a predicted post-registration improvement in the quality of their work.

A decision to require a trade to be registered should be based on an analysis of the consequent costs and benefits. The costs include:

- the possible exclusion from the trade of people who may be capable of doing an adequate job but who are unwilling to pay the registration fee or acquire the relevant qualifications
- the cost of the registration and enforcement arrangements
- the additional costs faced by consumers (because registration fees are passed on to consumers, and registered practitioners may be able to charge higher prices because they face less competition), resulting in some jobs not being undertaken that otherwise would have been
- unnecessary demarcation inflexibilities, where a building practitioner in one category may be prevented from doing straightforward work in another.

The benefits may be found in a higher level of quality and lower levels of defects and disputes. Whether the benefits outweigh the costs is an empirical question.

In the draft inquiry report, the Commission noted that it is not convinced, on the limited evidence presented, that extending registration to brickwork, carpentry and concreting would be beneficial. While some of the work performed by these trades may be defective, consumers contracting through a registered builder have redress firstly through the builder, then through Building Advice and Conciliation Victoria (BACV) and, as a last resort (if the builder dies, disappears or becomes insolvent), through builders warranty insurance.<sup>17</sup> The registered builder has a strong incentive to ensure the tradespeople used are competent. Safeguards are also available under building contracts. The Commission does not, however, recommend precluding future changes to registration categories if circumstances change. Subjecting future changes to external scrutiny, however, would expose and quantify the costs and benefits of the type outlined above.

The Commission recommended in the draft inquiry report that changes to registration categories should be justified through an RIS. The Master Builders Association of Victoria supported the assessment of registration system changes against sound policy principles via an RIS (sub. DR151, p. 11).

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<sup>17</sup> Consumers contracting with any practitioner would have access to safeguards under the Fair Trading Act, the Domestic Building Contracts Act, and could seek redress through the practitioner or BACV.

The Department of Sustainability and Environment, however, advised the Commission that:

- proposed changes to the classes of practitioner that have to be registered are already subject to a regulatory impact statement before being included in the Building Regulations;
- the BC [Building Commission] has commenced an assessment (earlier this year) into the cost and benefits of registering bricklayers, carpenters, concreters and plasterers—consistent with standard practice of the BC, the assessment is being carried by independent consultants; and
- categories and classes of building practitioners are determined by the process outlined above for bricklayers, carpenters, concreters and plasterers and not by the Minister for Planning as stated in the draft report (page 136). (sub. DR172, p. 13)

The expansion of the regulatory framework that is being considered is extensive, and the Commission notes that proposed changes to registration categories are potentially subject to an RIS and that a cost–benefit evaluation is being prepared. This clearly warrants public scrutiny so an informed decision can be made.

### **Registration fees**

The Building Act requires that the appropriate fee accompany applications for registration. Registration fees increase the cost of setting up as a building practitioner but are also a key element of the cost recovery arrangements discussed in chapter 11.

### **Part time registration**

The average age of registered building practitioners (47 years) exceeds that for the construction industry as a whole (chapter 2), suggesting that part time work may become attractive to a growing proportion of the workforce. Many inquiry submissions mentioned skill shortages in the industry. This combination of an older workforce and emerging skill shortages suggests that the Victorian Government’s view that ‘State regulation, where possible, should encourage and not inhibit labour force participation’ (DTF 2004, p. 48) is particularly relevant to housing construction. If occupational regulation imposes a burden that is identical for part time and full time building practitioners, it may discourage some people from remaining in the workforce on a part time basis. Equally, other aspects of the regulatory framework may discourage participation by part time practitioners.

The Commission received little support for its draft recommendation that the Building Practitioners Board (or successor) develop a model for part time registration (based on building practitioners with a satisfactory registration history), to be discussed with insurers and builders’ representative associations. Lawrence Reddaway (sub. DR138, p. 2) agreed that the system should encourage

practitioners ‘to continue to contribute to the industry after they cease full time employment’ but considered ‘the difficulty for part timers ... is to obtain insurance at a premium that is realistic’ and called for ‘the insurance industry to provide an insurance scheme in which the premium is more closely related to the actual work undertaken’. He did not perceive the need for a part time registration system.

The Housing Industry Association supported additional flexibility in the registration system and identified the ‘requirement to obtain [builders] warranty insurance eligibility as a prerequisite to renewal of a domestic builder registration might act as an impediment against casual involvement in the industry’ (sub. DR163, p. 15). But the Master Builders Association of Victoria opposed the draft recommendation, observing that it would be costly to implement and monitor a part time registration system for little benefit, particularly given the challenges of defining part time work (sub. DR151, pp. 11–12). The Department of Sustainability and Environment pointed to the administrative difficulty of complying with part time registration, and noted that registration fees (\$90) do not appear to be a barrier to many practitioners working part-time (sub. DR172, p. 13). The Australian Institute of Building Surveyors also disagreed with the recommendation, claiming it would be likely to have an ‘adverse impact on ... determining proportionate liability under the Act’ (sub. DR130, p. 3).

The City of Melbourne responded that:

There are other occasions when the current registration categories fail to adequately address genuine circumstances where a non-builder proposes to do relatively minor works. It would be desirable to improve the current system to better cater for a variety of non-traditional practitioners. (sub. DR136, p. 7)

The Commission also spoke directly with five building practitioners to inform its understanding of potential regulatory barriers to part time employment. The practitioners identified four areas of interest: (1) builders warranty insurance; (2) occupational health and safety requirements; (3) Australian standards referenced in the Building Code of Australia; and (4) local planning laws.

#### *Builders warranty insurance*

Consistent with views expressed in some inquiry submissions, all practitioners identified builders warranty insurance as the most likely regulatory impediment to registered practitioners working part time, with upfront administrative costs likely to have a disproportionate impact on registered builders with a smaller turnover who work part time. Practitioners also felt the costs of restructuring asset holdings or taking out bank guarantees would impose additional burdens on those seeking to work part time.

Practitioners indicated that the statutory warranty period on building work could also be a barrier to part time work, with one practitioner noting that he would

not continue to work past retirement age in any capacity, given concerns about possible future litigation and the possibility that he would have to pay someone to rectify any defects that arose because he would no longer be physically capable.

Practitioners noted that insurers offer products featuring streamlined application processes that may be relevant to registered practitioners seeking to work part time, but some felt that the restrictions attached to these products may make them unattractive. Practitioners used to working on high value homes, for example, may not be satisfied with being restricted to work on lower value jobs.

#### *Other barriers*

Practitioners also pointed to the perceived high fixed compliance costs of regulation, which could impose a greater proportional burden on registered practitioners wanting to work part time. Examples included the costs of keeping abreast of the standards referenced in the Building Code of Australia, variations in local planning laws across local government areas, and current occupational health and safety requirements. One practitioner expressed concern about the increasing level of litigation in the industry and felt that part time practitioners would find it more difficult to offset the costs of any occupational health and safety claim made against them.

#### *The Commission's view*

The fixed costs of the regulatory system may impose a heavier proportionate burden on part time practitioners. No inquiry participant, however, specifically identified a need for a part time registration system. Some participants even considered that such a system would impose greater costs than any benefits it would deliver. In addition, the Commission notes that the industry provides opportunities for a practitioner to scale down activities by working as a subcontractor or tradesperson, without the need (for building practitioners) to maintain their registration.<sup>18</sup> While reducing regulatory complexity and compliance costs would benefit both part time and full time practitioners, it is not clear that a part time registration model is needed. However, given that builders warranty insurance may be an impediment to part time work, the Building Commission could encourage insurance providers to offer products that would assist practitioners seeking to scale down their involvement in the industry—for example, buying out their insurance liabilities.

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<sup>18</sup> The scope to undertake such work could increase if the threshold for practitioner registration were raised to \$12 000.



### **Finding 6.2**

The fixed costs of complying with regulation may impose a higher proportionate burden on part time builders. Reducing these costs could encourage more participation by part time builders, but there is no evidence of a need for a part time registration model.

### **Recommendation 6.5**

**That the Building Commission continue to monitor the impact of regulation on the incentives for part time work by building practitioners. The commission should also encourage insurance providers to offer products that account for some practitioners' desire to reduce their hours of work before retirement.**

### **Registration of companies**

Corporate or unincorporated bodies such as companies, businesses and partnerships are not required to register as practitioners; the Building Act requires that only natural persons be registered as building practitioners. Section 176 of the Building Act, however, allows a partnership or corporation to use the title of building practitioner if at least one director or partner is a registered building practitioner in that category. This provision has the effect of company registration.

The National Competition Policy review of architects and building legislation (Freehills Regulatory Group 1999) proposed that companies and partnerships be subject to registration requirements. The current registration category review is considering this proposal (BC & BAC 2003). The Business Licensing Authority proposed the registration of companies, using the example of the registration arrangements for real estate agents, which allows both individual and corporate registration (sub. 61, p. 3). The Plumbing Industry Advisory Council indicated that the registration of plumbing contractors would lead to 'better informed plumbing businesses; better consumer services and protection; better communication with the whole industry' (sub. DR132, p. 13).

While company registration would have benefits, it would not be without costs. These costs, in turn, would depend on how it were implemented—for example, whether it is voluntary or compulsory and whether screening processes, ownership requirements or requirements about how registered companies are structured could reduce competition and the efficiency with which companies are managed.

The Victorian Competition and Efficiency Commission considers that the Building Commission and Building Advisory Council review of practitioner registration categories should explore options for company registration, but pay particular attention to its impacts on competition and consumer protection. Any proposal would require changes to legislation and regulation and should be exposed to public scrutiny.

### **Owner–builder regulation**

In the second reading speech for the *Building (Amendment) Act 2004* (Vic.), the minister noted that the Act’s purpose is ‘to prevent speculative builders avoiding insurance and registration requirements by falsely claiming to be owner–builders’ and ‘to enable a home owner to make more fully informed decisions about carrying out domestic building work as an owner–builder’ (Delahunty 2004, p. 1849).

The government was concerned that unregistered builders have been operating as de facto owner–builders. Avoiding registration allows these builders to avoid the scrutiny of their competence, which is part of the registration process. The Act provides for an owner–builder to be issued in any three-year period with only one certificate of consent for carrying out domestic building work. Exceptions include work valued at less than \$12 000 and subsequent work on a dwelling for which the owner–builder had previously obtained a consent. Prior to being issued with a certificate of consent, owner–builders must provide a statutory declaration that they have read an information statement about the costs and benefits of becoming an owner–builder. The amendment also prevents owner–builders from developing multiple dwelling projects.

The Commission supports requiring owner–builders to be more aware of the implications of being an owner–builder.<sup>19</sup> It will be useful to demonstrate that the restrictions placed on owner–builder activity are yielding the expected net benefits, especially given the high proportion of work undertaken by owner–builders (chapter 2). The Commission proposed in the draft inquiry report that the Building Commission monitor and report publicly on the impacts of the new owner–builder requirements and that the government use this information to

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<sup>19</sup> From the owner’s perspective, becoming an owner–builder has significant consequences, including:

- higher premiums for building inspections (with guidelines issued by the Australian Institute of Building Surveyors suggesting a premium of 25 per cent for inspections involving an owner–builder)
- the absence of builders warranty insurance, even where an owner–builder subsequently engages a registered builder
- reduced ability to access the dispute settlement procedures of Building Advice and Conciliation Victoria (although they may still be used if disputes arise about faulty workmanship on the part of registered practitioners contracted by the owner–builder for amounts more than \$5000).

review the owner–builder provisions of the Act in two to three years, considering non-regulatory alternatives to the present arrangements.

The review could consider alternatives to the present approaches, including:

- requiring vendors to disclose in the contract of sale that building work has been carried out by an owner–builder, to increase the awareness of consumers who purchase an owner–builder property after the insurance period has expired
- requiring owner–builders to attend a relevant course, similar to requirements in New South Wales and Queensland
- more vigorously enforcing the current law. The Building Commission and Consumer Affairs Victoria already have the power to prosecute unregistered builders performing work in excess of \$5000 for owner–builders, although few prosecutions are launched (sub. 84, p. 78; sub. 91, p. 19).

The Master Builders Association of Victoria supported the recommendation and suggested that:

... the Building Commission needs to vigorously enforce, through random audits, the owner builder legislation. In light of the VCEC’s theme of greater accountability for regulators and government agencies responsible for the housing sector, MBAV proposes that the Building Practitioners Board ... be given extra funds and powers to investigate unregistered practitioners. (sub. DR151, p. 12)

The Australian Institute of Building Surveyors (sub. DR130, p. 3) and the Housing Industry Association (sub. DR163, p. 15) also supported the recommendation. Consumer Affairs Victoria too supported the proposal, after ‘an appropriate period of operation’, and suggested the review could examine whether legitimate owner–builders are being constrained by legally technical requirements (sub. DR166, p. 11).

The Department of Sustainability and Environment indicated that the impacts of the owner–builder Regulations will continue to be monitored and assessed against the requirements of s196 of the Building Act (which sets out the Building Commission’s functions). Subject to ministerial agreement, the Building Commission intends to report on the impact of the new owner–builder regulations in its annual report. The department noted that the three alternative approaches proposed by the Victorian Competition and Efficiency Commission in the draft inquiry report were considered in the consultation process leading to the new arrangements. In particular, the department’s submission noted that: the *Sale of Land Act 1962* (Vic.) requires vendors to provide purchasers with owner–builder (and other) building permits issued over the previous 10 years; compulsory owner–builder training courses were not pursued, given the potentially onerous burden they could impose and the adverse implications for

housing affordability; and a ‘major trigger for enforcement’ was effectively removed as a result of the recent *Bird v. Barber* court ruling (sub. DR172, pp. 13–14).

The Building Regulations Advisory Committee stated:

BRAC supports the ongoing review of all regulations and currently uses its broad membership to monitor the implementation of the regulations and obtain an early indication of issues as they emerge. Why the owner–builder regulation was specifically identified in the draft report is not clear. There should be a consistent approach to the review of building regulations, regardless of the particular topic. (sub. DR142, p. 8)

The City of Melbourne also commented that it was ‘not apparent why this legislation should be dealt with in a different manner to any other legislation’ (sub. DR136, pp. 7–8).

While inquiry participants had mixed views about the draft recommendation, given the importance of the new owner–builder regulation, the Commission continues to consider that a timely review is appropriate. Monitoring the new regulation could be used as a model for monitoring and assessment under s196 of the Building Act and thereby inform the Act’s review in due course.

#### **Recommendation 6.6**

**That the Building Commission monitor and report publicly by July 2007 on the impacts of the new owner–builder requirements introduced by the *Building (Amendment) Act 2004*, and that the Victorian Government use this information to review the new requirements. This review should consider non-regulatory alternatives to the present arrangements.**

#### **Other unregistered builders**

Consumer Affairs Victoria suggested in its initial inquiry submission that:

The low level of registration among builders and of builders warranty insurance cover are matters of concern. The current building regulatory regime does not seek to control the activity of unregistered building practitioners. Only just over half of Victoria’s builders hold registration and only a small percentage of subcontractors are registered. As a consequence of low levels of registration, there are significant question marks over the regime’s overall effectiveness in this regard. (sub. 91, p. v)

In its submission in response to the draft inquiry report, Consumer Affairs Victoria supported its initial submission, pointing out that:

- there are 10 757 registered domestic builders and 19 560 building practitioners in an industry that employs 175 800 workers as a whole
- total dwelling commencements have stayed at a high level since the peak in 1999-2000, while the number of registered practitioners has fallen
- a significant number of building practitioners who have been prosecuted are unregistered. (sub. DR166, pp. 11–12)

The Building Practitioners Board commented that:

The board is concerned about the number of unregistered practitioners carrying out work that requires registration. Many such operators hide behind the current owner–builder provisions thus putting consumers at risk. To this end, the board supports an increase in the volume of random audits amongst industry operators, in an attempt to identify and prosecute illegal operators. (sub. 26, p. 7)

While the data are not conclusive, an appreciable number of practitioners are unregistered:

- As noted, unregistered builders may be operating as owner–builders, which the recent Building (Amendment) Act is intended to address.
- Builders are not required to be registered if they work exclusively on jobs that are exempt from a requirement to have building permits, such as sheds and fences and on jobs whose cost is below \$5000.
- Tradespeople who carry out work under the supervision of a building practitioner do not have to be registered; however, the building practitioner must be registered and is responsible for all those working on the building site.

The registration system is not intended to cover all practitioners. Rather, it attempts to register a sufficient number of practitioners to provide consumer protection in all building work where it is deemed that regulation is required. This approach (or one based on universal registration) is not immune from evasion. Notwithstanding the number of unregistered builders, this does not indicate a breakdown of the system. As Consumer Affairs Victoria pointed out, ‘there is little empirical evidence as to the overall effect on building quality due to builders “dropping out” of the registration system or whether there would be a net economic benefit from taking steps to return them to the regulated part of the market’ (sub. 91, p. 30). The incidence of unregistered practitioners illegally undertaking building work could fall if the registration threshold were increased, as proposed above. Providing more information to consumers about the benefits of employing registered building practitioners could also help to contain the risks.

While it is difficult to estimate the number of unregistered builders operating illegally, the Building Practitioners Board suggested that one way is to gather

information through an audit program. An indicator of the extent of problems related to illegal activity is the number of complaints about defective work by unregistered builders. The way in which regulators address these complaints can have a large impact on the overall effectiveness of the regulatory framework.

## **6.4 Monitoring and enforcement**

To be effective, the building permit and registration systems must be enforced. This means ensuring those who should be regulated are being regulated and those who are regulated comply with Regulations. Enforcement involves costs, however, and if efficiency is a concern, the level of enforcement (and the consequent costs) should be no greater than the benefits.<sup>20</sup> A targeted, risk based approach may achieve a higher return from the ‘enforcement dollar’ than would less targeted strategies. Such an approach is likely to involve:

- the collection of information about compliance with regulation and the consequences of non-compliance
- an assessment of the emerging risks and the costs of addressing them
- a monitoring and enforcement program that is based largely on these risks, so the burden of enforcement falls most on high risk businesses but also contains a random check
- early warning before enforcement activity (to allow businesses to correct problems before going to court), to cut the administrative burden
- the use of any lessons learned from the enforcement process.<sup>21</sup>

Efficiency is not the only consideration in enforcement. Equally important are justice, respect for the rule of law, and safety and environmental considerations.

### **6.4.1 Monitoring and enforcing building permits**

The issuing of building permits and subsequent inspection of the building work are the process through which compliance with building standards is monitored and enforced. Chapter 5 noted that the evidence presented to the Commission suggests that the building surveyor/permit process is working well. Nevertheless, inquiry participants raised four issues that could influence the effectiveness of the building permit process:

- (1) the role of building inspections
- (2) a possible conflict of interest for building surveyors

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<sup>20</sup> Beston, for example, pointed out the costs of complying with the Plumbing Industry Commission audits (sub. 7, p. 1).

<sup>21</sup> Some of these components are drawn from Hampton (2005).

- (3) the role of councils in enforcing building permits
- (4) the auditing of building surveyors.

### **Clarifying the role of inspections**

The minimum standards of a building permit are checked through inspections and are a pivotal part of the enforcement framework. Consumer Affairs Victoria pointed out that the importance of inspections is increased by the number of subcontractors (who may not be registered practitioners) employed to fulfil the obligations of the permit (sub. 91, p. 33). The Commission found, however, that there is misunderstanding about the role of inspections because some consumers interpret inspections as a way of ensuring the quality of building work. The Royal Australian Institute of Architects and Archicentre Limited submission stated that:

... the public perceived that council inspections by building surveyors should be and were comprehensive enough to pick up poor workmanship and defective construction. (sub. 40, p. 8)

Consumer Affairs Victoria made a similar point:

Consumers may falsely believe that inspections by building surveyors against the minimum standards of the *Building Act 1993* are also an inspection of work specified in the contract. Improved consumer awareness of processes under the *Building Act 1993* may assist in reducing disputes. (sub. 91, p. 35)

Building quality, in terms of workmanship and building defects, is a contract matter between the consumer and the builder. Consumers need to be well informed to best protect their interests. If consumers mistakenly believe that building inspections indicate compliance with the building contract, regulation requiring inspections may discourage them from monitoring builders and building surveyors in their own best interests. Regulatory interventions can thus be 'lighter' where consumers understand their role.

The Building Commission recognises this issue and has posted a useful consumer guide on its website (BC 2005a) explaining the role of the building surveyor and inspections. There is scope, however, to provide further information. To increase consumer understanding, the guide could stress that the inspections do *not* assess compliance with the building contract. The Building Commission already provides equivalent information on occupancy permits, stating what they do, and do not, represent (BC 2003e, p. 3).

A number of inquiry participants supported the provision of information to consumers on the role of the inspection process and the occupancy permit (or the certificate of final inspection). The Australian Institute of Building Surveyors supported the recommendation, noting that 'the building inspector and building surveyor are too often joined into disputes and claims pursuant to the DBC

[Domestic Building Contracts] Act for matters relating to quality, workmanship and the like, for which ultimately they have no jurisdiction or responsibility' (sub. DR130, p. 3).

Several inquiry participants commented that consumers need to receive such information early in the building process—before the permit stage, when the Building Commission currently writes to consumers granted a building permit—and suggested how this could be achieved. Building Ethics Australia suggested that architects, building designers, draftspersons and other consultants involved early in the process could provide consumers with information on the role of building surveyors (sub. DR144, p. 5). Lawrence Reddaway suggested that a system of 'officially compulsory advice', by which the building surveyor would be compelled to discuss a range of building issues with consumers before issuing a building permit, would be preferable (sub. DR138, p. 2). Consumer Affairs Victoria also suggested that building surveyors should provide consumers with a clear statement about the scope of inspections (sub. DR166, p. 13). The Building Appeals Board supported initiatives to improve the provision of consumer information but argued that it must involve all registered practitioners and not just the building surveyor (sub. DR128, p. 10).

### **Finding 6.3**

Information on the role of the inspection process, building surveyors and the occupancy permit or certificate of final inspection—that is, what they are intended to achieve and *not* intended to achieve—would help consumers to make informed decisions when undertaking a building project.

### **Addressing conflicts of interest**

While there is some confusion about the role of inspections, there may also be some confusion about the role of building surveyors. The Commission asked in its issues paper (VCEC 2004) whether private surveyors face a conflict of interest, because they are required to represent the interests of the owner but generally depend on the builder for their engagement. About two thirds of builders have all their work in any year assessed by one building surveyor—a pattern that has remained relatively unchanged over the past five years (BC 2004d, p. 11). Some industry views about this issue were noted in section 5.2. In addition, Consumer Affairs Victoria noted:

... a perception of an apparent lack of independence of building surveyors providing certification against minimum building standards. The applicant for the building permit, usually the consumer, has responsibility for appointing a building surveyor. However, in many cases, builders select a surveyor who they have a pre-existing commercial relationship with. This has the potential to compromise the independence of the building surveyor. (sub. 91, p. 33)



The Department of Sustainability and Environment noted that the Building Act prohibits private building surveyors from undertaking building permit functions where they have a pecuniary interest in the designer or person undertaking the building work. The Act also prohibits a building surveyor issuing a permit where the work does not comply (sub. 84, p. 55). The department suggested that the Building Commission consider developing guidance documents and practice notes for private building surveyors to provide further information on the matter (sub. 84, p. 55).

Options to address this issue include:

- requiring the owner (and not the owner's representative, who is typically the builder) to select the building surveyor. The Australian Institute of Building Surveyors recommended legislative change to this effect (sub. 41, p. 7). Boroondara Council recommended that:
  - ... the only party that can appoint a building surveyor should be the owner (not agent on behalf of owners), and that standard appointment documents, to be detailed in the Building Regulations, be used so that the scope of work that the building surveyor has been appointed for is clearly spelt out. (sub. 66, p. 3)
- allowing the building regulator to appoint the building surveyor
- requiring random selection of a building surveyor from a pool of accredited surveyors
- returning some or all building surveying to councils
- making the owner's choice of building surveyor dependent on their acknowledgment that they understand the building surveyor's role and responsibilities.

While a conflict of interest might exist, evidence presented to the Commission has not identified a significant problem in practice, suggesting that any change should be relatively small. The Commission favours more information being provided to consumers about the role of inspections and building surveyors. The Department of Sustainability and Environment pointed out that it already provides educational material that is available on request, and that it is too late to provide information once it is notified about a building permit because by that time the building surveyor has already been appointed (sub. DR172, p. 14). Building Ethics made a similar point, noting that information needs to be available to consumers from councils, architects, draftspersons and other practitioners engaged early in the building process (sub. DR114, p. 5).

Increased consumer understanding of the roles of building surveyors and inspections would make consumers aware that it is their responsibility to ensure compliance with the building contract. Consumers will also be in a better position to assess whether the building surveyor is fulfilling his or her

responsibilities. They should be made aware too that they have the option of choosing a different building surveyor from that proposed by a builder. The Building Commission should provide the means to facilitate this choice—for example, through listings of the names of building surveyors on its website. It already provides a guide explaining the role of the building surveyor to councils and could make this available more widely.

#### **Recommendation 6.7**

**That the Building Commission coordinate the provision of information about the role of the inspection process, the occupancy permit (or certificate of final inspection), building surveyors and other key building practitioners—what they are intended to achieve and *not* intended to achieve—to applicants for building permits through councils, architects, building designers, draftspersons and other practitioners involved early in the building process. This information could be reiterated in a letter from the Building Commission to consumers granted a building permit.**

#### **Council enforcement responsibilities**

Although the Building Act requires the building surveyor to ensure compliance with a building permit, a council is responsible under s212 of the Act for administering and enforcing parts of the Act:

Local government plays a very significant role in building control. The building services provided through local government protect the community from major risks to life and property. The importance of a council's role in ensuring a safe building system in its municipality cannot be overstated. (BC 2004c, p. 5)

Within seven days of issuing a permit, private building surveyors are required to give the relevant council a copy of the permit and any other documents lodged with the permit application (Building Act, s30). Municipal building surveyors file this information. They can intervene on any project in the municipality, even if a private building surveyor is appointed for that project (BC 2005a, p. 11). The Municipal Association of Victoria commented that one disadvantage of private certification for local government is that the 'responsibility that sometimes falls on councils to address matters on development that have been approved by a private surveyor' (sub. 64, p. 3). It noted that the Victorian Municipal Building Surveyors group has prepared the 'municipal building control intervention filter criteria guideline' to assist councils to determine when they may need to intervene in building work where a property owner has appointed a private building surveyor.

Councils, therefore, have both the information about what private building surveyors have done and an incentive to monitor their performance, sharpened

perhaps by the fact that private surveyors have largely taken over a role previously performed by local government. Consequently, councils are a potentially important check on the performance of building surveyors.

### **Auditing building surveyors**

Notwithstanding the role of local government and better informed consumers in monitoring the performance of building surveyors, further performance monitoring may be justified given the pivotal role of building surveyors in administering building permits. Auditing is one way to encourage the maintenance of professional standards. The Productivity Commission observed that audit requirements for surveyors differ across jurisdictions, noting that the Australian Capital Territory audits building surveyors on a targeted basis, depending on their past performance and demonstrated capacity. New South Wales also intends to revise its accreditation and investigation procedures for private and municipal building surveyors (PC 2004c, p. 205). In Victoria, the Building Commission's compliance strategy combines response work (for example, investigations), educative work (for example, audits) and dispute intervention (for example, inspections). Matters discovered through audit or inspection may trigger an investigation. The Compliance and Conciliation Division is responsible for the Building Commission's audit and investigations functions (BC, pers. comm., 21 June 2005).

The Building Commission combines random audits with targeted investigations. For the past seven years, it has audited municipal building surveyors' files, which contain information on building permits issued by private building surveyors. The scale of the program has varied and the business plan specifies a minimum of 16 municipal audits in 2004-05 and 2005-06. Each regional office selects three municipal councils annually, with the balance selected by the Melbourne office. Each audit involves analysing a minimum of 30 files, as well as interviewing the municipal building surveyor. Because private building surveyors lodge their permit applications and related documents with a municipal building surveyor, each audit covers a large number of private building surveyors.

The Building Commission also undertakes 'hot spot' or 'special efforts' audits, focused on areas where a particular aspect may require special attention. In 2004-05, alpine areas and coastal regions (appropriate use of sheds) were audited. A minimum of four audit programs was scheduled for that year. Councils also notify the Building Commission if they have concerns about particular building surveyors. This information could lead the Building Commission to investigate particular surveyors.

## 6.4.2 Monitoring and enforcement of practitioner registration

The Australian Institute of Building Surveyors (Victorian chapter) suggested that:

It is understood that the auditing of practitioners for quality and workmanship is very limited. This process should be considered as part of the review of the DBC [Domestic Building Contracts] Act. (sub. 41, p. 10)

The Royal Australian Institute of Architects and Archicentre Limited also considered that the auditing of workmanship quality is inadequate. They suggested increasing the number and comprehensiveness of building inspections (sub. 40, p. 9). The Builders Collective suggested rigorous monitoring of builders:

We propose that either a builder or a consumer can make a complaint to the board which would then trigger an inspection to clarify the complaint on-site within 14 days. The board would direct the owner and/or builder accordingly, depending on the nature of the problem. The decision adjudicated is to be binding however can be appealed to the courts upon payment of a fee to be determined by the [relevant authority]. In order to limit the frivolous and troublemaking, we would also propose to limit appeals to claims above, for example \$10 000. (sub. 92, p. 17)

It also argued for sanctions on builders (and consumers) who ignore decisions:

If no appeal is mounted and the builder is directed to rectify the problem but neglects to do so within the time frame given, then the builder could be immediately suspended for a period of say 60 days ... Such a penalty may deem the builder unable to register any new projects for that period unless the issues are dealt with or the costs reimbursed back to the board. That is, the board at their discretion can have the issues resolved and then pursue the builder for reimbursement. At that stage, and if still refusing to compensate the board, the builder could also be deregistered for a period of three years before being able to reapply for entry into the industry. (sub. 92, p. 18)

The Auditor-General Victoria's 2000 report alerted the Commission to the potential significance of auditing of building practitioners. This report concluded that the Building Commission had adopted a 'minimalist approach' to performance audits, involving short paperwork reviews focused on compliance with the administrative requirement of the Building Act, with no provision for inspections of building work. The Auditor-General considered that this 'minimalist approach' did not satisfy the legislative intention for performance audits to:

... examine work carried out by registered building practitioners to ensure that the work has been competently carried out and does not pose any risk of injury or damage to any person ... (Auditor-General Victoria 2000, p. 55)

Another conclusion reached by the Auditor-General was that the Building Commission had allocated insufficient resources to the Building Practitioners Board to fulfil its legislative responsibility for monitoring practitioners' conduct and ability to practise (Auditor-General Victoria 2000, p. 61).

The Commission was also aware of an apparent contrast between the auditing effort of the Building Commission, the Plumbing Industry Commission and the Office of the Chief Electrical Inspector:

- The Office of the Chief Electrical Inspector reported that 500 000 jobs were certified during 2003-04, with specialist inspection companies undertaking 39 000 audits (OCEI 2004, p. 11).
- The Plumbing Industry Commission certified 283 000 jobs and audited 15 730 during 2003-04 (PIC 2004a, p. 26). (Not all these audits related to housing.)
- The Building Commission conducted 102 office based audits of domestic builders in 2003-04. One third of these audits were followed by one or more site inspections. While the audit program found matters needing builders' attention, it reported that none was of significant concern (BC 2004a, p. 24).

Given this contrasting experience and the comments by the Auditor-General, the Commission's issues paper questioned whether the level of enforcement activity is appropriate. In its submission to the inquiry, the Building Commission responded that:

... three indicators of the optimum level of regulation and enforcement are:

- the rate of preventable death, injury and property loss resulting from domestic building fires
- the rate at which young children suffer a drowning death or injury in private swimming pools
- the rate of complaints to the Building Commission about practitioner conduct. (sub. 84, p. 61)

It commented that:

- the Metropolitan Fire Brigades Board reported three preventable deaths in domestic fire incidents in 2003-04
- Kidsafe reported that no children aged under five years old died as a result of immersion incidents in private outdoor swimming pools in Victoria in 2003-04
- the number of complaints about professional conduct and related enforcement activity is small compared with the number of permits issued.

The Plumbing Industry Commission gave a more complete description of its audit strategy in its response to the issues paper (box 6.7).

## Box 6.7 **Plumbing Industry Commission enforcement strategy**

The Plumbing Industry Commission (PIC) described its enforcement strategy as follows:

The proactive driver is the audits and inspections system. The reactive driver is the PIC receipt of enquiries, complaints and other notifications concerning the work carried out by plumbers and unregistered persons.

The PIC spent about 20 per cent of its operating budget on its outsourced contracts to perform audits and inspections. Additionally, about 30 per cent of its 56 staff are allocated to the investigations section, with a salaries and related expenses cost of about \$1.15 million. The PIC further incurs enforcement related expenses across most of its other functions such as legal, consumer information, advertising, travel and phone costs. Overall, the PIC estimates that at least half its yearly operating expenditure is aimed at enforcement.

### **Audits and inspections**

The audit and inspection system for compliance certificates and underground sanitary drainage work is the centrepiece of plumbing industry enforcement. In the 2003-04 financial year the PIC carried out 15 730 audits of compliance certificates and 2859 inspections of underground sanitary drainage projects.

The PIC then chooses a random sample of the lodged certificates for an audit. The number of audits must be no less than 5 per cent of the number of lodged certificates. The sample size was 5.5 per cent in 2003-04. Plumbers are required to book an inspection time for all underground sanitary drainage jobs. The PIC again chooses a random sample for an inspection—6 per cent of the booked drainage jobs were inspected in 2003-04. Plumbers are able to book an inspection time through an automated system 24 hours a day seven days a week.

Plumbers face substantial penalties if a compliance certificate is not lodged when required and the PIC reinforces the legal requirement through:

- distributing information aimed at maximising consumer awareness of their right to be given a compliance certificate for all substantial plumbing jobs
- ongoing communication to plumbers through PIC publications and other channels concerning this strict requirement, including maximising publicity about prosecutions in cases of non-compliance
- education and testing of knowledge about this requirement in plumbing industry training and accreditation systems.

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## Box 6.7 **Plumbing Industry Commission enforcement strategy (continued)**

Part of the PIC enforcement strategy is to set high standards for the audits and inspections; even minor technical departures from the mandatory standards are classified as an audit 'failure'. The PIC has adopted this strategy to maximise the impact of the audits for plumbers.

While 18 589 audits and inspections is a major enforcement activity, this figure is still only 6.5 per cent of the plumbing jobs requiring a compliance certificate, and probably less than 4 per cent of the total number of jobs carried out by plumbers each year. The PIC seeks to gain the maximum education and compliance impact from this comparatively small proportion of audits and inspections by requiring plumbers to meet all mandated standards when they experience an audit or inspection.

To the knowledge of the PIC, there is no evidence of significant non-compliance with the compliance certificate audit or drainage inspection regulatory requirements.

### **Complaints and disputes**

... the investigation section duty officers received 7603 telephone calls from consumers making enquiries or complaints about plumbing work in 2003-04. An overview of the process after receiving an enquiry or complaint is provided below. ... the PIC issues notices and orders to plumbers, holds disciplinary hearings and prosecutes plumbers in the Magistrates' Court. In 2003-04, there were 14 disciplinary hearings, 28 prosecutions and 56 notices and orders were issued.

Source: DSE, sub. 84, pp. 76-8.

The Commission could not find a similar published explanation of the Building Commission's enforcement strategy. Subsequent discussions with Building Commission staff suggested that:

- it is not reasonable to compare the apparently low audit rate for building practitioners with the rates for electricians and plumbers because registered building practitioners face a 100 per cent inspection rate (through building surveyors' inspections), whereas electricians and plumbers self-certify their work
- the Building Commission has a risk based audit strategy. It audits a minimum of 30 files selected from each of the 16 local government councils audited annually. These files cover building permits issued by private and municipal building surveyors.
- the Building Commission receives information about practitioners' performance from councils, directly from members of the public and also from complaints made directly to it or via Building Advice and Conciliation Victoria. This information is then used to inform decisions about whether particular complaints should be investigated or audits should be undertaken (possibly on a random basis) where information has revealed an issue. A new team was formed in 2004 to receive complaints and provide customer

service to complainants and respondents. (Chapter 8 recommends that the Building Commission and Consumer Affairs Victoria should formalise an agreement to ensure that complaints data is shared and used effectively.)

- an annual program, where candidates are selected randomly from recently issued building permits, is in place to audit domestic builders.<sup>22</sup> In 2004-05, the program delivered audits of 142 domestic builders, with inspections of 108 of those builders' sites. The 2005-06 audit program is for 150 domestic builders, with inspections of 150 of those builders' sites. About 70 per cent are from the Melbourne metropolitan area.
- individual audits are conducted, based on information provided to the Building Commission concerning a practitioner. Inquiries are undertaken when the commission believes there is a strong probability that the case will be proven (table 6.2). In the last three years, the proportion of registered practitioners reprimanded has been between 0.1 per cent and 0.2 per cent each year, and the proportion whose registration has been cancelled is negligible, although the number increased to 15 in 2004-05.
- the allocation of resources to enforcement is determined in the Building Commission's annual planning process, but not reported publicly.

**Table 6.2 Building Practitioner Board inquiries, 2003-04**

	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>	<i>2004-05</i>
<b>Total inquiries held</b>	<b>24</b>	<b>26</b>	<b>42</b>	<b>76</b>
Case proven / found guilty	24	26	42	76
Reprimand	19	16	34	37
Fine	15	12	33	45
Costs awarded against practitioner	17	16	33	64
Registration suspended	3	1	1	8
Registration cancelled	3	1	0	15

Source: BC 2004a, p. 24.

<sup>22</sup> The audit may have office based and site based components. In the former, the audit checks the builder's compliance with obligations under the Domestic Building Contracts Act, along with other factors such as awareness of the Building Code of Australia. The site based component assesses compliance with regulated standards, so is a check on the performance of both the building practitioner and the building surveyor.



This approach to strategy seems to have a number of the desirable features outlined, but the effectiveness and efficiency of the strategy are difficult to assess from publicly available information. Because the Building Commission is a public entity funded largely by levies paid by consumers, the Victorian Competition and Efficiency Commission considers that the rationale for its strategy and funding, together with an assessment of the outcomes of the strategy and expenditure, should be regularly published. Public reporting should also cover lessons and any consequential regulatory changes. The Commission argues in chapter 10 that public reporting of performance against specified performance indicators has significant benefits; similar benefits would also be achieved in this important area of the Building Commission's and the Plumbing Industry Commission's responsibilities.

## **Box 6.8 Other models of monitoring and enforcement**

### **WorkSafe Victoria**

WorkSafe Victoria, the occupational health and safety enforcement arm of the Victorian WorkCover Authority, manages the regulatory functions that relate to work related deaths, injuries and disease. The principles that underpin its activities are:

- targeting activities to areas of highest need and best effect
- enforcement action that is in proportion to the seriousness of non-compliance
- a consistent approach and consistent outcomes for similar situations and circumstances
- fairness in compliance and enforcement activities (for example, impartiality, balance, integrity).

WorkSafe uses a 'constructive compliance strategy' to meet these principles. The strategy, which balances positive motivators and deterrents, includes:

- encouraging compliance via funding for programs and premium incentives
- providing workplaces with advice and information on how to comply and engaging and communicating with stakeholders (including education and training)
- deterring non-compliance via a credible risk prosecution scheme, and publishing and using enforcement data to inform future inspection activity and policy.

### **Civil Aviation Safety Authority (CASA)**

CASA's primary function under the *Civil Aviation Act 1988* (Cwth), is the safety regulation of civil air operations in Australia and Australian aircraft operating overseas. A review of CASA's governance and enforcement activities in 2003 led to the *Civil Aviation Amendment Act 2003* (Cwth)—which introduced a greater range of enforcement tools and greater accountability and impartiality in CASA's decision making, particularly in terms of personal conflicts, political interests and market powers within the industry.

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## Box 6.8 Other models of monitoring and enforcement (continued)

CASA's performance framework is based on four outputs: (1) development and application of quality safety standards; (2) education, surveillance and enforcement of compliance; (3) promotion of aviation safety; and (4) timely and consistent aviation services. CASA reports 'effectiveness indicators' for these outputs:

- enhanced level of safety in the aviation industry
- focused use of safety resources
- enhanced perception of CASA's effectiveness as a regulator and educator
- clear, concise, unambiguous and internationally consistent standards
- compliance with Australian aviation safety legislation.

A range of performance measures for each output is grouped under particular strategies and reported (in terms of result and progress) in CASA's annual reports.

### **Drinking Water Inspectorate**

The Drinking Water Inspectorate regulates public water supplies in England and Wales. It takes enforcement action on standards, particularly fitness for human consumption. Performance is measured via a Code of Enforcement describing service levels for water companies and the public. Examples of the service levels are:

- preparing final inspection reports within four weeks of the end of inspection (63 per cent in 2004)
- processing and dealing with applications for undertakings (works) within four weeks of receipt (85 per cent in 2004)
- completing water quality investigations within three weeks of the receipt of all requested information (56 per cent in 2004).

The inspectorate can then view the performance data in the context of where it has allocated its resources for that period, and consider how resources can be best allocated in the future.

Sources: VWA 2004, 2005; [www.casa.gov.au](http://www.casa.gov.au); [www.dwi.gov.uk](http://www.dwi.gov.uk).

Performance reporting could include publication in the annual report of data such as:

- the rationale for the allocation of funds to the various instruments available for encouraging regulatory compliance
- the rationale for the audit and investigation strategy—how the focus of audits and investigations is determined, the rate of audit and investigation, and outcomes
- the types of breach identified
- the outcomes of inspection in each of these areas.

Box 6.8 contains examples of the monitoring, enforcement and performance reporting strategies adopted by other regulators.

In its draft inquiry report, the Commission recommended that the Building Commission and the Plumbing Industry Commission publish in their annual reports the rationales for their monitoring and enforcement strategies, the funds allocated to monitoring and enforcement, and their performance indicators. This would permit the policy department, building practitioners, building owners and others to assess these strategies and identify any lessons learned.

Few inquiry participants commented on this issue, but Moreland City Council (sub. DR158, p. 12) and the Master Builders Association of Victoria (sub. DR151, p. 13) supported the proposal.

#### **Recommendation 6.8**

**That the Building Commission and the Plumbing Industry Commission publish in their annual reports the rationales for their monitoring and enforcement strategies, the funds allocated to monitoring and enforcement, and the two agencies' performance indicators, to permit assessment of their strategies and identify any lessons learned.**

## **6.5 Impacts on competition**

The inquiry terms of reference direct the Commission to consider the 'impact on competition of permits, licences and fees issued by Victorian regulatory bodies for housing construction and related practitioners'. The permit and registration systems affect competition in a number of ways. Consumer Affairs Victoria described how a registration system can limit competition:

As a general rule, industry and occupational associations tend to be strong supporters of licensing of their particular industry or occupational group. This has led to persistent concerns that occupational licensing ends up benefiting the industry or occupation in question at the expense of the consumer. See, for example, Kessel (1958) and Rottenberg (1980).

The empirical evidence is limited but confirms that occupational licensing generally increases the earnings of the regulated occupations, restricts their mobility and reduces consumers' access to low quality services (Svorny 2000). Although this body of research tends to concentrate on the health professions, it does include analyses of the licensing of plumbers (Pfeffer 1974) and of the construction industry in the United States (Perloff 1980). That said, as of 2000 there were no empirical studies in the peer-reviewed literature that had attempted to estimate the net economic benefit of any licensing restrictions (Svorny 2000). (sub. 91, p. 23)

A well-functioning regulatory environment, however, can enhance competition by correcting information asymmetries. To the extent that the registration system provides accurate information about the competence of builders, it should also reduce the costs to consumers of collecting information about builders' skills. This reduction of transaction costs should encourage market transactions, expand the size of the market and aid competition. Moreover, effective registration regulation (regulation of inputs) can reduce the need for other forms of regulation (output regulation).

While there are forces working in opposing directions, and this is an empirical issue, competitive forces appear strong in the housing construction sector:

- There are a large number of builders, and the industry is probably best characterised as competitive (chapter 2).
- Qualification hurdles for domestic (limited) builders are not onerous.
- There is scope for building activity outside the regulatory system (although this has been reduced with the passage of the Building (Amendment) Act).
- While the requirement that registered builders hold insurance is a barrier to entry, that barrier has reduced somewhat with increased competition among insurance providers (chapter 7).

That said, expansions in the regulatory framework could undermine competition by reducing threshold levels at which activity enters the framework or by increasing required competency levels for practitioners. The Commission has recommended that changes in the framework not be introduced without public scrutiny of the costs and benefits, to avoid undue restrictions on competition and the consequent adverse impacts on consumers.

## 7 Insurance

This chapter describes insurance arrangements required under Victorian regulation for building practitioners. It outlines the recent disruption in insurance markets in Victoria, and changes introduced by private insurers and the Victorian Government in response. The chapter assesses whether regulation is warranted and what, if any, changes to current arrangements might be needed. It does so against a background of a maturing insurance market, the current need for regulation to protect consumers, and the effect of that regulation on the supply of building practitioners and housing affordability. Insurance related concerns identified in inquiry submissions are assessed. Lastly, the chapter considers the scope for reducing regulation in this area over time.

### 7.1 Introduction

The *Building Act 1993* (Vic.) requires that certain building practitioners have insurance cover for their work.<sup>1</sup> These provisions are augmented by ministerial Orders that specify the insurance policies required and the coverage of that insurance. Table 7.1 contains a summary of these arrangements.

The market providing these insurance products has experienced major disruption in recent years. Key causes were the collapse of HIH, the terrorist attack of 11 September 2001 and a major downturn in global equity markets (which put pressure on premiums to maintain profits). The fallout from these shocks led insurers and re-insurers to re-assess their product offerings and/or vacate the market, and governments to revise the ‘rules of the game’ for mandatory insurance.

These changes had significant implications for Victoria’s housing construction sector. They affected the depth and competition in insurance markets; access to insurance and the price/premium at which it was available; and the coverage of that insurance. In turn, these changes had cascading effects on the protection afforded to consumers by building practitioners’ insurance, on housing affordability and on the ability of practitioners to ply their trade (and thus on the supply of builders). But these external circumstances do not necessarily mean that the market, and remaining market participants, could not have performed better. Such are the complexities of the interrelated features of building regulation that it is hard to discern what inflexibility for insurance behaviour arose from other regulatory features—for example, a reliance on the registration system for building practitioners as assurance of continuing competence.

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<sup>1</sup> In accordance with the provisions in part 9, division 3 of the Act.

**Table 7.1 Insurance required by building practitioners**

<i>Building practitioner</i>	<i>Insurance required</i>
Domestic builder	<i>Home builders warranty insurance:</i> the policy must comply with the Domestic Building Ministerial Order (box 7.1).
Domestic owner–builder	<i>Owner–builder warranty insurance:</i> the policy must comply with the Domestic Building Ministerial Order.
Domestic plumber	<i>Plumbers insurance:</i> The policy must cover any liability to pay for the cost of rectifying any plumbing work required as a result of defects in the plumbing work; any trade practices liability; any public liability; and any completed work liability.
Building surveyor, building inspector, draftsman, quantity surveyor, engineer (civil, electrical, fire safety, mechanical), architect	<i>Professional indemnity insurance:</i> the professional indemnity insurance policy must be of the kind specified in section A of the Building Practitioner’s Ministerial Order.
Commercial builder (unlimited)	<i>Professional indemnity insurance:</i> the indemnity insurance policy must be of the kind specified in section B of the Building Practitioner’s Ministerial Order.
Demolisher (low- and medium-rise buildings, and unlimited), erector or supervisor (temporary structures)	<i>Public liability insurance:</i> the public liability insurance policy must be of the kind specified in section C of the Building Practitioner’s Ministerial Order.

Source: BC undated H.

In the light of these changes, and a subsequent maturing of the insurance market in Victoria, it is appropriate to examine the regulation of building practitioners’ insurance to answer some threshold questions. Is mandatory insurance still warranted? And are current regulations governing who and what should be covered by that insurance still appropriate? Moreover, if arrangements are no longer appropriate, what changes should be made? These judgments need to be made in the context of an insurance market where system lags are long. The Victorian Competition and Efficiency Commission understands that a period of four to six years is generally required before the success or otherwise of a new scheme can be judged and, while the Commission looks at the current situation, it is too early to assess the full impact of the 2002 changes to builders warranty insurance in Victoria.

Most of the inquiry submissions on insurance related to builders warranty insurance (for builders and owner–builders) and plumbers insurance. Professional indemnity insurance attracted substantially less comment in submissions, while comment on professional liability and public liability insurance was negligible. The Commission has thus focused mainly on builders warranty insurance, with a lesser focus on plumbers insurance and professional indemnity insurance. This emphasis appears appropriate in view of the pervasive influence of warranty insurance and the examples of economic and personal experiences raised in submissions. The commercial interests at stake also need to be recognised. Insurance companies have a direct interest. But the Housing Industry Association (HIA) and the Master Builders Association Victoria (MBAV) also derive revenue from brokerage arrangements.

## 7.2 Builders warranty insurance

As noted in chapter 6, domestic builders who wish to carry out work above a certain value may not be registered to practise unless they have obtained (or show evidence that they are eligible for) builders warranty insurance. If a builder is to operate on any material scale, access to such insurance is thus essential.

Mandatory insurance arrangements in Victoria changed significantly on 1 July 2002. The Domestic Building Insurance Scheme was introduced in May 1996, but its scope was significantly reduced by Ministerial Order in 2002 (box 7.1).

### Box 7.1 Coverage of builders warranty insurance

The Domestic Building Ministerial Order requires that a warranty insurance policy covers the building work carried out under the contract and that no money is payable under that contract before the policy is issued. The policy indemnifies the building owner in respect of loss or damage resulting from non-completion of the domestic building work. It must also indemnify the building owner in respect of loss or damage resulting from all or any of the following events:

- domestic building work that is defective
- a breach of any warranty implied in the domestic building contract by s8 of the *Domestic Building Contracts Act 1995* (Vic.). This Act outlines what the builder is required to warrant in terms of how the work will be carried out and the materials used. The Act also warrants that the work will comply with all laws and legal requirements of the *Building Act 1993* (Vic.) and the Regulations made under it
- a failure to maintain a standard or quality of building work specified in the contract
- conduct by the builder in connection with the contract that contravenes a trade practices provision.

Source: Domestic Building Insurance Ministerial Order no. 298, Friday 23 May 2003.

The Victorian and New South Wales governments jointly developed the new arrangements for consistency under a 10-point plan, with the agreement of insurers (DSE, sub. 84, p. 26). Some of the changes were influenced by the collapse of HIH in 2001 and by the general flow-on effects to insurance markets arising from the 11 September 2001 terrorist attack.

The changes were designed to stabilise the domestic building insurance market while still providing a level of protection to consumers.<sup>2</sup> The new arrangements include the following:

- Homeowners can claim against their policy only as a last resort, such as when the builder is dead, or insolvent or has disappeared and is not capable of rectifying any defective or incomplete building works. (Previously, owners could also claim against their policy where the builder was still available to rectify defective or incomplete works—that is, a so-called ‘first resort’ claim).
- A \$12 000 threshold was established for works requiring a builder to carry insurance (previously \$5000)—although builders must still be registered with the Building Practitioners Board to undertake domestic building works over \$5000.
- The minimum period of cover for structural defects was reduced from 6.5 to six years.
- The minimum period of cover for non-structural defects was reduced from 6.5 to two years.
- Buildings of more than three storeys that contain two or more separate dwellings (high rise) no longer require warranty insurance cover.
- The minimum maximum cover for the total aggregate of claims was increased from \$100 000 to \$200 000.<sup>3</sup>
- The Victorian and New South Wales governments agreed to attempt to harmonise builders warranty insurance.
- Insurers’ liability in respect of claims above \$10 million arising from the death, disappearance or insolvency of any single builder will be capped.
- The two governments agreed to harmonise insurance reporting requirements (DSE, sub. 84, p. 26; Wong 2002, p. 35).

In conjunction with the change to claims as a last resort, the Victorian Government established Building Advice and Conciliation Victoria (BACV)—a service to deal with disputes between homeowners and builders where the builder is available to rectify the fault. The service is available free of charge.

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<sup>2</sup> Building Commission undated C.

<sup>3</sup> Insurance policies, however, usually limit claims for non-completion to 20 per cent of the original contract amount.



Consumer Affairs Victoria, the Building Commission and the Victorian Civil and Administrative Tribunal (VCAT) manage the service. The cost of the service is financed by a 0.064 per cent levy imposed on the value of most domestic and commercial building permits.

In addition, the Victorian Government acts as a re-insurer of claims above \$10 million arising from the death, disappearance or insolvency of any single builder (Wong 2002, p. 35). Insurers pay premiums to the Consolidated Fund for this re-insurance cover, which has helped to re-establish a viable market in Victoria for builders warranty insurance.

In 2004, the Victorian Government introduced more stringent eligibility criteria for providers of builders warranty insurance (box 7.2). These criteria were designed to ensure insurance providers are financially stable and able to protect consumers for an extended period. The criteria thus reinforce the consumer protection afforded by that insurance and bring Victoria more into line with other states.

### **Box 7.2      Qualifying requirements for providers of builders warranty insurance**

On 1 January 2004, the Victorian Government proclaimed changes to the regulations governing insurance for domestic building works. These changes provide that only 'designated insurers' can issue builders warranty insurance.

'Designated insurers' are either:

- (a) general insurers within the meaning of the *Insurance Act 1973* (Vic.) (that is, insurers authorised in writing by the Australian Prudential Regulatory Authority), or
- (b) Lloyds underwriters within the meaning of the Insurance Act, or
- (c) insurers that have been specified by the Minister for Planning.

Any insurers that are neither (a) nor (b) will be required to meet a minimum credit rating by an acceptable insurance rating agency.

The minister can specify insurers as designated insurers if they meet the minimum credit rating requirements of an acceptable insurance rating agency. Once an insurer becomes a designated insurer, this information is gazetted.

Source: BC undated G.

Against this background of regulation and change, inquiry participants highlighted concerns relating to:

- whether insurance should be mandatory and whether appropriate information is available about the way the market is working

- whether last resort insurance is appropriate, whether it compromises consumer protection and whether consumers understand what they are getting
- current thresholds and exemptions
- whether private or government suppliers should provide insurance
- the effect of insurance on housing affordability
- the effect of insurance arrangements on the ‘supply’ of builders.

Builders warranty insurance provides support for consumers through a recourse for defects if the builder is unavailable. The insurance process should sift out the highest risk builders. However, it would be a mistake to try to analyse the effects of builders warranty insurance in isolation from the rest of the housing regulation regime. Registration standards help to maintain a pool of skilled builders. Permit inspections scrutinise the maintenance of minimum standards. And non-regulatory characteristics, such as good consumer information, help produce good outcomes.

### **7.2.1 Should insurance be mandatory?**

All state and territory governments in Australia impose regulation requiring mandatory builders warranty insurance (although their requirements may differ—for example, differences in the minimum insured value and maximum value of cover). However, a number of inquiry participants—from individual builders to industry associations—questioned why such insurance should remain compulsory. Travis Clarke, a builder, stated:

VCEC [the Victorian Competition and Efficiency Commission] should seriously consider whether this insurance needs to be mandatory. Firstly, other markets (particularly in Canada and the US) have demonstrated that left to themselves, builders in the marketplace who believe that it will give them a competitive edge will take out home warranty insurance anyway and use this as a marketing device, setting themselves apart from other builders. It is then up to the consumer to choose whether to pay the extra required to engage such a builder or take the ‘risk’ and save some money by choosing a builder without it ... (sub. 2, p. 1)

Similarly, the Building Appeals Board (BAB) noted:

Since its inception, ... the warranty insurance protection afforded to consumers has been watered down due to the demands of the major insurers. As both the indirect and direct costs associated with warranty insurance have escalated, the consumer protection attached to the insurance product has lessened to the extent that it is now questionable whether the benefit warrants the cost. (sub. 74, p. 6)

These quotes highlight the two key issues for mandatory warranty insurance: can the average consumer make an informed choice? And is it likely that the benefits of mandatory warranty insurance exceed the costs?

### **Informed choice**

The submission from Travis Clarke suggested the option of letting the consumer decide whether to pay more and choose a builder offering warranty insurance or to take the ‘risk’ and save some money by choosing a builder without it. The HIA also suggested the consumer should be able to waive the requirement for the builder to provide warranty insurance (sub. 58, p. 20). But while consumers generally choose goods and services with the price–quality–risk combination they want, their ability to do so is compromised where information on these attributes is inadequate or effectively unavailable (PC 2004c, p. 30). This situation—the so-called ‘information asymmetry’ facing consumers discussed in chapter 3—is part of the reason for compulsory warranty insurance across Australia.

A fundamental problem in this area is that consumers do not know what they don’t know, so will be unaware of information deficiencies they need to address. The Productivity Commission noted this problem in its review of building regulation when it quoted a submission to the Campbell report:

... I agree with you that the buyer should be aware. The challenge we face at the moment is that most buyers are not aware of what they should be aware of ... (Campbell report 2002, p. 168, cited in PC 2004c, p. 32)

While undoubtedly an ongoing problem in the housing construction sector, this is not necessarily sufficient reason to make warranty insurance mandatory. Such lack of awareness might be addressed by, for example, educating consumers of what they should be aware.

A more fundamental problem, as the HIA noted, is that consumers enter a home building contract infrequently, perhaps only once or twice in their entire life (sub. 58, p. 11). Accordingly, even an aware consumer would have little or no experience to guide them in assessing the financial viability of a builder, or to recognise the signs that a builder might be ‘shaky’. Further, if a consumer directly seeks to determine a potential builder’s financial state, a builder whose business is ‘shaky’ would be unlikely to provide information that would cast doubt on their financial strength. And consumers would not necessarily have the wherewithal to accurately assess such information to determine the risk of a builder becoming insolvent.

The HIA suggested consumers be allowed to opt out of builders warranty insurance, but only where the consumer’s solicitor has provided written proof that their client has been informed of the risks of doing so (sub. DR163, p. 18). However, this does not address the fundamental problem—that while

consumers might be aware of the cost of a builder not being available to complete works, they would not be in a position to fully assess the risk of this occurring with their builder. Moreover, this option has some shortcomings. First, for a solicitor to provide the necessary proof would require sufficient due diligence to ensure professional conduct. This would incur a cost to consumers that may not be known in advance. Second, the price signal of a premium saving from opting out is likely to be obscured in the aggregate contract cost, or partly or fully appropriated by the builder in a higher margin. Third, builders wishing to offer a choice would still need to incur the costs of obtaining access—the opt out option would not reduce this cost to them. Fourth, because the risk profile of a builder is related to their level and type of financial exposure, this option would present intractable problems for insurers in assessing and pricing a builder’s risk profile, because not all activity would be in scope.

Some inquiry participants noted sources of advice available to consumers—for example, referrals by industry groups and/or from previous customers based on a builder’s previous work. They suggested such advice could overcome the ‘information failure’ facing consumers. However, such advice essentially relates to the historical quality of a builder’s work. While valuable in that regard, it is unlikely to provide a forward-looking measure of the risk of that builder becoming insolvent, disappearing or dying. Even for a curious consumer, therefore, the scope to obtain sufficient information to determine a builder’s financial standing is limited. Against this background, it is difficult to see how in current circumstances, consumers might make an informed choice when entering what is generally the largest individual purchase in their life.

The submission from Travis Clarke, noting overseas experience, also suggested mandatory insurance is unnecessary because builders would have an incentive to voluntarily offer such insurance as a differentiating marketing tool. Leaving aside the difficulty of transplanting overseas behaviour outside its cultural and institutional framework, it is hard to see how a voluntary offering of insurance could overcome the information problems noted. Consumers generally would still be ignorant of the real risk associated with an uninsured builder (and thus of the potential cost of choosing them). As a result, consumers may not fully appreciate the value of an insured builder and, to that extent, may not be prepared to pay the extra cost.

A perverse outcome could arise if the lower cost of uninsured builders led to an increase in the share of building activity undertaken by builders at greater risk of financial collapse. This is likely because those builders at most risk would face the highest premiums and thus be the most likely to not insure. In turn, this could lead to consumers being worse off.

This situation occurred when voluntary insurance prevailed and was one reason for the introduction of compulsory insurance:

Responsible insured practitioners have been disadvantaged at the tender stage, as the cost of their insurance has often made their prices uncompetitive when compared to practitioners who elect not to carry insurance cover. (Knowles 1993. p. 1348)

On balance, the Commission considers the inability of the average consumer to determine the likely risk that a builder will fail financially is an inherent characteristic of the housing construction sector.

Information provided to the Commission during the inquiry also indicated consumers to be ill informed about builders warranty insurance. They are generally unaware it exists for their protection and unaware of the limited extent of the cover it provides. The Builders Collective drew attention to the latter when it stated that consumers mistakenly ‘believe that warranty insurance protects them in case defects arise in the course of the project and in case the builder refuses to fix them. This used to be the case before the HIH collapse and most consumers and many builders have still not come to terms with the very limited nature of the [current] policies’ (sub. 92, p. 5). This is in contrast to the situation with plumbers insurance. With that insurance (also mandatory), a plumber must give the consumer a document that contains a brief description of the insurance and what it covers (see section 7.4).

The Commission suggested in its draft report that consumers should be provided with similar information on builders warranty insurance before a contracted job begins. If this were possible via the provision of a simple brochure along the lines of that produced for plumbers insurance, it could be provided at minimal cost. The City of Melbourne supported this view (sub. DR136, p. 8), while the City of Moonee Valley considered such advice would be a useful measure ‘as it will allow consumers to have a better understanding of what they are insured for’ (sub. DR99, p. 3). The Moreland City Council considered such early advice could avert later disputes (sub. DR158, p. 3 of attached comments).

Inquiry participants offered various views on how the Commission’s suggestion might be achieved. Some noted that the worth of providing such information depends on when it is made available to consumers. Building Ethics (sub. DR114, p. 5) and the BAB (sub. DR128, p. 8) noted that providing the information after a consumer has signed a contract is of limited value. The BAB believed the design stage is the appropriate time to deliver a package of information to consumers.

To provide knowledge at a sufficiently early stage, Building Ethics suggested:

The Building Commission or Consumer Affairs Victoria should prepare a detailed document clearly showing the different approaches to the provision of warranty insurance. This document needs to inform consumers of the range of available approaches to warranty insurance, from basic ‘insolvency insurance’ to thorough project monitoring programs. This document should be provided to consumers at an early stage, possibly by architects and designers at the design stage. (sub. DR114, p. 5)

CGU noted that builders should not be solely responsible for distributing information of this type to consumers. It suggested builders could refer consumers to sources such as insurers’ web sites to obtain this information. Alternatively, it suggested that Consumer Affairs Victoria (CAV) be responsible for developing a booklet of this type—possibly an expanded version of its existing fact sheet on home warranty insurance and similar to the consumer buying guide that has been mandatory in New South Wales for builders to distribute to homeowners (sub. DR135, p. 1). The MBAV supported the need to provide consumers with information about warranty insurance. It suggested the Building Commission could include this information in a letter to clients who have obtained a building permit, noting the extent of warranty insurance cover (sub. DR151, p. 13). The National Association of Steel-Framed Housing, while noting the provision of upfront information would be useful, considered it would be better:

... if the builder were to provide, along with the insurance details, a step by step process which demonstrated exactly what measures were planned so that insurance would not need to be relied upon. (sub. DR122, p. 3)

The HIA noted that every home building client, whether buying a completed new home or contracting to build or renovate, already receives a copy of the warranty insurance document from either the insurer or the broker (sub. DR163, p. 17). Similarly, Archicentre and the Royal Australian Institute of Architects noted that such a document already forms part of most contracts administered by architects (sub. DR164, p. 6). The Department of Sustainability and Environment supported requiring building practitioners to inform clients about the cover they hold, and suggested including such information in the standard building contract used by industry associations and insurance brokers (sub. DR172, pp. 15–16). It noted that the MBAV and the HIA (which would cover a large part of the market) have indicated a willingness to consider this option (sub. DR172, p. 16).

Evidence provided to the Commission indicates that much of the information that consumers should know is already available—for example, on the CAV and Building Commission web sites—and provided to consumers. At issue is how to draw that information to the attention of consumers as early as possible in the

home building process. While builders could assist by providing their clients with a document describing the insurance, it may also be worthwhile for the Building Commission to include such material on application forms for building permits or attach it with approvals of building permits. At the same time, CAV's oversight of major domestic building contracts provides an avenue for it to combine an interest in the contractual advice given to consumers (including through principal players such as the HIA and the MBAV) with the provision of early information on the characteristics of builders warranty insurance.

A consequence of consumers better understanding the limits of builders warranty insurance coverage is that they would be better placed to take measures to protect their own interests—for example, identifying defects and prompting early resolution of disputes.

### **Recommendation 7.1**

**That Consumer Affairs Victoria and the Building Commission coordinate the production and timely placement of a document that describes builders warranty insurance and what it covers (similar to that provided for plumbers insurance)—for example, in the letter sent to consumers granted a building permit. The Building Commission should also negotiate with industry associations to include this information in standard building contracts.**

## **Benefits and costs**

### *Benefits*

Builders warranty insurance provides direct benefits to consumers where their builder disappears, dies or becomes insolvent before their building is completed or any defects are fixed. Of these scenarios, the incidence of insolvencies<sup>4</sup> is the most prevalent. Box 7.3 provides a case study of the benefit consumers derive from this insurance.

Public data on the number of insolvencies in the Victorian housing construction sector (and thus the likely risk for consumers) is not directly available. While some agencies collect data on insolvencies, their data do not identify the incidence within the housing construction sector. Insolvency and Trustee Services Australia, for example, records personal insolvencies, but not in a way that allows insolvencies in the housing construction sector to be identified with any confidence. Similarly, the Australian Securities and Investments Commission, which records incorporated entity insolvencies, does not record data on the type

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<sup>4</sup> Insolvent failures are a narrow, legal definition of failure, and involve businesses that have ceased operations as a result of bankruptcy (unincorporated businesses) or liquidation (incorporated businesses).

of industry in which a company may engage, and was unable to provide the Commission with information on company insolvency in the housing construction sector.

### **Box 7.3 The new builders warranty insurance in action**

When a building company with more than 40 contracts was placed in receivership, Consumer Affairs Victoria worked quickly with insurers to ensure homeowners would not be left high and dry. Because the company was insolvent, homeowners with incomplete buildings or identified defects could make a claim under the builder's warranty insurance. Consumer Affairs contacted the insurer and explained the gravity of the situation. Many homeowners were anxiously awaiting the completion of their houses; some were renting alternative accommodation and, in one case, a couple were living in a caravan until their house was built.

The insurer fast tracked the claims and had assessors on the building sites within seven days. On each of the approved claims, the insurer agreed to pay up to 20 per cent of the contract price. The insurer even helped owners make contact with new builders who could complete their projects and avoid further delays.

Source: CAV 2004, p. 3.

Moreover, a lack of comprehensive data on the number of claims that any one insolvency might precipitate also complicates an accurate assessment of how beneficial builders warranty insurance might be. The case study cited in box 7.3 indicates the potential for multiple claims from any builder insolvency. Similarly, data in the Queensland Building Services Authority annual report for 2003-04 suggest multiple claims from a failed building business would be the norm. That report noted that the 17 most significant licensee failures generated almost 400 claims payments. These represented an average claims cost of over \$20 000, with the most expensive identified payment being for \$174 880.

A measure of this risk may also be gathered from Vero Warranty's experience of the number of domestic builders who became insolvent across Australia over the period 2000 to July 2005 (table 7.2). Given that Victoria's share of the nation's domestic housing market is around 30 per cent, the data suggest Victorian builder insolvencies covered by Vero policies of about 50 in 2000 to about 14 for the six months to July 2005. Actual claims as a result of insolvencies in Victoria will be higher to the extent that Vero holds only a proportion of the total warranty insurance market, and that each insolvency gives rise to multiple claims.

These figures suggest, at current levels of housing activity and under a mandatory insurance regime, that about 0.4 per cent of builders in Victoria may become insolvent on average in any year. This indicates the scale of benefit afforded consumers by the scheme. This might be compared with Vero's average premium as a percentage of the average contract price (0.49 per cent) from which claims would be paid. While the risk of this insolvency is small, the size of



the financial commitments that consumers have at risk is generally very large. Accordingly, the benefit accruing to consumers from mandatory insurance is likely to be significant.

**Table 7.2 Builder insolvencies<sup>a</sup> and claims across Australia, 2000 to July 2005**

	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005 (to July)</i>
Insolvent builders	165	155	110	90	90	45
Associated claims	1000	1050	650	580	660	280

<sup>a</sup> While the aggregate numbers also include builders who died or disappeared, the proportion of builders in these categories would average only 3–5 per cent in any year.

Source: Vero, pers. comm., 15 September 2005.

If activity in the housing construction sector turns down from its cyclical strength, however, it is reasonable to expect the number of business failures will rise and claims will rise. As the Australian Owner Builders and BuildSafe noted, ‘Traditionally claims escalate when the building industry goes into decline’ (sub. 62, p. 2). Empirical studies in Australia support this view, with evidence that ‘Short run decreases in economic activity as measured by changes in [gross domestic product] increase the bankruptcy rate’ (Bickerdyke, Lattimore & Madge 2000, p. 52). An increase in business failures coincident with declining economic activity is a generally evident phenomenon.<sup>5</sup> In such circumstances, the benefit to consumers from warranty insurance could be expected to increase commensurately. The recent decline in housing starts, noted in chapter 2, suggests consumer use of this cover is more likely to increase in the immediate future, rather than decrease.

Moreover, mandatory warranty insurance (and eligibility conditions imposed by insurers) also affects the average incidence of insolvency. To a lesser extent, it may also affect the incidence of builder disappearances where these are related to financial difficulties. It does so as a result of insurers screening out builders with a high risk of failure and/or limiting the amount of activity they might undertake at any time, which helps prevent builders from overextending themselves financially. (Insurance companies claim that it is not unknown for building principals to have gone out of business and restarted a number of times—so-called phoenix companies.) This preventative intervention can thus help to

<sup>5</sup> A study of the determinants of failure among individual UK public and private companies over the period 1991–2001, for example, found a negative correlation between gross domestic product growth and failure, even after controlling for all of the firm level characteristics (Bunn & Redwood 2003).

reduce the incidence of builder insolvencies. Without mandatory insurance, the incidence of insolvencies would likely be greater than the current average.

Mandating insurance will thus lead to the pool of licensed builders exhibiting a lower risk of failure than would otherwise be the case. As a result, the industry is more likely to show greater stability and in turn provide greater confidence to consumers and suppliers. Although difficult to quantify, this is nonetheless a tangible benefit. And it was to achieve this benefit that the HIA argued for compulsory warranty insurance for homebuilders three decades ago in response to calls from members to maintain confidence and certainty in the sector (Grellman 2003, p. 12).

Existing insurance arrangements also provide benefits to consumers indirectly. Where insurers require builders to hold sufficient assets in their business to cover potential liabilities (rather than in independent trusts), those assets are within the reach of consumers or their insurers seeking rectification by those builders via contractual remedy. Thus, the asset holding requirements of insurers have the spin-off effect of improving consumer protection more generally.

Quantifying the direct benefits from the current builders warranty arrangements is difficult because aggregate data on claims and payments since the introduction of the new arrangements are not publicly available. However, as an indication of these benefits, from 1 July 2002 to 30 June 2005, Vero received 4500 claims from Victorian homeowners and settled approximately 2900 of those claims (Vero, pers. comm., 31 August 2005). Moreover, based on confidential information provided to the Commission by insurers such as Vero and CGU, the Commission is satisfied that the annual value of claims paid is of substantial benefit to consumers.

The potential consumer benefit can also be inferred from the claims against warranty insurance policies written under the previous insurance arrangements by HIH.<sup>6</sup> That data (at 19 August 2005) indicate for the period 1996–2001 that 3777 claims were lodged against builders warranty insurance policies issued by HIH. The claimant did not proceed with the claim in 451 cases, while 812 claims were rejected, 619 were addressed and rectified by the builder, and 973 (34 per cent) resulted in approved insurance payments of almost \$20 million (at a cost to administer of some \$5 million). The remaining 922 claims are still to be finalised. The bulk of the 973 payments would represent claims where the builder was no longer available to complete a job or rectify defects.

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<sup>6</sup> These data were provided by the Housing Guarantee Fund Ltd, as managers of the Domestic Building (HIH) Indemnity Fund. The introduction of the 10-point plan in 2001 means that this claims experience is not directly comparable with current insurance arrangements. However, it is still useful in indicating the likely claims experience in the housing construction sector.

Some inquiry participants were sceptical that builders warranty insurance provides any significant benefit at all to consumers. The Builders Collective, for example, argued that consumers derive almost no benefit from the current insurance arrangements because it could find virtually no evidence of builder insolvencies and thus of claims being lodged or paid. (As noted, there is information available that is overlooked in criticism of builders warranty insurance.) Given its view that ‘Warranty is a consumer issue first and foremost’ (BCA 2005), the Builders Collective inability to verify a significant consumer benefit led it to conclude that the current arrangements should be replaced with a scheme offering more certain consumer protection.

This inability to verify consumer benefits has also led the Builders Collective to call for comprehensive information on the claims experience of warranty insurers to be made public. In competitive markets generally, detailed commercial information on individual product/service revenues and costs is not available. Rather, companies are subject to broader corporate regulation and reporting (and prudential regulation in the finance sector). Consumers rely on that for assurance of corporate behaviour. Where competition is in question, the Australian Competition and Consumer Commission (ACCC) has regulatory responsibilities. In circumstances where insurance is mandatory, there is a case for more public information and accountability.

The call for adequate data to assess the performance of builders warranty insurance is consistent, in principle, with views expressed more generally by the ACCC and the Insurance Council of Australia:

The industry should provide consumers at large with general premium trend data for the various classes of insurance, and comprehensible explanations outlining the influence of major cost drivers on premiums. The absence of publicly available premium information does not promote consumers’ general level of awareness or confidence in the general insurance industry ... (ACCC 2002, p. iv)

Consumers need data, not only to assess the products and proposals of insurers, but also to evaluate the merits of government and regulatory measures. Policymakers and regulators also derive significant benefits from compelling insurers to provide data, including:

- having better information to identify systemic issues in the industry and to be able to better test or monitor the effectiveness of regulatory interventions and reforms. (ICA 2004, pp. 6 and 8)

The Commission accepts the need for public information to support regulation in this area and perceives merit in requiring insurers to provide government with the information needed to assess the effectiveness of the scheme. This argument has force because of the mandatory nature of the scheme. To address this issue, New South Wales introduced market practice guidelines that require insurers

operating in its builders warranty insurance market to supply information to the government for it to assess the scheme (box 7.4).

#### **Box 7.4 New South Wales market practice guidelines**

The guidelines are designed to bring more transparency and accountability to the provision of Home Warranty Insurance. The Guidelines will require insurers to provide contact details, explain their complaint handling procedures, and public release of premiums and builders' forms. Compliance with the guidelines is mandatory as a condition of operating in the New South Wales builders warranty insurance market.

The guidelines include provisions to assist the government to verify that the scheme is providing the consumer benefits intended of it. For example:

An Insurer must provide with the information provided under subclause 3.1:

- (a) with respect to the Premium Rates the proportion of each component of the premium represented by the Insurer's expenses, its assumptions relating to reinsurance premium and recoveries, commission and other fees or allowances paid to intermediaries, risk premium and profit margin; and
- (b) a summary of past claims experience of the Insurer specifying paid claims and reserves for reported claims.

Source: Department of Fair Trading (NSW) 2004.

The Victorian Government is developing similar guidelines through a memorandum of understanding on the provision of information, and a code of conduct for insurers in their dealings with builders (box 7.5). Vero noted that it supports this move (sub. 71, p. 10).

#### **Box 7.5 Proposed Victorian arrangements with builders warranty insurance providers**

The Department of Treasury and Finance and the Building Commission have committed to develop options for ministers for a proposed agreement between the State Government and insurers providing builders warranty insurance in Victoria. The purposes of the agreement are:

- to maintain scheme stability, with an agreed framework for any future proposed changes to the scheme
- to provide better information to government in relation to insurers' premiums, claims experience and processes for approval of builders' applications for cover
- greater transparency for builders in relation to approval criteria and insurers' service standards with builders and intermediaries.

(continued next page)

### **Box 7.5 Proposed Victorian arrangements with builders warranty insurance providers (continued)**

Two rounds of consultation have been completed in Victoria. Insurers have indicated in-principle support for the introduction of an agreement between the government and individual insurers.

The New South Wales Government has finalised its arrangements with insurers. The agreements have been ratified and the supporting documents are being signed. The 10 point plan agreed between Victoria and New South Wales in 2002, and the general commitment between the two states to harmonise builders warranty insurance agreements, will be respected as options are explored in Victoria.

There is a strong preference by insurers for the Victorian arrangements to mirror the New South Wales model. This will minimise the administrative requirements for insurers to provide reports and meet service delivery standards. It will also allow interstate comparisons to be made.

In New South Wales, existing legislation provides a formal mechanism for the agreement to be ratified. This is not the case in Victoria, which has a less regulatory approach. The preferred process to be followed in Victoria is that the government and the insurers will enter a MOU.

The MOU and the agreements covered under it are to be monitored for 24 months, and the findings reported to the Minister for Finance and the insurance industry. No legislative change is required for the MOU to be introduced. If legislation is required to make any aspect of the arrangements mandatory, this can be explored at a future date.

*Source:* DTF & the Building Commission 2005.

The Commission endorses the Victorian Government's move to introduce these guidelines, and considers that the process should be expedited. The service standards set through the process should include expected approval times and minimum periods for meeting new information requests (made of builders) and giving notice of intention to cease cover or increase premiums.

### **Recommendation 7.2**

**That the Victorian Government finalise and implement guidelines for the provision of information and a code of conduct for builders warranty insurers, as a matter of urgency.**

The creation of the Office of the Small Business Commissioner has provided an avenue for builders—as small businesses—to seek advice and dispute resolution for their dealings with insurance companies. This avenue of support for builders and good market outcomes could be facilitated by the placement of the office's advice with key builders organisations (for example, the MBAV and the HIA)

and the regulators (CAV and the Building Commission). It will also open up an avenue to transmit complaints information to the regulators.

### **Recommendation 7.3**

**That the Office of the Small Business Commissioner further develop means to facilitate advisory and dispute resolution services for small business builders, especially relating to builders warranty insurance issues.**

#### *Costs*

The costs arising from mandating warranty insurance have two main elements: the direct cost of each policy borne by consumers,<sup>7</sup> and the cost incurred by builders. Taking the first of these, the Commission received a number of submissions that claimed the cost of warranty insurance in Victoria is excessive, having increased significantly since the collapse of HIH. The Builders Collective of Australia, for example, noted ‘Since the expanded role of the private insurers as de facto regulators, premiums have exploded to an average of \$2500’ (sub. 38, p. 5). In a later submission, the Builders Collective explained this estimate in terms of an assumption that nearly all builders were in the category 3 risk group—a medium risk group. However, evidence provided by insurers indicates the increase in premiums is considerably less than that suggested by the Builders Collective. Premiums did increase following the collapse of HIH, but it is important to put any increase in context. Much of the substantial increase in premiums was ‘catch up’ following years of depressed industry pricing brought about by HIH buying market share with premiums less than commensurate with the policy risk. Premium increases also reflected a higher claims experience post-HIH collapse—another legacy of HIH chasing market share by less rigorously screening higher risk builders.

The Builders Collective of Australia argued the premium increases resulted from the exercise of market power by the largest insurer remaining in the market following the collapse of HIH (sub. 38, p. 5). However, in the past year or so, a number of insurers have entered the market and eight builders warranty insurance providers now operate in Victoria.<sup>8</sup> In addition, the number of

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<sup>7</sup> Consumers bear additional, indirect costs in dealing with insurers when any claim is made. However, because only a proportion of all policies will give rise to a claim, these costs are, in aggregate, considered to be minor.

<sup>8</sup> At September 2005, eight warranty insurance providers were qualified to operate in the Victorian market: Vero Warranty, Australian Home Warranty (AII), CGU, Lumley, Calliden Limited (which underwrites Building Ethics Australia), QBE, Exporters Insurance Company Ltd and Australian Unity. (Australian Unity offers warranty insurance only for owner-builders, which would include registered builders operating as owner-builders).

insurance brokers promoting their product offerings has also increased significantly. As a result, competition in the provision of warranty insurance has increased markedly. Accordingly, the Commission considers that a lack of competition in pricing and product offering is less likely to be an ongoing concern.

The growing maturity and competition among warranty insurance providers in recent years have had a moderating effect on the level of premiums. Vero (sub. 71, pp. 14–15) supplied evidence that its weighted average Victorian warranty insurance premiums, as a percentage of contract value, fell from 0.55 per cent in early 2003 to around 0.49 per cent by the end of 2004. Moreover, Vero noted that this average in Victoria is below the national weighted average of 0.57 per cent and significantly less than that of New South Wales (0.86 per cent). It also noted the Victorian average is significantly less than that in Queensland (0.70 per cent).<sup>9</sup> Responses to the Commission’s survey of Victorian building practitioners indicated average premiums clustered around 0.4–0.8 per cent (table C.6, appendix C).

For 2005, there is evidence that average premiums, generally, are lower than for 2004. In 2005, Vero introduced a range of discounts and rebates, and its average premium to average contract value further reduced. At September 2005, Vero stated that the vast majority of its policies were issued at a cost of less than \$1500 (sub. DR171, p. 12). Moreover, confidential evidence Vero submitted to the Commission indicates that, in aggregate, it issues considerably more policies in Victoria to category 1 and 2 builders (those with lower risk and lower cost premiums) than to category 3 builders. Other insurers also advised the Commission of premium reductions in 2005. Building Ethics, for example, noted:

Over the last eight months builders accredited with Building Ethics have experienced two significant reductions in warranty insurance premiums. This is directly attributable to the risk management and quality assurance program. There is every reason to expect this trend to continue as the risk management process continues to prove itself. (sub. DR114, p. 5)

Further, to put the average premium cost in context, note that warranty cover extends for six years for structural defects and for two years for other defects. Using an example of a \$200 000 house, an insurance premium of around 0.5 per cent would cost \$1000, or (from a consumer’s perspective) notionally about \$170 a year over the life of the policy covering structural defects.

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<sup>9</sup> But the Queensland scheme extends to so-called ‘first resort’ claims, so a direct comparison is not so useful.

The second major cost associated with compulsory warranty insurance is that incurred by builders. This arises mainly from application/compliance costs and, particularly for some, from restrictions on their ability to practise. Insurance companies require a range of data (primarily financial) to assess the eligibility of a builder for insurance. They may also require some builders to restructure their asset holdings or take out bank guarantees to qualify for the level of insurance sought. Some inquiry participants raised concerns about the cost of compiling the necessary information for insurers. L&F Holdings noted the considerable costs it recently incurred in doing so (sub. DR140, p. 3). Other builders expressed concern at the cost of restructuring their assets to qualify for warranty insurance policies, particularly where required to place a significant proportion of their financial assets within their business structure. As McCormick Builders and Property Power noted:

... insurance companies make eligibility for [homeowner's warranty] insurance difficult, and in some cases impossible to obtain. The financial and background information required is often onerous on small builders, and the criteria required for eligibility does not take into account structuring of companies for taxation reasons and personal asset protection issues. (McCormick Building, sub. 33, p. 1)

We are severely disadvantaged by the practices of the insurance companies through the lengthy application assessment period, by forced indemnities, and the subsequent costly restructuring of businesses and capping of turnover. (Property Power, sub. 85, p. 1)

Some of these application/compliance costs are likely to be one-off, upfront costs. While they may initially be substantial, once incurred, the cost in each ensuing year is likely to be marginal. More significant is likely to be the cost of providing a bank guarantee,<sup>10</sup> given its ongoing nature, and the ongoing opportunity cost of not being able to structure one's assets to minimise tax. L&F Holdings provided the Commission with its experience following a request in August 2002 from its insurance provider to provide a bank guarantee to obtain warranty insurance:

To remain in business as a registered building practitioner and to obtain building permits and in order to obtain a bank guarantee we were forced to deposit a sum of \$50 000 in a term deposit account. ... After much hassle, frustration and strong debate the facility was offered at high ongoing financial cost to our business. ... we believe the security asked by the insurer and the financial costs asked by the bank are rather excessive. (sub. 83, p. 2)

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<sup>10</sup> A bank guarantee is likely to be required only if a builder does not meet minimum financial tests of soundness, such as holding net assets of 10 per cent of annual turnover.



Building Ethics Australia provided an example of the possible cost involved:

... a builder undertaking \$2.5M in domestic building work annually may be required by some insurers to provide bank guarantees of between \$250 000 and \$500 000. The cost of these guarantees would be up to \$20 000 per year. (sub. 34, p. 3)

The Commission sought confirmation from one of the major banks of the likely cost of a bank guarantee. The bank responded that an indicative cost for a bank guarantee (which would typically be for 10 per cent of a builder's expected annual turnover), available for six months is around 2.4 per cent of the value of the guarantee sought. In the example given by Building Ethics, if the builder were to construct 10 houses worth \$250 000 during the year, the bank guarantee would cost \$6000 every six months—an average \$1200 per dwelling.

Accordingly, where bank guarantees are required for insurance, their cost would appear to be around 0.5 per cent of the value of a house. The cost could thus have a major effect on the profit margins of the builder concerned, although whether it is absorbed in a builder's profit margin or passed on (in part or whole) to the consumer would depend on market conditions. However, this requirement applies to a very small proportion of total builders. Set against the industry as a whole, these costs seem to have a minor effect on the average cost of housing construction.

The Commission received a number of submissions, however, detailing the personal and economic costs to small builders from having their turnover severely constrained by limits imposed by insurers, or from being forced out of business when access to insurance is denied. Chivest Investments and Cronin Builders noted:

Insurance companies have placed limits on how many jobs we could take and their contract value and we have been placed many times in the ridiculous position of having to turn away work. (Chivest Investments, sub. 67, p. 1)

We had applied for a certificate of insurance to be issued for a contract that we had signed, when we phoned about a week later to ask where our certificate was we were told our company had been placed on monitor and we were ineligible for insurance until we provided Vero with an unconditional guarantee for \$240 000—they effectively shut down our business. (Cronin Builders, sub. 51, p. 1)

CAV noted this situation has improved, although it is still a concern:

... changes to building warranty insurance have supported improved access to warranty insurance ... Despite these encouraging changes, a significant number of builders still have difficulty in obtaining builders warranty insurance. In particular, builders with minimal assets are required to pay higher premiums by

insurance companies. This is compounded by the lack of portability between insurance companies for those builders insured. (sub. 91, pp. 30–1)

It is clear that the operation of the warranty insurance market following the HIH collapse imposed a significant personal and economic cost on a number of (generally small) building firms. The cost of lost activity overall has been relatively small, however, when viewed against the aggregate number of builders and industry activity. This is because, from an economy-wide perspective, that ‘lost’ activity has largely been redirected to other builders.

Moreover, the maturation of the insurance market and the evidence from inquiry submissions suggest such excessive costs are largely a feature of the past. Colmac Homes noted that the current system still has problems, but that ‘it has become a bit easier to obtain warranty insurance with at least more underwriters in the market ... [and] even our situation is a lot better than it was now that CGU has entered the market’ (sub. 80, p. 2). Further, new entrants have introduced less restrictive conditions for access. Building Ethics Australia, for example, provides insurance under conditions that emphasise frequent inspections of the builder’s work and the work history of the builder:

The builder is free of the need to provide financial security resulting in significant cost savings. The builder is able to structure his business in such a way as to better take advantage of market conditions, tax planning and to access finance for business development. These benefits enable savings to be passed on to consumers. (Building Ethics Australia, sub. 33, p. 3)

The Builders Collective of Australia said:

Now that other insurers have entered the market it would appear that the eligibility crisis is largely passed; however, this only applies to those builders who are actually trying to access warranty insurance. (sub. 92, p. 8)

The MBAV summarised the position:

Undoubtedly, the worst of the negative consequences of the warranty insurance system have now passed, the system is more stable, due to the entry of additional insurers and state government reforms ... (sub. 88, p. 12)

On the information available to the Commission, the average cost of insurance to Victorian consumers appears generally lower than that in most other Australian states. It also appears that excessive costs experienced by builders (particularly costs arising from an inability to obtain either insurance or a sufficient level of insurance) are largely a feature of the past. The Commission’s view is that mandatory warranty insurance appears justified in view of the information asymmetries facing consumers and the protection that such

insurance affords against the substantial potential costs of an uninformed choice. On balance, the benefits of mandatory warranty insurance also appear likely to exceed the costs, particularly given the growing competition in Victoria's insurance market.

### **Finding 7.1**

On balance, mandatory builders warranty insurance appears justified in view of the information asymmetries facing consumers and the likely net benefits that such insurance provides. Mandatory insurance as a condition for registration also provides benefits in removing builders with a higher risk of financial failure from the pool of registered builders. In doing so, the policy is likely to improve stability and confidence in the industry.

### **7.2.2 Is last resort insurance appropriate?**

In July 2002, the Victorian Government limited warranty insurance cover to claims where the builder is dead or insolvent or has disappeared—a so-called 'last resort' cover. Previously, owners could also claim against their policy where the builder was still available to rectify defective or incomplete works—a so-called 'first resort' cover. The change in cover was accompanied by the establishment of a service to deal with disputes between homeowners and builders where the builder is available to rectify the fault. That service is available to consumers, free of charge, through the BACV.

Inquiry participants differed in their views on the effect of these changes on consumer protection. Some were critical of the changes, claiming they involved a major erosion of consumer protection. McCormick Builders stated that 'The [homeowner's warranty] insurance provides little protection to consumers' (sub. 33, p. 1). MR Constructions stated that 'the [warranty insurance] policies are virtually worthless to consumers' (sub. 78, p. 2), while the National Association of Steel-framed Housing noted 'It is not clear how "last resort" insurance can be adequate as a support mechanism for consumers' (sub. DR122, p. 1). Such criticism has been accompanied by calls for the re-instatement of the former arrangement. Other inquiry participants considered the changes had a negligible net effect on the level of consumer protection and did little except formalise the existing practice.

Two questions need to be answered: has the change seriously eroded consumer protection? If so, is a return to so-called first resort cover appropriate and feasible? Regarding the first question, the practical difference in consumer protection appears minor. Currently, if their builder is still available, consumers can seek recourse under the *Domestic Building Contracts Act 1995* (Vic.) for the

rectification of defects or uncompleted works. This arrangement is little different from that before the changes. As *The Age* noted around the time of the changes:

Insurance companies have long expected home buyers to exhaust all avenues of appeal before claiming on their policies ... Effectively, first resort is little different to last resort except that it results in home buyers having false expectations about their insurance rights. (Gittins 2002)

The current arrangements do differ, however, in one important respect. Previously, when a consumer lodged a claim where a builder was still available, the insurer pressured the builder to address the matter. If this did not resolve the issues, payment under the insurance policy was available (albeit not always immediately). This does not occur today, because consumers are not insured for claims against their extant builders. Current arrangements might thus be viewed as lessening consumers' 'bargaining power' to obtain redress. In practice, however, homeowners often initially contact their insurer with a complaint against their builder. In turn, the insurer (because the complaint highlights a contingent risk) has an incentive to intervene to help manage the dispute, often in conjunction with the regulator.

#### **Box 7.6 Building Advice and Conciliation Victoria**

BACV is a joint service delivered by Consumer Affairs Victoria (CAV) and the Building Commission. The BACV service:

- provides information, advice and assistance for consumers in relation to home building and renovating problems
- monitors and maintains standards for building contracts and building
- can use personnel from both the Building Commission and CAV to conciliate.

If a consumer makes a written complaint to BACV, and BACV considers this complaint to be valid, BACV (through CAV services) will attempt to engage with the owner and the builder to resolve the issue. CAV first offers telephone-based conciliation. If the telephone conciliation is unsuccessful, and an inspection is needed, CAV will refer the case to the Building Commission for a section 43F inspection or a section 43F inspection and conciliation. If an inspection is not needed but the matter is not resolved, CAV will offer additional conciliation services to the parties.

To use the site conciliation services provided by the Building Commission, both parties must sign an Agreement to Conciliate. If an agreement is reached—that is, if the issue is resolved—the parties must sign a Terms of Agreement, which states the terms of the agreement between the owner and the builder, which can be presented in Victorian Civil and Administrative Tribunal (VCAT) proceedings.

If a party refuses to conciliate, BACV may continue to assist the owner and complete a report that will advise the owner and the builder about their options. If the other party declines the BACV conciliation, a report can still be offered.

Source: The Allen Consulting Group 2005, p. 12.

However, the changes also established a range of services available through BACV, which was designed to provide a substitute for insurer oversight and to facilitate the resolution of disputes (box 7.6). The HIA noted:

Even though the regulations moved the scheme to a 'last resort' basis in 2002, consumers have the benefit of speedy and cost effective dispute resolution systems through the BACV and VCAT in the event that there are problems with the home and the builder is still trading. (sub. 58, p. 20)

Not all inquiry participants had a positive view of the efficacy of the alternative arrangements. The MBAV, commenting on BACV and VCAT as avenues for consumers to seek rectification, noted:

This can be costly and time consuming for all parties involved and leaves consumers questioning exactly what they are paying for (and being covered against) when provided with warranty insurance. (sub. 49, p. 8)

The Builders Collective was also critical of dispute resolution arrangements. In the case of VCAT, it noted 'the huge costs involved at VCAT which can and do quickly destroy the consumer's ability to properly defend themselves' (sub. 92, p. 13). In the case of the BACV, it noted:

Victorian builders are unable to access the government's dispute and resolution forum ... A builder, knowing that a problem may be developing cannot instigate any dispute resolution action if the client refuses. This leaves the builder to merely wait for the eventual litigation to occur. By the time this arrives, the dispute has escalated well beyond what it should have ever been expected to. In addition, consumers are not required to go to BACV, they can simply bypass this ... process and head straight to court at VCAT. (sub. 92, p. 7)

Mr Romauld Andrew commented:

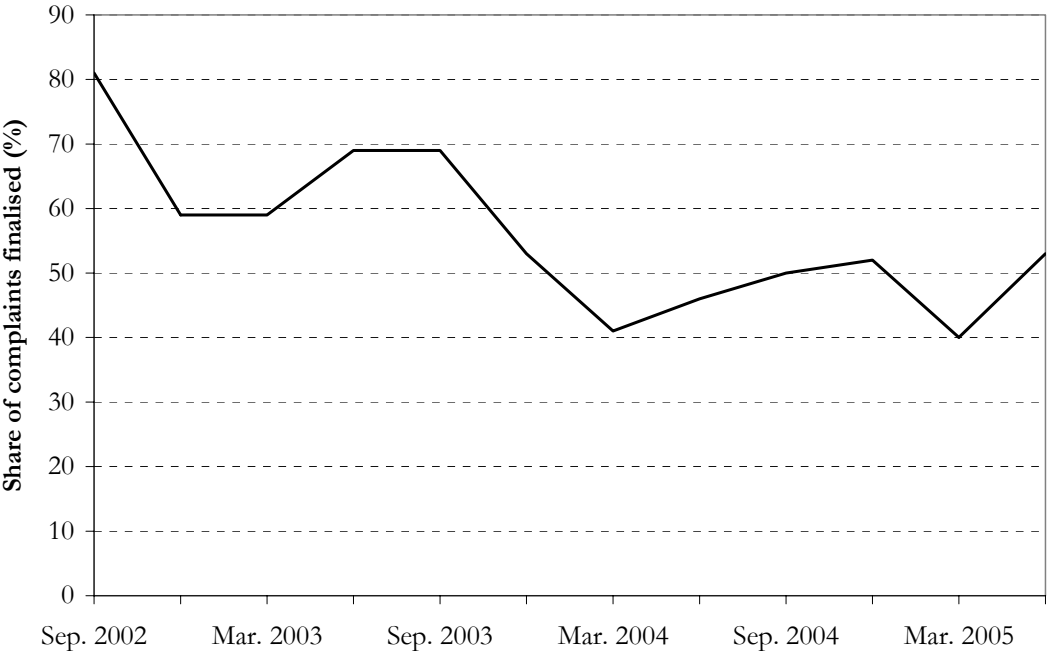
It defies logic to deny what is self-evident, i.e. reduction in cover leads to a reduction in cover. If insurers now have less risk, then obviously consumers get less cover. The real question is, do the Act and BACV 'provide an effective substitute'? The answer is no. First, recourse under the Act was always available so it cannot be described as a substitute. Secondly, complex disputes where the consumer protection is required cannot and are not resolved by BACV. BACV has not reduced the number of domestic building disputes or insurance appeals at VCAT, and BACV is unable to deal with such disputes. It therefore follows that the reduced cover leaves consumers worse off than before, while insurers are better off. The extent to which this is so is difficult to quantify. However, if the old scheme was a 'cruel hoax' (to quote Professor Allen) then I leave it to you to find a suitable description for the new scheme. (sub. DR167, p. 5)

However, a review of the use and performance of BACV suggests that the move to 'last resort' has not left consumers in the lurch, and that the BACV service is providing an avenue for consumer protection. In 2003-04, for example, BACV

received 20 120 telephone or written enquiries and 1634 formal written complaints (The Allen Consulting Group 2005, p. 15). Additionally, and against a backdrop whereby the builder’s obligation under the Domestic Building Contracts Act is the prime avenue of consumer protection, only a small number of complaints end up as disputes requiring resolution. A survey of domestic consumers and practitioners in 2003-04 found that about 1.7 per cent of all domestic building works (or about 1500) resulted in a dispute,<sup>11</sup> with the owners valuing disputed items at between \$28 000 and \$218 000 (The Allen Consulting Group 2005, pp. 29–30, 33).

The success of BACV in resolving disputes fluctuated between 80 per cent in September 2002 and 40 per cent in March 2005, and averaged around 60 per cent (figure 7.1). Since March 2005, the resolution rate has improved to greater than 50 per cent. Disputes not resolved at BACV are referred to other authorities such as VCAT for facilitation, negotiation or investigation. However, a consumer can apply at any time to VCAT to resolve any dispute that has arisen under a domestic building contract in Victoria.

**Figure 7.1 Building Advice and Conciliation Victoria resolution rates**



Source: BC undated A, S3-05 BACV resolution rate.

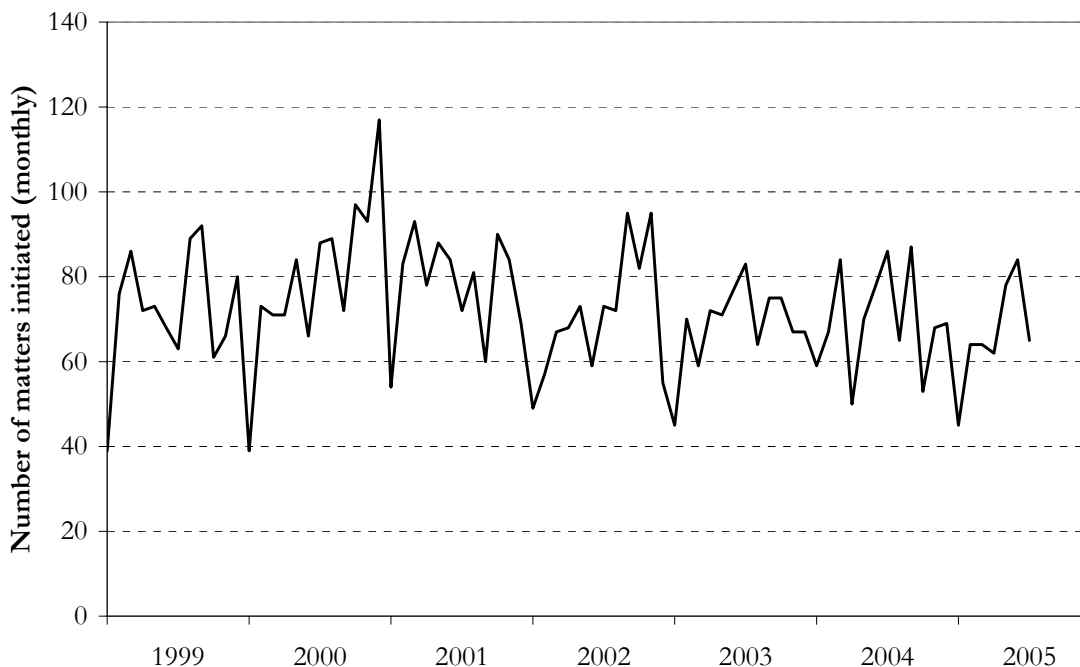
<sup>11</sup> A dispute refers to a serious argument concluded only by involving third party intervention such as binding determination by arbitration at VCAT or the courts.

Significantly, however, there is no evidence of any sustained increase in disputes before VCAT corresponding to the move to ‘last resort’ (that is, from June 2002). Although the number of matters initiated by consumers in the VCAT domestic building list has exhibited marked fluctuations from quarter to quarter, the trend from 1999 to 2005 has shown no sign of increasing (figure 7.2). This crude measure suggests that removing insurers from so-called ‘first resort’ claims has not resulted in an upsurge in unrequited claims seeking resolution elsewhere.

Nonetheless, a number of improvements to the BACV should be considered. First, regarding the relationship between BACV and VCAT, CAV should assess the technique used by the Small Business Commission to promote conciliation and dispute resolution before matters flow to VCAT. This involves a cost allocation rule for VCAT, whereby costs might be awarded against a party that goes to VCAT without first trying (BACV) conciliation measures.

Second, in order to improve the functioning of BACV, CAV should assess an access fee. This fee would be intended to deter time consuming but insignificant claims that can arise with a free service. (It could also help stabilise BACV funding, which is a concern of CAV). Third, this assessment should be combined with a redesign of the BACV scheme to allow builders to have access to it.

Figure 7.2 **Domestic building list matters initiated in the Victorian Civil and Administrative Tribunal**



Source: BC undated A, S3-07 VCAT disputes.

The Commission is not convinced that the move to ‘last resort’ insurance has resulted in a general loss of consumer protection for events formerly covered under so-called ‘first resort’ cover. Consumer protection under the Domestic Building Contracts Act, and supported by the services available through BACV, is broadly equivalent to that formerly available, although improvements are worth making. Moreover, to keep regulatory intrusion to the minimum, mandatory insurance should be constrained to the minimum, (that is, the ‘last resort’ product).<sup>12</sup> Accordingly, the Commission considers the current ‘last resort’ cover is appropriate and perceives no compelling grounds for a return to the former coverage.<sup>13</sup>

This debate is almost academic, because private insurers are unwilling to offer such ‘first resort’ cover. Were providers compelled to do so, they would likely retire from the market. Vero stated:

So-called ‘first resort’ [builders warranty insurance] does not and cannot work because it fails, on several counts, to meet two of the primary tests of insurance, i.e. those of insurable/financial interest and insurable event.

Vero will not participate in the market if the insurance system reverts to a so-called ‘first resort’ scheme. This is insurance based on unsound principles. (sub. 71, pp. 6 and 8)

### **Finding 7.2**

The data available to the Commission suggests that the change in the cover of builders warranty insurance to ‘last resort’ appears not to have been associated with a general loss of consumer protection for events formerly covered under so-called ‘first resort’ cover. Recourse under the *Domestic Building Contracts Act 1995* and the establishment of dispute resolution services through Building Advice and Conciliation Victoria can provide an effective substitute for that cover.

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<sup>12</sup> This would correspond to the case for asymmetric paternalism: ‘A regulation is asymmetrically paternalistic if it creates large benefits for those who make errors, while imposing little or no harm on those who are fully rational’ (Camerer et al 2003). A well-informed consumer would be likely to spend the equivalent to secure information to protect them.

<sup>13</sup> This is not to argue that current dispute resolution arrangements do not need to be improved, or that other factors may not provide compelling reasons for change. Linking changes in dispute resolution arrangements with building practitioner registration has been suggested as a way of significantly improving compliance with licensing regimes and providing another path of consumer protection.



#### **Recommendation 7.4**

**That Consumer Affairs Victoria assess whether to amend current Building Advice and Conciliation Victoria (BACV) arrangements to include:**

- **a rule for allocating costs against a party that seeks resolution in the Victorian Civil and Administrative Tribunal without first seeking to resolve a dispute through BACV**
- **access for builders to the BACV process**
- **fees for access to the BACV process.**

### **7.2.3 Are current exemptions appropriate?**

Some inquiry participants questioned whether existing exemptions from warranty insurance are appropriate. Two particular concerns relate to multi-storey buildings and architect/engineer led projects.

#### **Multi-storey buildings**

On 1 July 2002, Victoria introduced changes to builders warranty insurance that meant buildings of more than three storeys that contain two or more separate dwellings (high rise) no longer require warranty insurance cover. Victoria is not unique in this regard, because no other scheme in Australia provides coverage for high-rise dwellings (HIA, sub. 58, p. 22).

The Builders Collective was critical of this exemption:

We note that there are considerable exemptions to the current Victorian system of consumer protection whereby all residential buildings of three levels and above, ... are exempt from the provisions of warranty insurance and consumer protection. We feel that this is further discriminatory against smaller builders as they enjoy no exemptions whatsoever. The fact remains that people in these multi-unit developments are still building their home and we feel that it is preposterous that they have no acceptable consumer protection facility employed. (sub. 38, p. 12)

It is not correct, however, that these consumers have no acceptable protection against non-completion in the absence of warranty insurance. Domestic building contracts provide some protection insofar as settlement cannot take place until the unit has been completed. Moreover, the *Sale of Land Act 1962* (Vic.) provides some protection against the cost of non-completion. That Act regulates the sale of land and property, including off-the-plan sales for property to be built under domestic building contracts (such as high-rise apartments). The Act requires off-the-plan contracts to provide for the deposit to be held in trust until the registration of the plan of subdivision. Additionally, the Act provides some

protection against delays in registering the plan of subdivision—s9AE(2) gives the developer 18 months from the signing of the contract, or whatever other period is specified in the contract, to register the plan, failing which the purchaser can rescind.

The HIA summed up this arrangement when it noted that consumers purchasing multi-storey property do not rely on builders warranty insurance because:

... the major risk faced by a homeowner is for non-completion of the home and this risk does not apply in high rise construction as there is no construction contract with the owner. (sub. 58, p. 21)

Although this is literally correct, CAV drew attention to the possibility that the developer and the builder are sometimes the same entity, albeit separated by a corporate veil (sub. DR166, p. 13).

Regarding the other risk covered by warranty insurance—the rectification of defects—the HIA considered that here, too, high-rise dwellings are fundamentally different from those covered by warranty insurance:

... the bodies corporate in high rise developments would typically be well resourced, relative to the average home owner of a detached home, and therefore able to manage the risks in their development ... (sub. 58, p. 21)

The characterisation by the HIA of bodies corporate as ‘well resourced’ and ‘able to manage the risks’ will not, however, be universally so. The developer might hold voting rights, or the appointment of the body corporate manager may pre-date the unit holders’ involvement (although the body corporate manager only serves at the continuing wish of the unit holders). Further, while a body of unit holders should be able to bring more resources to bear than an individual owner can, its ability to influence the construction process is limited. As CAV noted:

The construction contract sets out the obligations that the warranty insurance exists to protect in the circumstances of the builder dying becoming insolvent or disappearing. Therefore, at the time the body corporate is created the contract between the developer and builder has already been signed and the obligations under the contract have begun. The body corporate has no contractual nexus with the builder. (sub. DR166, p. 13)

The general case for mandatory warranty insurance for the construction of multi-storey residential property is not as strong when considered against the rationale for government intervention—that is, information asymmetries. The Grellman report, for example, noted that high-rise construction over three storeys is fundamentally a commercial project, with project risks different from those of an ordinary house construction (Grellman 2003, p. 32). For such projects, the incidence of information asymmetry between developer and builder is likely to

be minimal compared with that facing the average person in choosing a builder for their (non high-rise) dwelling.

The Grellman report also argued that developers and builders involved in high-rise projects are generally larger organisations with more robust financial management than that of small builders. Consequently, the risk of non-completion and structural failure is reduced. Empirical studies of business failure support this observation, consistently finding that a fundamental characteristic distinguishing small businesses from large ones is their higher probability of ceasing to trade.<sup>14</sup> Additionally, a financier will often monitor the builder/developer's financial security during construction, further contributing to a lower risk of insolvency (Grellman 2003, p. 32).

The Building Designers Association of Victoria was critical of the exemption for other reasons:

Buildings of more than three storeys that contain two or more separate dwellings (high rise) now no longer require builders warranty insurance. ... This key change to the domestic building insurance effectively transferred liability to building practitioner professionals, while leaving builders free from any liability for such construction. (sub. 43, p. 8)

Architeam Cooperative Limited made the same point:

It is also the view of Architeam that not to have builders warranty insurance for buildings more than three storeys has effectively transferred the liability to the designer and allowed the builder to be free from any liability and this is manifestly unfair. (sub. 39, p. 3)

However, the builder would still be subject to their legal obligations under the contract with the developer. It is thus not true to say the builder is free from liability for incomplete or defective work. Only where the builder is not available (because they have died or disappeared or are insolvent) might the liability for completion or rectification of defects fall to other practitioners. But even here, the professional performance of other practitioners, which would necessarily be the focus of any claim, is not related to the builder's solvency or health.

Moreover, this criticism misses the point about why warranty insurance is mandatory for some dwellings. The rationale for mandating insurance is to correct for information failures that deny the average consumer the ability to make an informed choice; the insurance is not intended as an instrument to redistribute liability among building practitioners.

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<sup>14</sup> See, for example, Bickerdyke, Lattimore & Madge 2000, pp. 18–19.

The Commission's view is that the absence of builders warranty insurance does not mean people purchasing high-rise dwellings are bereft of consumer protection. The Sale of Land Act provides some protection in this regard. Additionally, the characteristics of high-rise construction mean that market failure from information asymmetries is less likely.

Further, mandatory insurance for high-rise dwelling construction might be impractical. Vero, for example, noted:

Any attempt to once more include a mandatory requirement for high-rise multi-unit developments will be impossible to implement as no re-insurance support exists in this country (or overseas) for a cover of this nature. (sub. 71, p. 10)

However, CGU disagreed that such a market might be impractical. It noted circumstances have changed, more insurers are in the market and dwindling reinsurance is no longer the case. Accordingly, it recommended that government could reconsider the issue of mandatory builders warranty insurance for multi-story dwellings (sub. DR135, p. 2).

The HIA also considered that added consumer protection is warranted. While it viewed completion risk as not being an issue for high-rise homeowners, it noted that risks of defective work post-completion remain (sub. DR163, p. 18). Vero, too, noted that more needs to be done to protect buyers of multi-story dwellings from bearing an inappropriate proportion of maintenance risk:

... we believe a better framework is achievable, particularly if a BWI-style backstop 'defect' risk protection for the body corporate is achieved by mandating their cut-through to the performance guarantee provided by the builder to the developer (accompanied by a minimum three year defects period). (sub. DR171, p. 8)

Similarly, CAV noted:

The Sale of Land Act does not provide sufficient consumer protection for consumers in multi-storey developments and the exemption that applies to builders warranty insurance in these developments over three storeys should be removed. (sub. DR166, p. 6)

As noted, the insurance market has changed considerably over the past two years. The above discussion indicates that the risk for consumers of non-completion and structural defects in multi-story dwelling construction is inherently lower, given characteristics of high-rise construction and, to some degree, the protection afforded consumers under the Sale of Land Act. Some concerns remain, however, that consumers are poorly placed to assess or manage the risk of a builder not being available to correct defective work. The Commission thus considers the prospect of encouraging voluntary builders warranty insurance or defects insurance should not be ruled out for multi-story

dwellings. Given the likely minimal risk of non-completion or structural defects in multi-story dwelling construction, any such warranty insurance should be confined to non-structural defects—for example, those relating to inadequate water-proofing or fire-proofing. Consumers would need to weigh up the purchase price consequences of such insurance.

### **Finding 7.3**

Given the characteristics of high-rise construction and, to a lesser extent the protection afforded consumers under the *Sale of Land Act 1962*, the current exemption of multi-storey dwellings from mandatory warranty insurance for completion risk and structural defects is appropriate. However, encouragement of voluntary builders warranty insurance or defects insurance for non-structural defects is worth assessment by CAV in conjunction with the insurance industry.

### **Architect/engineer led construction**

The MBAV considered it is unnecessary to require builders to obtain insurance for architect/engineer led projects above \$1 million (an arbitrary limit that MBAV selected):

Builders undertaking these types of projects are subject to external accountability measures provided by architects, and engineers. This provides a superior form of protection for ‘wealthy’ consumers whereas conventional housing projects have none of these external scrutineers of the building process. MBAV is concerned with the impost upon the conventional warranty insurance model upon builders of high value homes. (sub. 49, p. 9)

... subsequent purchases of high value homes are also protected by the fact that not only architects check contracts and select builders, but also contracts are designed, administered, checked and verified by architects/engineers. (sub. 49, p. 10)

However, while an architect/engineer led project offers advantages such as the use of non-standard building contracts that give extra protection for consumers (particularly the retention of 10 per cent of the contract value until the work is certified as complete—box 7.7), the building contract for such projects remains between the consumer and the builder. Removing the requirement for builders to carry warranty insurance would mean the customer bears the completion and defects risk if the builder dies or disappears, or becomes insolvent.

### **Box 7.7 Consumer benefits from RAIA/MBAV contracts**

Royal Australian Institute of Architects (RAIA)/Master Builders Association of Victoria (MBAV) building contracts protect the client, in that the consumer:

- pays only for work completed
- pays the builder on a 'cost to complete' basis, as assessed by the architect. Payment usually occurs six to eight weeks after work is complete.
- holds retentions of up to 10 per cent of the contract value
- has a maintenance period of six to 12 months
- pays only when the architect certifies the work(s) as complete.

Source: MBAV, sub. 49, p. 10.

More fundamental is the issue of whether architects or engineers are capable of assessing the risk of a builder becoming insolvent. Although architects and engineers work within the building industry, they generally face the same information asymmetries as faced by everyday consumers in evaluating the risk that a particular builder might become insolvent. The proposal also founders on the practicality of having to separate the financial dealings of a builder who builds both architect/engineer managed homes and other housing construction projects. Archicentre and the RAIA considered there is no satisfactory reason to exempt such projects from builders warranty insurance (sub. DR164, p. 7).

### **Finding 7.4**

Architects and engineers generally face the same problems as faced by average consumers in assessing the financial health of a builder and determining the risk that a builder might become insolvent. The Victorian Competition and Efficiency Commission finds no compelling grounds to exclude a builder of an architect/engineer led housing project from the requirement to have builders warranty insurance.

## 7.2.4 Should government provide warranty insurance?

Several inquiry participants advocated a return to a government run warranty insurance scheme, citing the Queensland scheme as the model of choice.<sup>15</sup> The Builders Collective of Australia noted:

The Queensland scheme has been very successful and is subject to ongoing performance reviews from both consumers and builders ... this would be the preferred arrangement to base a national or state-by-state model upon. (sub. 38, p. 11)

One motivator for such calls is the desire to avoid a repeat of the immense disruption in private insurance markets that followed the collapse of HIH. However, the evident maturing of the insurance market in Victoria, coupled with stricter prudential oversight by APRA (itself a legacy of the HIH collapse), reduces the likelihood of this occurring.

Other features motivating calls to implement a Queensland-type scheme in Victoria are the apparent ease of access to insurance and lower premiums. These, for example, were among reasons given by the Builders Collective in support of its initial call to move to such a scheme (sub. 38, p. 11). Evidence to the Commission indicates that access was a problem following the collapse of HIH, but has improved markedly over the past 18 months. Similarly, lengthy delays in approvals appear to be largely a problem of the past. Vero indicated the extent of change in this arena: for its operations, it noted that pre-2002, a builder could expect to be ‘in the system—awaiting certificate issue’ as long as 60 days, whereas that time now is less than 25 days. Moreover, Vero stated that ‘More than 97 per cent of all builder clients who apply for [builders warranty insurance] are accepted for the turnover levels they request’ (sub. 71, p. 4). This acceptance rate, together with evident greater competition in the market (which can be expected to encourage better levels of service), has led the Commission to consider that the Queensland scheme offers no compelling advantages in terms of access.

Regarding the apparent advantage of lower premiums, the Builders Collective of Australia maintained that the Queensland system enjoys premiums 50–70 per cent cheaper than those in Victoria (sub. 38, p. 10). Information reviewed by the Commission, including its own survey of Victorian building practitioners, did not support this view. That survey indicated average premiums clustered around 0.4–0.8 per cent (table C.6, appendix C). Additionally, evidence presented by Vero suggests the Queensland premiums generally are not lower

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<sup>15</sup> Queensland’s home warranty insurance scheme is provided by the Queensland Building Services Authority—a statutory authority established under the Building Services Authority Act 1991 (Qld). The scheme provides protection against non-completion of contract works and rectification of defects.

(table 7.3). Vero indicated that the average premium for its policies as a percentage of contract value in Victoria (0.49 per cent) is considerably less than in Queensland (0.70 per cent). Allowing for the higher cost of the broader cover available under the Queensland scheme (by adding the 0.064 per cent BACV levy to the Victorian average) does not alter the ranking.<sup>16</sup> On this basis, the comparable average Victorian premium would rise to about 0.554 per cent, still markedly less than in Queensland. The Queensland scheme thus appears to provide no compelling cost advantage over arrangements in Victoria.

The HIA considered government provision of warranty insurance is not appropriate:

HIA does not support the monopoly warranty insurance arrangements that apply in Queensland. The lack of competition in the Queensland scheme has resulted in a regime where all builders face the same premium, irrespective of their financial or management strength. (sub. 58, p. 21)

The Queensland scheme does not risk rate builders for the purpose of issuing insurance, effectively classing all builders into the one risk category. This means builders at lower risk of insolvency are forced to cross-subsidise higher risk builders. Such arrangements provide no incentive for builders to improve their risk profile. As the National Competition Council noted, this sort of intervention in the premium setting process serves only to distort the incentives that risk based pricing creates (NCC 2003, p. 22). A government run scheme could risk rate builders, removing cross-subsidies. But a more sophisticated scheme without competition may run at higher costs.

Most importantly, a monopoly provision of insurance (as with any product or service) raises concerns about the lack of competitive pressure on a supplier to improve pricing, product offerings and service. Further concerns relate to the conflict of interest inherent in the Queensland model. As the HIA noted:

... [the Queensland scheme] produces all the problems with monopoly providers of any service. For example, premiums are set by regulation and provide no incentive for the insurer to operate efficiently. If there are inefficient practices in the running of the insurance scheme they can be covered by increasing premiums. (sub. 58, p. 21)

On the other hand, the Queensland scheme is integrated with the builder registration system. This feature allows the registration authority to identify the incidence of claims against builders for rectification work and their subsequent performance, and to pressure builders to complete works for which they are

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<sup>16</sup> The BACV service was introduced to facilitate resolution of so-called 'first resort' claims. Its cost, therefore, may be considered a proxy for the premium/cost associated with settling such claims.



responsible. As the Builders Collective noted, this link can improve consumer protection. (However, while integrating insurance and registration within a government agency offers this advantage, it is not essential. The key is the early identification of poor builder performance and linking this to registration, rather than government ownership. If nothing else, the Queensland-type model points to how consumer protection in Victoria might be improved—for example, by better linking complaints lodged with BACV with consideration of a builder’s ongoing registration).<sup>17</sup> Overall, the Commission agrees with the HIA’s conclusion on this topic: ‘the interests of the home owners and the building community are better served by a vibrant competitive market for warranty insurance’ (sub. 58, p. 22).

Another consideration in the move to a government scheme is the cost of losing consistency with other markets and thus reducing the size of the insured pool. Victoria and New South Wales constitute about 70 per cent of housing construction activity in Australia. Removing Victoria from the insurance pool would increase the volatility of risk in the pool for both states and, at the same time, reduce economies of scale. Private insurers’ costs (and premiums) in other states would also be likely to rise if Victoria adopted a government run scheme.

Finally, although private provision has been associated with a period of upheaval following the HIH collapse, the evidence of recent entrants into, and the maturing of, the market indicates these events are now largely behind us. (Monitoring market stability in the future would, as discussed elsewhere, be enhanced by better public accountability of key performance data). Moreover, the Victorian Government has facilitated insurers to make a market, and it would be premature to renege on that position. As CGU Insurance noted, ‘[the] home warranty insurance market should be free of structural change for another three years, in order for insurers and regulators to have statistically relevant data to assess the success of the current regime’ (sub. 15, p. 4).

In present circumstances, the Commission is not convinced that a government monopoly provider of warranty insurance would deliver outcomes superior to those of current arrangements. Nonetheless, improvements to current arrangements can and should be made, as described elsewhere in this chapter.

### **Finding 7.5**

The Victorian Competition and Efficiency Commission is not convinced that a shift from the private competitive provision of insurance to a Queensland-type government monopoly provider would deliver, in aggregate, superior outcomes for Victoria’s housing construction industry and consumers.

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<sup>17</sup> This is discussed in chapter 6.

## 7.2.5 Insurance and affordability

Builders warranty insurance (while providing the benefit of consumer protection) adds to the cost of housing construction. It does so directly via the cost of premiums and indirectly via costs incurred by builders to obtain that insurance. To that extent, warranty insurance may reduce housing affordability.

Vero provided a measure of average premiums for a range of constructions and builder risk categories, and a comparison with Queensland's single rate for its more comprehensive scheme (table 7.3). The Queensland rates broadly equate to Vero's category 3.

Table 7.3 **Average premiums in Victoria (Vero) and Queensland**

<i>Contract value (\$)</i>	<i>Dwelling type</i>	<i>Category 1 premium (\$)</i>	<i>Category 2 premium (\$)</i>	<i>Category 3 premium (\$)</i>	<i>Category 5 premium (\$)</i>	<i>Queensland scheme (\$)</i>
12 000	Improvement	69	92	159	351	141
20 000	Improvement	69	92	159	351	141
160 000	Alterations	449	604	1040	2291	1128
160 000	New home	449	604	1040	2291	1128
250 000	New home	736	989	1703	3754	1410
500 000	New home	942	1267	2181	4805	1410

Source: Vero, sub. 71, p. 15.

Vero indicated that the majority of its policies are for builders in categories 1 and 2, and that, overall, its average premium in Victoria (as a percentage of average contract value) was 0.49 per cent by January 2005—a level that compared favourably with the national average of 0.57 per cent (sub. 71, p. 14). Moreover, the average premium as a percentage of average contract value had fallen from 0.55 per cent since January 2003 (figure 7.3).

Figure 7.3 **Average premium for Vero policies, as a percentage of average contract value in Victoria**



Source: Vero, sub. 71, p. 15.

Changes in Victoria's warranty insurance market suggest that the stability and maturation of the market will continue. Central to this forecast is the growth in the number of providers, although Vero still appears to have a major share of the market. As noted, at September 2005, eight warranty insurance providers were qualified to operate in the Victorian market. This situation is far from the days following the collapse of HIH, when Vero was effectively the only insurer for many builders. In addition, the number of brokers offering warranty insurance has grown rapidly in recent years—a move that has strengthened competition in the market.

The Tasmanian Department of Justice acknowledged this point in its issues paper for a review of the *Housing Indemnity Act 1992* (Tas.):

The effect that the entry of new insurers to the market will have on premiums as the market becomes more competitive remains to be seen but it is not unrealistic to assume that increased competition may see premiums adjusted downwards. At the least, the growing number of providers offers builders the opportunity to shop around to obtain the best price. (Department of Justice 2005, p. 28)

Warranty insurance might also add indirectly to the cost of housing via the costs incurred by builders to obtain that insurance. For some builders, the costs in

obtaining a bank guarantee would be around 0.5 per cent of the value of a building contract. For a \$250 000 house, this corresponds to about \$1200. Whether this cost would be borne by the consumer or absorbed by the builder (in terms of reduced profit margin) would depend on market circumstances. However, the proportion of builders affected by this requirement is low (probably less than 10 per cent). Additionally, because the requirement predominantly affects small builders, the number of houses built by those affected would represent an even smaller proportion of total housing construction value. Moreover, the circumstances occasioning a bank guarantee are, arguably, those where the insurance providers' interests are aligned with the consumers' interests, limiting risks arising from the most risky builders.

Warranty insurance thus appears to add about 0.5 per cent to the cost of a building contract via premiums. In a small proportion of cases, it may add as much again. However, at best, this cost is a crude and misleading measure of the effect that mandatory warranty insurance might have on housing affordability. A true measure of this effect is the additional cost that mandatory insurance imposes relative to insurance not being mandatory. If it were not compulsory, what proportion of dwelling construction would have such cover?

Australian experience provides no guidance on this question, because all states and territories require mandatory insurance. Overseas experience too is of limited value, because plucking one feature out of a total and different regulatory/legal framework is highly problematic. The Commission is thus wary of transferring to Victoria the high rate of voluntary uptake that the HIA noted in the United Kingdom:

There is no legislation in the United Kingdom mandating that new homes be constructed under a warranty policy. Yet under the voluntary warranty scheme over 90 per cent of the houses built are covered by warranty insurance. (sub. 58, p. 22)

Disentangling the level to which this uptake might be comparable in Australia is beyond the resources of this inquiry. Suffice to say that the additional cost of mandatory insurance (relative to voluntary insurance) would, for aggregate housing construction, be less than the average 0.5 per cent added to the cost of a building contract via premiums.

On balance, the Commission considers that mandatory insurance imposes a modest cost on dwelling construction, and a cost likely to continue to be constrained by competition. Moreover, compared with the alternative of voluntary warranty insurance, mandatory insurance is unlikely to have a significant impact on housing affordability in aggregate.

### **Finding 7.6**

The Victorian Competition and Efficiency Commission considers that mandatory insurance imposes a modest cost on dwelling construction, and a cost likely to continue to be constrained by competition. Moreover, relative to voluntary warranty insurance, mandatory insurance is unlikely to have a significant impact on housing affordability in aggregate.

## **7.2.6 Effect on the supply of builders**

Inquiry participants were critical of insurance arrangements because of their perceived effect in reducing the supply of builders (and, as a result, reducing competition). These concerns about supply are twofold. The first (and most significant) relates to builders in general being unable to obtain insurance or, where they can obtain it, having that insurance impose limits on their business turnover. The second concern relates to the insurance arrangements possibly impeding new entrants (particularly young builders) to the industry.

### **Effect on builders generally**

The MBAV summarised the background to most inquiry participants' concerns:

Following the collapse of the largest provider of builders' warranty, HIH Insurance, in March 2001 and the withdrawal of Dexta Corporation from the market in 2002, thousands of builders across Australia were thrown into chaos as they sought mandated warranty insurance as a prerequisite to obtaining builder permits for their clients. Delays of up to six (6) months were not uncommon, with devastating effects upon their business, suppliers, apprentices and family. ... Conditions placed upon builders/contractors by warranty insurance providers include turnover limits and requires them to provide indemnities (including bank guarantees) as well as suffer arbitrary underwriting changes without warning. (sub. 49, p. 7)

Other organisations also drew attention to the effect of warranty insurance in reducing the supply of builders. Building Ethics Australia noted:

The inability of many small, specialist and older builders to obtain adequate warranty insurance for their business needs has seen many exit the domestic building industry. (sub. 34, p. 4)

Several builders provided examples of the difficulties they faced in obtaining insurance or insurance for the value of work they wished to undertake—difficulties that restricted their ability to provide building services to the housing construction market (box 7.8).

## Box 7.8      **How insurance can affect the supply of builders**

The following quotes indicate how warranty insurance requirements can affect the supply of builders in the housing construction market:

These various insurance companies have placed limits on how many jobs we could take and their contract value and we have been placed many times in the ridiculous position of having to turn away work. Even within these restrictions, and the consequent limitation placed on the income we could gain, we lost a year of that when we could not find an insurer for five months after HHH went bankrupt and more than four months when Dexta left the market. (Chiwest Investments, sub. 67, p. 1)

My husband and I have had enough of all these worries that we plan to semi-retire next year—we are only in our forties—but the financial risk we have for our subcontractors in the areas of warranty insurance and OH&S is too much to bear—if we are fined or there is claim made on our nest egg we could lose our home and ultimately the nest egg we have built up for our retirement. We have got to the stage where that we would rather change our career to one of much less risk. (Cronin Builders, sub. 51, p. 1)

Being a typical family business, we apprenticed our eldest son and over recent years he has personally managed our projects very successfully, however has been refused insurance simply because he could not afford both the upfront guaranteed fee and conditions demanded by the insurer. He is a very competent tradesman, vital to our business, the industry requires well qualified tradesman like him to be in the industry, presently he is considering alternative employment opportunities mainly because of the dictatorial attitude of the main insurers. (L&F Holdings, sub. 83, p. 2)

We are severely disadvantaged by the practices of the insurance companies through the lengthy application assessment period, by forced indemnities, and the subsequent costly restructuring of businesses and capping of turnover. It disturbs me that an insurance company has more control over my business than I do. (Property Power, sub. 85, p. 1)

CAV also noted that a significant number of builders still have difficulty in obtaining such insurance, while acknowledging that access to builders warranty insurance has improved over the past few years (sub. 91, p. 30). The Office of the Small Business Commissioner provided similar comment:

I consider that there are genuine problems associated with the regulation of builders warranty insurance for small business builders in Victoria. These problems are having an adverse impact on some small business builders. In particular, some builders are experiencing difficulty in accessing builders warranty insurance, due to the seemingly onerous administrative and prudential requirements required of them by insurers. This is despite recent reforms in the area. (sub. DR155, p. 8)

Since mid-2003, the Office of the Small Business Commissioner has received 14 unfair market practice complaints under the Small Business Commissioner Act 2003 from small business builders concerning builders warranty insurance. These complaints generally concern difficulties with small businesses accessing builders warranty insurance. (sub. DR155, p. 9)

However, while inquiry participants indicated the history of problems that insurance has caused, they also highlighted how recent changes have significantly improved matters. The HIA noted:

With the recent emergence of some much needed competition among underwriters, there is evidence of more flexible approaches to underwriting being adopted together with improved standards and conditions of service. For example, one underwriter is offering low volume builders access to cover with streamlined entry conditions, saving builders substantial cost to have accountants prepare detailed financial statements and accounts. In addition, there are more flexible approaches being taken to turnover limits and the value of building jobs. (sub. 58, p. 21)

Similarly, Port Phillip Constructions noted how the offerings available today are a vast improvement over those available to them in the recent past:

The annual turnover for my business partner and I was capped at \$500 000 per year, and individual job limits were also put in place. ... Our individual job limits make us unable to quote on many jobs that are well within our capabilities therefore restricting our trade.

Vero Insurance, who has been our insurer through HIA Insurance, recently released a product that would allow us a maximum annual turnover of 2 million dollars. This is a much better scenario for our business. (sub. 81, p. 1)

Other builders too provided evidence that things are improving, with Colmac Homes noting:

Although now it has become a bit easier to obtain warranty insurance with at least more underwriters in the market, even our situation is a lot better than it was when it was through Vero and HIA insurance services now that CGU has entered the market. (sub. 80, p. 2)

One new entrant, Building Ethics Australia, is also offering insurance with less onerous financial requirements of builders, relieving builders from having to restructure their assets or provide costly bank guarantees. This offering accords with the approach advocated by the Building Appeals Board, which noted:

There is an urgent need for an alternative product that encourages new entrants to the domestic building industry, discourages early retirement or withdrawal by older, experienced and skilled builders, and at the same time offers consumers ongoing protection and quality assurance during the building process. (sub. 74, p. 9)

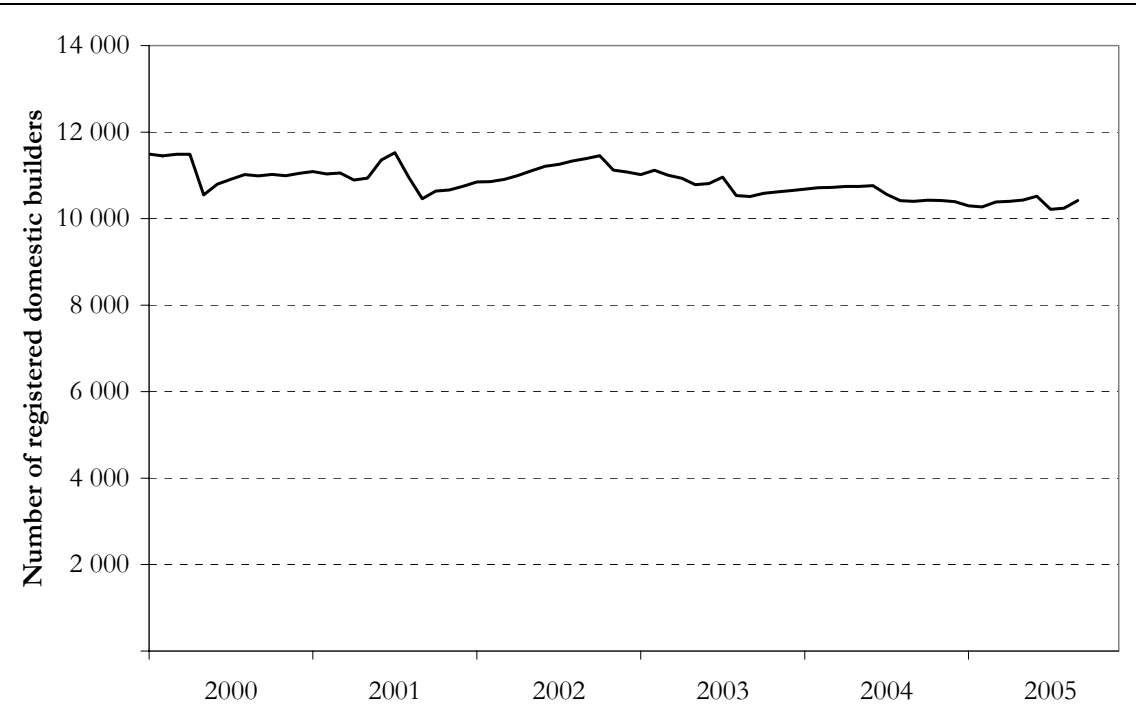
The maturation of the market has also led to improvements in product offerings and service from the dominant provider, Vero. Vero noted that it has introduced Express Assess, a service for 80 per cent of builders with an annual turnover of \$2 million or less. The service offers a simplified assessment and application form and aims for a 72 hour turnaround time (sub. 71, p. 12).

In short, there is evidence of a maturing market, with new entrants and increased competition and product offerings making it easier for builders to access insurance and cover for the level of activity required. These changes appear to address (although not dispel completely) concerns about the effect of insurance on the supply of builders. The Tasmanian Department of Justice corroborated this view in its recent issues paper:

... related to the issues of cost and the complexities of meeting insurers' requirements is the time taken by insurers to determine whether or not to offer cover to a builder. Evidence suggests this is less problematic now than it was several years ago following the collapse of HIH and the departure of Dexta from the Tasmanian housing indemnity market. ... With several insurers now operating in the Tasmanian market, timely access to insurance is less of an issue now than in the past. (Department of Justice 2005, pp. 28–29)

In any insurance system, higher risks may be filtered out by either exclusion or price, which is part of the consumer benefit. A small number of complaints about access is not necessarily a sign of systemic failure. Moreover, from an industry-wide perspective, the effect of insurance on the aggregate number of domestic builders appears to have been relatively small. Data from the Building Commission, for example, shows the total number of registered domestic builders changed only marginally from 1999-2000 to 2004-05 (figure 7.4).

Figure 7.4 **Domestic builders registered with the Building Practitioners Board**



Source: BC undated A, A3:04 Registered practitioners.



Further, from a consumer's perspective, the available supply of domestic builders has continued to offer a competitive choice. As the HIA noted:

Despite the difficulties that builders faced immediately following the collapse of HIH, the home building market has remained extremely competitive. There are currently around 9800 domestic builders [unlimited] registered in Victoria, only marginally down on the 10 400 registered in 2000 at the peak of the pre-GST boom in home building. (sub. 58, p. 21)

Notwithstanding apparent recent improvements in access to builders warranty insurance, the experience of many small builders suggests some oversight of insurers' conduct is appropriate. This was a theme in the Tasmanian Department of Justice issues paper, which noted:

... insurers' processes must be transparent and builders should be informed of the requirements they must meet, the criteria on which a decision will be made as to whether to offer cover and how premiums will be determined. (Department of Justice 2005, p. 27)

For some types of insurance, insurers subscribe to a code of practice (administered by Insurance Enquiries and Complaints Ltd, an impartial body that is independent of any insurer—effectively an insurance ombudsman service). But the code does not encompass builders warranty insurance, so this service is not applicable for handling builders' complaints about how insurers treat them.

For builders warranty insurance, insurers have committed to standards of service and to advertise the standards they aim to achieve. QBE, for example, advertises that 'QBE and its authorised agents/brokers are bound by mutual service standards to ensure that both builders and their brokers/intermediaries receive a high level of service at all times' (QBE undated). Similarly, Vero advertises its Warranty Service Level Agreement and Warranty Service & Certainty (Vero undated). However, the Builders Collective argued that these standards have little practical meaning, because they are not always adhered to or enforceable:

One of the most difficult scenarios for a small building business dealing with the Warranty insurers is the lack of transparency and accountability. The insurers have, and continue to use their dominant position to dictate all terms of engagement to builders. There is no traditional avenue for complaint as the builder is not the consumer and the policy is not bought in the builder's name. ... In this scenario the insurer is accountable to no-one. (sub. 92, p. 11)

To address this issue, New South Wales and Victoria committed to introducing guidelines regulating the provision of home warranty insurance. New South Wales has already adopted market practice guidelines (box 7.4) and Victoria is moving to introduce similar arrangements (box 7.5). The Commission endorses this initiative, which should address many concerns expressed in the inquiry submissions. Moreover, as noted earlier (recommendation 7.3), the Office of the

Small Business Commissioner provides a service to receive and investigate complaints from small business builders; this service would support the workings of the guidelines.

A subset of the supply shortage induced by warranty insurance is the claim that it has dissuaded builders from becoming registered and has pushed them into the owner–builder segment. Submissions from the Builders Collective exemplified this view:

The current Victorian ‘system’ [for warranty insurance] is pushing qualified and experienced personnel out of the legitimate industry into a black market of non-compliance providing appalling consumer protection. Only by lifting onerous restrictions on builders to practise their craft will governments be able to entice these disaffected contractors back into a compliant system. (sub. 38, p. 18)

On the surface we now have a competitive market where four or so insurers are now offering builders warranty insurance. Within this limited competitive environment premiums have still not moved substantially and eligibility criteria is still as onerous as it ever was for builders. Consequently there are still many builders who are not convinced that it is their best interests to return to the industry as a bone-fide builder. The alternative for these individuals is to continue working for ‘owner builders’ or pursuing other work as subcontractors. This is evidenced by the enormous amount of work being registered by owner builders—at least 10 times the rate of Queensland (for example) where genuine owner builders are tightly regulated. (sub. 92, p. 9)

CAV also suggested that this was the case (a view echoed by the Office of the Small Business Commissioner—sub. DR155, p. 17):

An obstacle for builders seeking registration is the mandatory requirement for them to hold builders’ warranty insurance. This has consequences for registration rates and compliance with the Building Act 1993 and Building Regulations. There is a suggestion that builders unable to meet the insurance liquidity requirements operate as speculative owner–builders, or opt out of registration altogether. ... If builders warranty insurance was easier to obtain, there may be greater compliance with the registration and other provisions of the Building Act 1993. (sub. 91, p. v).

If warranty insurance were of such significance in affecting compliance and owner builder activity, one would expect owner–builder activity by non-registered builders to have increased sharply with the introduction of the post-HIH insurance arrangements. However, building permit data offer limited support for this view.

In 2000, the year before that in which HIH collapsed, the number and value of owner–builder permits issued to non-registered builders as a proportion of the total issued were 32.4 per cent and 22.5 per cent respectively (table 7.4). The proportion of permits by number has since risen each year, to 38.1 per cent in

2004. The proportion of activity by value, however, rose to 23.7 per cent in 2001, fell to 22.7 per cent in 2002 and then rose marginally to 23.6 per cent in 2004.

**Table 7.4 Number and value of building permits allocated by builder type, Victoria**

	<i>Registered builder</i>		<i>Owner–builder (registered)</i>		<i>Owner–builder</i>		<i>Total no.</i>
	<i>no.</i>	<i>%</i>	<i>no.</i>	<i>%</i>	<i>no.</i>	<i>%</i>	
<i>Number of permits</i>							
1998	56 232	71.7	1546	2.0	20 698	26.4	<b>78 476</b>
1999	61 070	70.3	2121	2.4	23 659	27.2	<b>86 850</b>
2000	52 769	65.1	2050	2.5	26 263	32.4	<b>81 082</b>
2001	54 820	63.4	1791	2.1	29 815	34.5	<b>86 426</b>
2002	56 283	62.5	2381	2.6	31 376	34.8	<b>90 040</b>
2003	54 723	60.6	2566	2.8	33 024	36.6	<b>90 313</b>
2004	51 696	58.7	2762	3.1	33 545	38.1	<b>88 003</b>
<i>Value of building work (\$m)—nominal value</i>							
1998	3774	77.6	172	3.5	915	18.8	<b>4861</b>
1999	4537	75.6	272	4.5	1191	19.9	<b>6000</b>
2000	4111	72.5	286	5.0	1273	22.5	<b>5670</b>
2001	4933	71.2	354	5.1	1642	23.7	<b>6929</b>
2002	5678	71.6	448	5.6	1804	22.7	<b>7930</b>
2003	5906	69.8	574	6.8	1978	23.4	<b>8458</b>
2004	6013	68.9	657	7.5	2057	23.6	<b>8727</b>

Source: BC 2005f

In the Commission's view, these numbers do not provide compelling evidence that recent insurance arrangements are pushing builders into 'a black market of non-compliance' or stimulating owner builder activity by non-registered builders. The data also indicate Victoria has historically exhibited a high rate of owner–builder activity and, therefore, that warranty insurance arrangements from 2001 do not explain Victoria's owner–builder activity being many times that of Queensland. Similarly, the data do not provide grounds to believe that changed

warranty arrangements will lead to a significant reduction in owner–builder registrations and a corresponding increase in builder registrations.<sup>18</sup>

The Commission’s conclusion on this matter is consistent with that of the independent review of the New South Wales home warranty insurance inquiry (the Grellman inquiry). The Grellman report commented on the view that warranty insurance has dissuaded builders from becoming registered and pushed them into the owner–builder segment:

Allegations are rife that there has been a proliferation of owner–builder activity intended to circumvent the home warranty insurance provisions, but there is no hard evidence to support that contention, despite the efforts of the inquiry to determine this. Generalisations from isolated incidents are all that exist. (Tyler 2004, p. 5)

### **Effect on new entrants**

Various inquiry participants claimed that having to obtain insurance cover (or prove eligibility) to obtain registration is a material barrier to new builders (particularly younger builders) entering the industry. The Building Designers Association of Victoria commented:

Access to this so called insurance is less based on industry skill or experience and more on financial adequacy of the builder. ... Providers of this facility have been prepared to issue cover on receipt of liens on builder’s assets by way of substantial bank guarantees. ... if young practitioners need to demonstrate sound financial capacity or to place control of assets in the hands of others, it must inevitably preclude the traditional progression of young tradespersons to builder status. This, in turn, will reduce the numbers of small scale businesses from the domestic sector, reducing competition and potentially raising costs and prices. (sub. 43, p. 8)

Similarly, the MBAV expressed concern that:

Current methods of assessment make it difficult for inexperienced or new builders to commence building due to stringent financial requirements imposed by insurers. New entrants should be able to enter the industry on a restricted basis with, where appropriate, a limited number of jobs at a time to establish their credibility. Not to do so will diminish or stifle the business opportunities of new entrants to the market and ultimately reduce competition. (sub. 49, pp. 8–9)

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<sup>18</sup> Moreover, the regulation governing owner–builders has recently been tightened (chapter 6).

Concerns that the financial tests to qualify for warranty insurance effectively preclude young builders or new entrants are not unique to Victoria's insurance arrangements. A recent New South Wales inquiry noted:

Home warranty insurance makes it difficult for a qualified, ambitious young builder with limited capital to enter the industry other than as a corporate employee or subcontractor. In a society that values the contribution made by small business entrepreneurs, this will lead to a loss of innovation and a lack of personal fulfilment. (Tyler 2004, p. 26, from Builders Collective sub. 79)

However, evidence presented to the Commission suggests movement to address these concerns. As noted, a maturing market and added insurer and broker competition have been associated with providers offering products to address this issue. Vero, for example, has introduced a product called New Builder Access aimed at new entrant builders. The product is a simple application that allows the builder to complete two jobs without any financial assessment. On successful completion, the builder is then granted cover for further jobs until they choose a mainstream warranty product. The MBAV acknowledged that young builders now have access to a variety of insurance products tailored to their needs:

Over the course of the last 18 months, there has been an improvement in these prospective builders' ability to access warranty insurance, as new application criteria by insurers have provided a transparent assessment system for these potential new builders to use when applying for insurance. ... As a consequence, the ability of new applicants to become registered builders has been improved since mid 2004. (sub. 88, p. 13)

### **Finding 7.7**

There is evidence of a maturing builders warranty insurance market, with new entrants, increased competition and product offerings making it easier for builders (including new builders) to access insurance and cover for the level of activity required. These changes appear to substantially address earlier concerns about the effect on the supply of builders of licensing requirements that require builders to hold (or qualify for) warranty insurance. Moreover, despite the adverse impact of mandatory insurance on some builders' capacity to work, the effect of this regulation on the total supply of registered builders appears to be relatively small.

A summary of the Commission's view on some of the main issues discussed in this section is provided in box 7.9.

## Box 7.9 **Builders warranty insurance—a summary of issues**

This summary of some of the main issues surrounding builders warranty insurance should be read in light of the more detailed chapter text.

- *Consumers are poorly informed about the limits of builders warranty insurance cover.* Agreed. Better information is needed, including steps beyond insurance that consumers can take to manage their interests.
- *Information about the workings of the market is inadequate.* Agreed. The mandatory product needs to be supported by appropriate public accountability of key outcomes of the market.
- *Is the builders warranty insurance market competitive?* The market is contestable (new entry has occurred) and there are multiple providers (insurers and brokers). Premiums have been falling and new products have been offered. The market shows signs of healthy competition.
- *Are premiums and profits for insurers excessive?* A competitive market deals with these fears. Estimates of premiums and profits exceeding \$100 million in Victoria<sup>19</sup> are gross exaggerations. Average premiums are less than 0.5 per cent of contract values, from which significant claims are paid. Insolvencies are around 0.4 per cent.
- *Is a crisis imminent because builders struggle to access builders warranty insurance?* Most inquiry participants say earlier difficulties have lessened. Access to builders warranty insurance has been simplified (for example, for new/smaller builders), with faster approval times. Some high risk builders will be filtered out, but that could benefit consumers.
- *Many builders are affected by warranty insurance.* All would have a stake in insurance improvements. Total registered builder numbers show small variations around 10 000, and owner–builder trend data do not support claims that a major shift to unregistered builders is due to builders warranty insurance. VCAT dispute data do not show an effect from change in builders warranty insurance. The Office of the Small Business Commissioner received 14 complaints from March 2004 to June 2005. CAV/BC dealt with 70 prosecutions against builders in 2003-04.
- *Builders have to restructure assets or obtain bank guarantees.* This imposition affects only a small proportion of builders who do not meet standard risk tests. Inhibiting builders from putting assets beyond the reach of consumers and their insurers could be considered a consumer benefit.

(continued next page)

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<sup>19</sup> For example, the Builders Collective noted that ‘Our estimate, based on publicly available data is that [builders] warranty insurance would produce up to, and maybe in excess of \$120 million dollars per annum in premiums for Victoria alone’. (sub. DR147, p. 4)

### Box 7.9 **Builders warranty insurance—a summary of issues** (continued)

- *Builders need help with disputes.* Agreed. Builders' access to BACV would help. A service charter by insurance companies should provide predictability—for example, notice periods for status changes. The Office of the Small Business Commissioner has a role to help resolve disputes.
- *Government should provide first resort builders warranty insurance, as in Queensland.* The history of government involvement in financial institutions is mixed. A government monopoly would mean no competition to contain costs or drive innovation, but could facilitate the integration of insurance and registration. In a Queensland-type scheme, lower risk builders cross-subsidise higher risk builders.

### 7.2.7 **Looking to the future of builders warranty insurance**

The Commission has concluded that there is, on-balance, a case for continuing with mandatory builders warranty insurance at this time if:

- the scheme can be made to work better, with better public accountability to ensure a confidence in a competitive market, and with a service code to give predictability for builders
- other components of the integrated system can also be improved, with BACV improvements (including access for builders), and better information for consumers on the limits of the insurance product and other ways they can protect themselves
- complementary improvements are made to the builders registration system, and better information is given to consumers to understand the limits of permit inspections and contractual arrangements.

In the long term, the Commission considers that moving to a voluntary builders warranty insurance scheme might be possible and preferable. However, the better workings that the Commission has recommended for other building regulation would need to be bedded down before such a change is contemplated. In particular, CAV would need to be able to provide assurances that consumer information systems have improved to the point of meeting consumer protection needs. Two years could be considered sufficient for the next reading on this. (Bearing in mind the long periods involved in bedding down insurance systems, that extra time would give insurers a better information base for assessing the risk of moving to a voluntary scheme.) The Commission has not made a recommendation on this longer term possibility, given the large number of prior steps to be satisfied.

## 7.3 Owner–builders warranty insurance

Section 137B of the Building Act makes it an offence for an owner–builder to sell a building without warranty insurance. As with builders warranty insurance, that cover can be applied only if the owner–builder (the vendor) dies, becomes insolvent or disappears. Thus, for as long as the owner–builder retains ownership, they elect to carry the risk of their own building.

### 7.3.1 Should insurance be mandatory?

The purpose of owner–builder warranty insurance is to protect purchasers of an owner built house. An owner–builder must provide insurance (and a defects inspection report) if the house is sold within six years from building completion. The insurance cover becomes effective from the point at which the property is sold and is valid for six years from the date of the building’s completion. The minimum maximum cover under an owner–builder policy is \$200 000—a level corresponding to that under builders warranty insurance. For the purchaser of an owner built house, their redress for defective work that becomes apparent after the sale is similar to that of someone buying a house built by a registered builder.

The case for mandatory owner–builders warranty insurance is no different from that for builders warranty insurance. Consumers face a similar problem in determining the risk of an owner–builder–vendor not being available to rectify any defective work. Consumers of owner built housing also face similar potential costs of uninformed choice, from which warranty insurance shields them. In contrast to builders warranty insurance, however, owner–builders are not required to provide bank guarantees (because a defects inspection report provides security to insurers in identifying risks). As such, they do not incur the costs associated with restructuring their assets.

#### **Finding 7.8**

On balance, mandatory owner–builders warranty insurance appears justified in view of the intractable information asymmetries facing consumers and the likely net benefits that it provides.

### 7.3.2 The Form 7 (formerly 10) regulation and consumer protection

A Form 7 (formerly Form 10) is an application for an occupancy permit, which is submitted to the relevant building surveyor. It is required to be submitted in relation to all building work that requires an occupancy permit, not only for owner–builder projects. A completed Form 7 should list all building practitioners (registered or otherwise) who were involved in the building work and who were



not known or listed at the time of application for the building permit (DSE, sub. DR172, p. 31).

The MBAV stated that Form 7s are important for conferring consumer protection because all tradespeople who are contracted to do a job in excess of \$12 000 are required to carry warranty insurance. The Form 7 thus reminds the owner to secure a warranty they might not have obtained from the registered building practitioner (Fagan & Fagan, sub. DR123, p. 15). The Department of Sustainability and Environment stated that the purpose of a Form 7 is to provide a public record of registered practitioners involved in the project. This facilitates the ready identification of likely respondents if the owner or other parties take an action in tort to recover economic loss (sub. DR172, p. 32). Fagan & Fagan also noted that having a list of all registered practitioners provides a link for later owners to determine the level of warranty on a given building, and better positions owner–builders to negotiate insurance if they decide to sell within the warranty period (sub. DR123, p. 15). On this latter point, CGU noted that a Form 7, while it may not provide consumer protection, captures details of contractors who should provide warranty insurance and thus is important to the ability of the insurer to offer owner–builder insurance efficiently (sub. DR135, p. 2).

The MBAV noted, however, that this mechanism is generally not used or policed. It claimed that ‘Consumers are left exposed because existing legislation is ignored’; accordingly, it requested that ‘this administrative shortfall be addressed as a matter of urgency’ (sub. 49, p. 8). The Department of Sustainability and Environment noted that legislation has recently been amended to address this issue, and it is now an offence of an owner not to notify the relevant building surveyor of the engagement of a builder (sub. DR172, p. 32).

In the case of owner–builders, the ‘consumers’ being immediately protected are the owner–builders themselves, because they generally live in the property initially. They thus bear the cost of any rectification if the practitioners they employed do not fix any defects, or if they cannot locate the practitioners and thus access their warranty insurance. Moreover, if the owner–builder sells the property within six years, the purchaser would be covered by the owner–builder’s own warranty insurance if defects requiring rectification emerge.<sup>20</sup>

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<sup>20</sup> Insurance companies will not issue owner–builder warranty insurance unless a defects inspection report has been completed.

CAV supported the view that a requirement for an owner–builder to fill out a Form 7 is unnecessary, noting:

Under current arrangements, an owner–builder must fill out ‘Form [7]’ which lists all registered building practitioners who have worked on an owner builder project where the value of the work exceeds \$5000. The Master Builders Association of Victoria has argued that the submission of this form provides consumer protection for the owner–builder because all tradespeople who engage in work over \$12 000 must carry warranty insurance.

CAV believes this form is unnecessary given that any owner–builder who engages a building practitioner for works over \$5000 must enter into a major domestic building contract. This consequently affords consumer protection under the [Domestic Building Contracts Act]. (sub. DR166, p. 14)

However, Michael Norris (member of the BAB, but writing in his personal capacity as a builder), commented:

The intent of Regulation 1002 of the Building (Interim) Regulations 2005 is to ensure that an occupancy permit is not issued without the information required on the Form 7 being provided to the relevant building surveyors. The Form 7 is intended to provide consumer protection to both the owner–builder and subsequent owners of the property. In the case of renovation/extension work, the information should be noted on the certificate of final inspection.

Enforcing the regulation places the responsibility for the work where it should be, that is, with the person who carried out the work. If policed, there would be a reduction in risk to insurers as each contractor would be identified, accountable and, in the case of work with a value exceeding \$12 000, carry warranty insurance for the work undertaken by them. This should result in a reduction in owner–builder warranty insurance premiums.

Warranty insurance provided to owner–builders for the benefit of potential purchasers of a property does not cover defects identified in the defects inspection report. Nor does it cover those parts of the works which are excluded by the inability of the inspector to gain access to the works. Subsequent purchasers, unless familiar with the warranty insurance policy wording, will be unaware that these defects are not covered by the warranty insurance policy. (sub. DR168, p. 1)

Given that an owner–builder assumes responsibility for engaging the building practitioners to work on their project, it is not clear that a Form 7 is producing the intended results. It is also not clear that the Form 7 requirement provides any meaningful additional protection to consumers who are not the owner–builder. Moreover, it is reasonable to expect that the amended Regulations affecting owner–builders (introduced in June 2005) will improve prospective owner–builders’ awareness of the implications of assuming the owner–builder mantle. This awareness should provide a measure of ‘consumer’ protection to the

owner–builder. However, the Commission recommends elsewhere in this report that the Building Commission review the workings of the new owner–builder Regulations (recommendation 6.6). Given the concerns raised, it would be better to postpone removal of the Form 7 until that review warrants it.

### **Finding 7.9**

The requirement for owner–builders to fill out a Form 7 (on the basis that it provides consumer protection) appears not to be having the intended results. The recommended review of the new owner–builder Regulations should consider its removal.

## **7.4 Plumbers insurance**

Plumbers insurance was introduced in 1997 as a measure for consumer protection, augmenting the auditing regime that inspects about 5 per cent of all works (DSE, sub. 84, p. 80). To provide this protection, the Building Act was amended to provide for ministerial Order to set mandatory insurance requirements for licensed plumbers. The Licensed Plumbers General Insurance Order 2002 (box 7.10) comprehensively prescribes the nature of the policy (DSE, sub. 84, p. 81).

The Plumbing Industry Commission noted that compliance with s221ZPA of the Building Act also draws insurance requirements to the attention of the consumer. Under this section, on completion of a job, a plumber must give the consumer a document giving the name, licence number and address of the plumber, and a document that briefly describes the required insurance (DSE, sub. 84, p. 81).

Where defective plumbing work is identified through either an audit or a complaint received by the Plumbing Industry Commission, the auditor or inspector mediates with the plumber to have the work rectified. In the majority of cases, the plumber will rectify the defective work; in these cases, there is no insurance claim. If the plumber does not rectify the defects, then the consumer can lodge a claim under the plumber’s insurance. Insurance applies, however, only when a compliance certificate is required (DSE, sub. 84, pp. 81–2).

### Box 7.10 **Licensed Plumbers General Insurance Order 2002**

Part 2 of the Order prescribes that a plumber must have insurance that indemnifies him or her for:

- any liability to pay for the cost of rectifying any plumbing work required as a result of defects in the plumbing work
- any trade practices liability
- any public liability
- any completed work liability.

Under the Order, a plumber must also have insurance that indemnifies him or her for any liability arising from any consequential financial loss reasonably incurred by the building owner as a result of any defects or non-completion of the plumbing work. Clause 14 of the Order stipulates what defects in plumbing work are. Examples of 'defects' in clause 14 are:

- a failure to carry out the work in a proper and workmanlike manner and in accordance with any plans and specifications set out in the contract
- a failure to use materials in the work that are good and suitable for the purpose in which they are used
- a failure to carry out the work with reasonable care and skill and, in the case of domestic plumbing work, a failure to complete the work by the due date (or within the period) specified by the contract.

Source: Building Act 1993, part 12A—Licensed Plumbers (Private Plumbing Work) Insurance Order 2002.

#### **7.4.1 Is insurance protecting consumers?**

The coverage of plumbing insurance is considerably more extensive than that offered under builders warranty insurance. It allows, for example, the consumer to lodge a claim without the dead–disappeared–insolvent restriction on builders warranty insurance (DSE, sub. 84, p. 83). The Plumbing Industry Commission considered that insurers are willing to offer such cover (in contrast to builders warranty insurance) because the plumbing industry's regulatory framework ensures there is little call on such insurance. The Department of Sustainability and Environment noted:

The [Plumbing Industry Commission] spends about 20 per cent of its total operating budget directly on its outsourced contracts to perform audits and inspections. ... PIC further incurs enforcement related expenses across most of its other functions, such as legal, consumer information, advertising, travel, phone etc. Overall the [Plumbing Industry Commission] estimates that at least half its yearly operating expenditure is aimed at enforcement. (sub. 84, p. 76)

In particular, the Plumbing Industry Commission considers the self-certification and auditing framework (box 7.11) plays a major role in minimising claims. The smaller scale of plumbing jobs (compared with new houses, for example) means the financial risks are smaller and, in that sense, the insurance is less complicated.

The Plumbing Industry Commission also noted that the global insurance crisis of 2001-02 did not result in a crisis in the supply of plumbers insurance. Together with the continuing strength of competition in the market for plumbers insurance, the plumbing industry regulatory framework has ensured accessibility to policies and has not been an issue for plumbers (DSE, sub. 84, p. 84).

### **Box 7.11 The plumbing self-certification and auditing system**

Under part 12A of the *Building Act 1993*, licensed plumbers in Victoria are required to self-certify their work. The certificate is backed by insurance coverage of up to six years. A completed compliance certificate documents details of the particular job and is unique to that job.

A certificate of compliance must be lodged in the following situations:

- when a type A gas appliance is installed, regardless of the total cost of the installation
- where consumer gas piping is installed and the cost of the installation is \$500 or greater
- for general maintenance work on a type A service pipe installation where pipes are renewed and all leaks made safe, and where the total cost of the work is \$500 or greater
- where a type A appliance is installed in a type B installation (although certificates of compliance do not apply to type B gasfitting work).

Source: PIC 2004a.

In contrast to builders warranty insurance, the Commission received no submissions arguing that plumbing insurance provides inadequate consumer protection (although one industry association claimed the protection offered is redundant in some circumstances—see below). Instead, it was informed that mandatory general plumbing insurance has performed well in providing protection for consumers and for plumbers (PIAC, sub. DR132, pp. 10–11).

It also did not receive any submissions that the cost of insurance is excessive relative to the benefits to consumers (again, except for the industry association claiming that this occurs in some circumstances). Information presented by the Plumbing Industry Advisory Council (sub. DR132, p. 11) and the Plumbing Industry Commission (DSE, sub. 84, p. 84) indicates that most sole trader plumbers pay an annual premium of \$800–1000—a cost broadly confirmed by Marsh Pty Ltd (sub. DR131, p. 4). Evidence presented by Marsh Pty Ltd also

indicated that plumbers insurance is insignificant in the overall cost of a dwelling (likely to represent less than \$100 for plumbing work valued at \$30 000), but nonetheless offers substantial consumer protection. In this regard, the Master Plumbers and Mechanical Services Association of Australia also argued that mandatory plumbing insurance is provided at a reasonable cost.

In view of the information received by the inquiry, the Commission considers that plumbers insurance generally provides a valuable benefit to consumers and is provided at reasonable cost.

#### **Finding 7.10**

Plumbers insurance generally provides a valuable benefit to consumers and is provided at reasonable cost.

### **7.4.2 Is insurance for air conditioning and mechanical services appropriate?**

The Air Conditioning and Mechanical Contractors Association Ltd of Victoria (AMCA) raised concerns with plumbing insurance (and compliance certificates) as it relates to the work of its members. Specifically, it noted issues with:

- the extent of insurance cover specified in the ministerial Order
- the cost of the insurance to business and the consumer
- the monopoly arrangement that operates in the market (sub. 4, p. 1).

The AMCA argued that commercial, industrial and high-rise residential construction is very different from domestic residential construction ‘in terms of the nature of its structure, engineering expertise of companies along with the way that the work is carried out’ (sub. 4, p. 3). It noted that a professional engineer or a qualified draftsman most often carries out the work, and that all contractors carry contract works insurance and are responsible for a 12 month defects liability warranty period. Moreover, the companies carry professional indemnity insurance when they undertake design work (sub. 4, p. 3).

Accordingly, the AMCA argued that plumbing insurance is redundant for air conditioning and mechanical services installed in commercial, industrial and high-rise residential buildings. In such cases, it noted:

... [plumbing] insurance does not in any practical way provide additional benefits or protection to the customer, as it only warrants the standard of workmanship and not the product. (sub. 4, p. 9)

As discussed in section 7.2 on builders warranty insurance, the problem of information asymmetry is significantly less with commercial developments. In general, commercial developments are undertaken by those experienced in the

industry. Those agents can generally make an informed choice of building practitioner. In these circumstances—and against the underlying rationale for government intervention—the case for mandatory insurance is weak. Moreover, the additional protection afforded to consumers by plumbing insurance appears marginal to that already provided (through contract works and professional indemnity insurance, for example).

The proposition that insurance should not be mandatory for air conditioning and mechanical services installed in commercial, industrial and high-rise residential buildings has some merit. However, initial submissions to the Commission contained little information on the relative benefits and costs involved, so the Commission sought more information before making a judgment.

In its response to the draft report, the National Fire Industry Association Victoria noted that its members also operate in the commercial/industrial and construction engineering sectors, under commercial contracts, to which warranty requirements are integral. It considered that an exemption should be extended to include its sector of the industry (sub. DR144, pp. 2–3). However, without information on the costs and benefits of mandatory insurance as it applies to National Fire Industry Association applications, the Commission could not make a judgment on this matter.

In response to the request for information on the costs and benefits involved, Plumbing Industry Advisory Council noted that it too has not obtained sufficient information to make a decision (sub. DR132, p. 12). The AMCA quantified the likely cost. It indicated that the actual premium involved is about 0.01 per cent of turnover. Some 60–70 per cent of a contract is commonly equipment cost, so the premium as a proportion of profit margin is substantial. The AMCA provided an example of a company with a turnover of \$50 million, where the premium would be about \$60 000. Using a typical profit margin of around 3 per cent, this \$60 000 premium would represent approximately 4 per cent of that profit. The AMCA further noted that no client of an AMCA member has ever called on the policy cover since its inception (sub. DR143, pp. 4–6).

The Commission is inclined to consider that such insurance should not be mandatory where air conditioning and mechanical services are installed in commercial, industrial and high-rise residential buildings. Accordingly, if the Plumbing Industry Commission can confirm that there has been an insignificant call on this insurance since its inception, the Commission recommends that it not be mandatory in these cases.

### **Recommendation 7.5**

**That for commercial, industrial and high-rise residential buildings, plumbers insurance not be mandatory for air conditioning and mechanical services.**

## **7.5 Professional indemnity insurance**

As noted in section 7.1, the Building Act requires that prescribed building practitioners need proof of insurance, as prescribed in the Building Practitioners' Insurance Ministerial Order, to practise in Victoria. This Order covers building inspectors, building surveyors, quantity surveyors, engineers (civil, mechanical, electrical and fire safety), draftspersons (architectural, interior and services) and architects. It took effect in 1996. One goal of mandatory professional indemnity insurance is to reinforce proportionate liability, which was also introduced in Victoria in 1996 (DSE, sub. 84, p. 28).

Concerns about indemnity insurance relate primarily to its possible effect on the supply of practitioners, its high cost (premiums), its effect on innovation and whether it provides genuine consumer protection.

### **7.5.1 Effect on supply, prices and innovation**

Since 1996, major changes in the insurance market have affected the availability, affordability and number of providers of indemnity insurance. Particularly significant influences were the collapse of HIH, 11 September 2001 and the poor performance of global equity markets. In the aftermath of these events, many practitioners had difficulty obtaining insurance, which was often available only at significantly higher prices (DSE, sub. 84, p. 28). The Macedon Ranges Shire Council noted:

During the last 2–3 years there has been a substantial increase in [the cost of] professional indemnity insurance. The consequence of this is a rise in building costs and fees to cover the rise in the insurance industry that only comes into play for a small sector of the total construction activity and yet all the industry must pay for the cost. (sub. 50, p. 2)

The BAB put this in perspective when it noted that for most professional practices, the professional indemnity insurance premium is the largest overhead and the second highest cost behind staff salaries (sub DR128, p. 7).



The City of Boroondara also noted the effect of indemnity insurance in reducing some practitioners' capacity to work:

The minimum level of professional indemnity insurance (being \$1 000 000) is inadequate and the cost of this insurance is such that many small or part time operators cannot survive. It is a concern that the insurance sector will start to determine who and how practitioners can operate (i.e. building surveyors not being able to give performance decisions or work on certain types of projects) by the use of premiums and excesses. (sub. 66, pp. 4–5)

The Building Designers Association of Victoria, too, drew attention to the effect of professional indemnity policies in limiting the work that practitioners might undertake:

... builders for insurance purposes, were obliged to restrict the number of contracts they could enter into within certain annual turnover figures, and as a result were unable to carry out further contracts until such time as existing contracts had been completed. As a consequence, designers and their clients found difficulty in acquiring the services of a builder to commence construction of a project within the expected timelines envisaged by clients. (sub. 43, p. 10)

Reddo Pty Ltd also noted the restricting effect of indemnity insurance on trade, but recognised the situation has improved recently:

The main issue here is not so much the major increase to premiums experienced as a result of the HIH collapse but more so in regard to the additional costs to include professional services that indirectly restrict trade because of the exclusion on policies. The availability of [professional indemnity] insurance has slowly improved over the past 12 months and has caused professionals to improve risk management strategies within their business. (sub. 70, p. 3)

The Department of Sustainability and Environment acknowledged this improvement: 'The [professional indemnity insurance] market showed signs of stabilising in 2004 with a new entrant in the Australian market and reports of increased availability and prices stabilising' (sub. 84, p. 28). This accords with the ACCC's findings for the professional indemnity market more generally:

The real average premium fell by 17 per cent in the period between year ending 31 December 2003 and half year ending 30 June 2004. This reversed the trend of increases in the real average premium since 2000. (ACCC 2005, p. 28)

In general, there appears to be no shortage of providers of indemnity insurance. And eligibility criteria for indemnity insurance have not caused problems anywhere near the extent experienced by builders seeking builders warranty insurance. High premiums, however, remain an issue despite recent evidence that they are easing. But this is a general issue, not one confined to indemnity insurance for building practitioners; it reflects a general re-assessment of risk and premiums across all insurance markets. While the cost of indemnity insurance

and its effect on practitioners' capacity to work are important issues, the Commission does not have sufficient information to judge the overall impact on industry costs and on housing affordability.

Another issue with indemnity insurance is the effect it might have on innovation in the housing construction sector. On this matter, the BAB noted:

... the high cost of professional indemnity insurance can stifle innovation by insurance companies refusing to cover performance based solution and not allowing professionals to undertake certain classes of work. For example structural engineers may have to strictly design within the prescribed limits of the Australian Standard and not adopt a more innovative performance orientated design. (sub. 74, p. 10)

It also considered this issue is due to the increasing number and nature of exclusions in policies (sub. DR128, p. 7). The HIA supported this view, noting anecdotal evidence that performance based building solutions are being used less and less because some indemnity policies specifically exclude certifiers using performance based alternative solutions:

This limits the scope for introduction of more cost-efficient products and systems to the market, stifling the opportunity for business efficiencies, competitive advantage and market efficiency. (sub. DR163, p. 20)

Vero, however, noted that while a particular insurer may take an overly conservative view of innovative building practices, given the competitiveness of the Victorian market, it would not be in an insurer's best interest to take too conservative a position (sub. DR171, p. 5).

Although stifled innovation appears to be a concern, the Commission did not receive sufficient information on which to judge the overall effect of indemnity insurance in this regard.

## **7.5.2 Is indemnity insurance protecting consumers?**

A key objective of mandating professional indemnity insurance is to protect consumers. However, the practical worth of such 'protection' depends on whether the insurer issuing that cover is likely or able to honour any claims. For mandatory insurance to provide genuine consumer protection, it may be necessary to set conditions on who can provide that insurance. This is the logic behind the recent requirement that only 'approved insurers' can provide builders warranty insurance (box 7.2).

Australian insurers offering professional indemnity insurance in Australia are subject to capital adequacy and solvency requirements, and scrutiny by the Australian Prudential Regulatory Authority (APRA). Foreign insurers offering products to consumers in Australia (through intermediaries such as agents or

brokers) are not subject to regulation by APRA. Although APRA scrutiny does not guarantee against insurer failures, it does provide greater confidence that the insurer is sound. If a building practitioner obtains professional indemnity insurance from a foreign provider, the protection afforded by that insurance is uncertain. On this issue, the HIH Royal Commission found that suppliers of insurance-type products should come within the purview of APRA as far as possible (Owen 2003, p. 39).

The Victorian Competition and Efficiency Commission understands that offshore providers of professional indemnity insurance are not required to meet a test of prudential fitness. This is a potential weakness in the consumer protection offered by mandatory indemnity insurance, especially given that many of the larger consulting companies are sourcing insurance in this way (BC 2004b, p. 39). Unless this weakness is addressed, there can be no guarantee that mandatory professional indemnity insurance for building practitioners will provide the intended level of protection for all consumers.

**Finding 7.11**

A potential weakness in the consumer protection offered by mandatory insurance is the absence of any requirement that a provider of such professional indemnity must meet an approved standard of prudential fitness.

Requiring professional indemnity insurers to meet requirements similar to those applying to providers of warranty insurance would address this potential weakness. The HIA offered support for this principle (sub. DR163, p. 21), as did Vero (sub. DR171, p. 5). Vero noted that there would be little point to pre-approving insurers, however, if the regulatory body does not have the power to issue directions to a rogue insurer and/or the ability to sequester funds if necessary (sub. DR171, p. 6).

Aside from these limited comments, the Commission received scant information on the costs or practicality of requiring eligibility criteria for providers of indemnity insurance. The administrative costs of monitoring and deciding on eligibility may be excessive relative to the benefits derived from having the criteria. In view of the limited information available to it, the Commission has not formed a judgment on this matter.



**Part C**

**The regulatory  
framework**



## 8 Improving the regulatory framework

This chapter outlines potential improvements to the housing construction sector's regulatory framework described in chapter 4. It focuses on three areas. First, it assesses the objectives of the *Building Act 1993* (Vic.) against best practice principles and examines how those objectives might be improved. Second, it addresses links between the Building Act and the *Domestic Building Contracts Act 1995* (Vic.). Third, it examines existing processes for assessing new regulation and possible improvements to those processes.

### 8.1 Introduction

The terms of reference require the Victorian Competition and Efficiency Commission to inquire into and report on ways to improve the processes for developing, administering and enforcing regulation in the housing construction sector. Accordingly, this chapter outlines potential improvements to the regulatory framework described in chapter 4.

The objectives of legislation are intended to influence the behaviour of those responsible for administering and complying with that legislation. This chapter thus begins by assessing the objectives of the Building Act against the best practice principles of regulation outlined in chapter 1. In the long term, the quality of the regulatory framework will depend on scrutiny of existing regulation to ensure it is still needed, and of any new regulation to ensure it is warranted and the best of the available alternatives. Sections 8.4 and 8.5 outline possible improvements to the processes for assessing new regulation.

The performance of the regulators in administering the regulatory framework is influenced by the extent to which they are publicly accountable for their decisions and by the constraints on them to operate cost effectively. The next three chapters describe accountability and cost recovery mechanisms.

### 8.2 Improving the objectives of the Building Act

Clearly defined objectives are the bedrock of a good regulatory framework, for at least four reasons. First, a clear objective helps to ensure regulation is used only when necessary. Underlying this objective should be identification of the problem that the regulation is intended to address:

Unless the source, nature and scale of the problem is fully understood, the proposed policy solution is likely to be inadequate, inappropriate and/or inefficient. (State Government of Victoria 2005b, p. 3-4)

The House of Lords Select Committee on the Constitution comments that the absence of a clear purpose can lead to ‘regulatory creep’:

Regulation can only be in the public interest where it serves a clear purpose. We question the apparent assumption that the present level of regulation, let alone an even greater extension of quasi-governmental powers, should remain a permanent feature of our policy. We have to resist the danger of regulatory creep. Many judge that regulatory burdens are increasing, sometimes unnecessarily. This regulatory tendency has to be checked, and the best means is effective accountability. (House of Lords Select Committee on the Constitution 2004, p. 5)

Second, what regulators do is likely to reflect the objectives of the legislation under which they operate:

It is crucial however that the objectives are clear. Confused objectives lead to confused policy making and delivery. (UK Better Regulation Task Force 2003, p. 20)

Objectives that are not clear lead to uncertainty about, for example, how regulation will be interpreted and what is required for compliance. Some uncertainty is inevitable in any business environment, but regulation that unnecessarily adds to this uncertainty can discourage investment and innovation:

We recognise that uncertainty is part of the price of adaptability, and that a regime that completely eliminated uncertainty or even sought to do so would be as costly as it was ultimately unworkable.

Rather, the issue is to eliminate uncertainty that is not essential to adaptability—and most notably, that arises simply from the failure to:

- clearly think through the goals that regulation can and should achieve
- recognise the constraints that information imperfections necessarily impose on regulation
- articulate parameters that can guide regulatory action. (NECG, p. 14)

Third, clearly defined goals provide the basis for assessing the performance of regulators and holding them accountable:

A major requirement for performance assessment is to state the goals clearly. These goals are usually laid down by law. In theory, the most effective approach is to give regulators clear and possibly single goals. (OECD 2003, p. 39)

This is particularly important for independent regulators. The Organisation for Economic Cooperation and Development (OECD) commented:

The independence of regulators is a costly principle, since these authorities are partly detached from the central executive power. Independence can produce unwanted effects unless it is balanced by proper requirements for accountability. (OECD 2003, p. 14)



These ‘unwanted effects’ could include hindering structural change, obstructing convergence between sectors or leading to structural rigidities, fragmenting government policies and actions, and risking ‘capture’ by those being regulated (OECD 2003, p. 5). The issue is not merely about the performance of regulators, as an abstract measure of public sector efficiency and effectiveness. It is as much about the performance of the Regulations—whether they are producing the intended results.

Fourth, objectives should guide the development of expertise within the regulator. A regulator whose task is to protect safety, for example, will develop different expertise from one that is pursuing multiple objectives:

Without the regulatory purpose, powers and functions being clearly identified for each public agency with responsibility for different aspects of the regulatory framework, efforts and resources can lack focus. Identified regulator purposes and functions should drive regulators’ performance and act as benchmarks against which regulators can be held accountable. We believe insufficient attention is currently paid to this aspect of consumer affairs regulatory architecture. (Smith & Ward 2004, p. 16)

The problems that can arise from poorly defined objectives—regulatory creep, the creation of uncertainty, the absence of accountability and poor regulatory focus—are magnified if a regulator is required to pursue objectives that conflict or involve tradeoffs. In this case, the regulator has to judge the priority of different objectives, which adds to the uncertainty for those being regulated and makes it more difficult for others to assess the regulator’s performance and for the regulator to focus its activities.

Chapter 4 noted that the objectives in part 1 of the Building Act refer to desired outcomes relating to protecting the health and safety of those who use buildings, to enhancing amenity and to constructing environmentally and energy efficient buildings. It also pointed out that the Governor in Council may, under s221ZZZV of the Building Act, make Regulations for plumbing work relating to water efficiency, as well as energy and environmental efficiency. While these objectives should guide what the legislation is intended to achieve, the Building Act has eight other objectives. Is having so many objectives conducive to achieving desired outcomes?

The best practice principles of regulation (outlined in chapter 3) provide a framework for assessing these objectives. While these principles relate to regulation as a whole, and not just to the statutory objectives, they are useful in

analysing the extent to which the Act's objectives should lead to the desired outcomes. The following principles appear particularly relevant:

- Regulation should be understandable and introduced only after proper consultation.
- Regulatory effort should be the minimum needed to achieve the objective, consistent with the scale of the problem.
- Regulators should be accountable.

Regulations are more likely to be understandable if their objectives are also understandable. They are more likely to be the minimum necessary if regulation itself is not an objective. And it is easier to hold regulators to account if their objectives are clearly defined and their progress towards those objectives is measurable and published.

### **8.2.1 Are the objectives understandable?**

The current objectives in the Building Act and the Building Regulations are ambiguous in three respects:

- (1) Few are defined.
- (2) It is unclear whether the Building Act is intended to regulate the 'quality' of buildings.
- (3) The relative importance of each of the objectives is not specified.

#### **Definition of objectives**

The Productivity Commission noted that 'clear specification of objectives is fundamental to all regulation', and 'objectives can be set only after the problem requiring a remedy is understood' (PC 2001b, p. 124). The objectives of the Building Act are not clearly specified, however, which may reflect some lack of clarity about the problems that the Act is intended to correct.

Few of the current objectives in the Building Act or the Building Regulations are defined, even though some are open to different interpretations. While enhancing 'the amenity of buildings' is a key objective, for example, 'amenity' is not defined in the Act or the Building Regulations. In the second reading speech introducing the Building Bill, the Minister for Planning (Maclellan 1993, p. 1689) suggested that the Bill 'will provide improvements to the health, safety and amenity of people who use buildings', but he did not clarify what 'amenity' means.

The Building Code of Australia (BCA) has a chapter headed 'Health and amenity', but does not define amenity. Items covered in this chapter include damp and weatherproofing, sanitary and other facilities, room sizes, light and

ventilation, and sound transmission. These may indicate the building characteristics that are relevant to amenity.

The Plumbing Code of Australia defines amenity as ‘an attribute which contributes to the health, physical independence, comfort and wellbeing of people’ (National Plumbing Regulators Forum 2004, p. 17). The attributes presumably relate to the plumbing systems covered by the code. The LexisNexis online legal dictionary, on the other hand, provides a definition of ‘amenity’ that suggests a different perspective:

The features and advantages of a locality or neighbourhood which it is considered desirable to preserve or encourage such as beauty or tranquility. The concept of amenity has been interpreted as embracing wide and flexible notions of the residents’ subjective perception of a locality: *Broad v Brisbane City Council* [1986] 2 Qd R 317. Amenity is commonly one of the matters to which a planning authority will give consideration when determining a development application. Amenity may be affected by the physical compatibility of a proposal in relation to the characteristics of the particular neighbourhood, and whether the proposal will interfere with the character or quality of the neighbourhood. Considerations include increasing population or noise or affecting visual quality but do not include moral or social issues: for example *Abbey Investments Pty Ltd v Sydney City Council* [1965] NSW 673; (1965) 12 LGRA 51; *McDonald Industries Ltd v Sydney City Council* (1980) 43 LGRA 428; *Lee v Concord Municipal Council* (1993) 79 LGERA 226. (LexisNexis undated)

The view of the courts, therefore, is that ‘amenity’ refers to the features and advantages of a locality or neighbourhood—and, by extension, of a building—that are considered desirable to preserve or encourage. This definition of amenity seems more relevant to planning legislation, while the two narrower perspectives of the BCA and the Plumbing Code of Australia seem more appropriate for builders and plumbers respectively. The key prerequisite is to specify the problem that the Act is required to correct in relation to amenity. If this problem were specified, the objective could be defined in a way that guided action under the legislation to address the problem.

The Productivity Commission noted similar problems with the definition of amenity in the Inter Government Agreement that underpins the Australian Building Codes Board (ABCB). It concluded:

Most definitions of amenity are relatively broad and, to some extent, all aspects of building design and construction affect the wellbeing, comfort and enjoyment derived from a building. In this sense, using the concept of amenity does not offer much guidance as to what should and should not be regulated by the BCA. This lack of guidance is the source of some confusion in the industry about the aims and the ambitions of the BCA. (PC 2004c, p. 95)

The absence of definitions of key concepts in the Building Act contrasts with the approach in other Victorian legislation. The first object of the *Food Act 1984* (Vic.), for example, is ‘to ensure that food is both safe and suitable for human consumption’. Food is defined in the Act as ‘unsafe’ if it would be likely to cause physical harm to a person who consumes it, and ‘unsuitable’ if, for example, it is damaged, deteriorated or perished to an extent that affects its reasonable use. These definitions provide clarity about the characteristics of food that are to be pursued under the Food Act. Equally, the definitions make it clear that the Act is not about other characteristics of food quality, such as taste and appearance.

### **Quality of buildings**

The objectives of the Building Act do not mention building quality, so it is not surprising that the Victorian Chapter of the Australian Institute of Building Surveyors concluded:

The Building Act and regulation outline compliance provision for minimum levels of health safety and amenity but do not regulate quality. The DBC Act (Domestic Buildings Contracts Act 1995) is purported to regulate building quality however the administration and enforcement of the DBC Act is considered to be inadequate. (sub. 41, p. 4)

The ‘headline’ in the Building Commission’s business plan for 2003-04, on the other hand, is that:

The Building Commission provides industry leadership and regulates building quality. (BC undated B, p. 1)

The Building Commission’s 2003-04 annual report describes how the commission has been regulating building quality by supporting continual professional development; promoting the uptake of information technology and telecommunications in the building industry; promoting careers in the building industry; undertaking practitioner branding; refining the registration process and increasing registration awareness; promoting building surveying as a career; providing compliance, conciliation and dispute reduction services; and promoting research, development and innovation. Some of the Building Commission’s activities to promote quality appear designed to improve the functioning of the regulatory instruments listed in the Building Act. Others, such as promoting careers in the building industry and the uptake of information technology, seem both open ended and closer to what an industry association, rather than a regulator, might be expected to do (as discussed in chapter 9).

While ‘regulating quality’ may be useful shorthand for some of the Building Commission’s activities, the quality of buildings includes many attributes that the Building Act does not mention (unless ‘amenity’ is interpreted particularly broadly). By indicating that it is regulating quality, the commission may create an

impression that it has a wider role and authority than that implied by the objectives specified in the Building Act. This could encourage some consumers to believe that the Building Commission regulates other attributes of the work done to construct a house, beyond health, safety and amenity, and that they need to pay less attention to quality when working with builders.

The interaction between the Building Act and the Domestic Building Contracts Act may increase the possibility that such consumer confusion could arise. The former Act focuses on certification of minimum standards, while specifications in building contracts are agreed between the builder and the consumer. Consumer Affairs Victoria (CAV) pointed out:

Confusion may arise if consumers believe processes under the *Building Act 1993* are linked to staged construction work under a contract. This confusion can come about partly because some contracts make reference to inspections and inspection reports. (sub. 91, p. 29)

To help consumers understand how the regulatory framework may assist them, the Building Commission should inform consumers that the processes it is administering under the Building Act are aimed at compliance with minimum standards and do not guarantee compliance with the standards and quality of work specified in building contracts.

### **Relative importance of each objective**

The relative importance of each of the amenity, safety, and energy and environmental efficiency objectives is unclear. An objective of the Building Act is to ‘establish, maintain and *improve* standards for the construction and maintenance of buildings’ (s4). However, improvements impose additional costs on consumers, which those consumers might not incur otherwise if given a choice. The Act is ambiguous about the level of standards in housing construction that regulators should pursue. Providing more of each attribute normally involves additional costs, requiring regulators to decide on the size of the costs that builders (and consumers) should have to incur in total and in relation to individual attributes. That is, regulators need to judge the relative importance of each attribute. But the Building Act does not provide any guidance on the relative importance of the objectives or on how regulators should determine this importance. It is arguable that regulators should not have to make such tradeoffs:

The tradeoffs between various objectives such as social goals and efficiency is inherently a political task, something for what independent regulatory agencies do not have a comparative advantage nor a democratic legitimacy. (OECD 2003, p. 39)

In the context of economic regulation, the Export and Infrastructure Taskforce suggested that requiring regulators to pursue multiple, sometimes conflicting objectives, can influence the behaviour of those who are regulated:

Given these 'laundry lists' of objectives, regulators have generally interpreted their function as being that of weighting the various goals that they have been set and seeking within that weighting, some especially desirable point. Given the resulting wide regulatory discretion, it is hardly surprising that this system is characterised by ambit claims and other influence-seeking tactics. (Exports and Infrastructure Taskforce 2005, p. 40)

### **The task confronting regulators**

Even if objectives are identified clearly and the requirement for tradeoffs is minimised, objectives are typically defined at a level of generality that requires the regulator to interpret the level of building performance that regulation should target:

The ideal solution would be for regulation to result in each individual attaining the level of building performance they would have chosen if there were no market failure. Unfortunately, this level of building performance will vary from individual to individual, and it is not possible for regulatory intervention to provide for this level of flexibility. (PC 2004c, p. 91)

The situation is complicated by the preferred level of building performance being likely to alter as incomes, technologies and consumers' expectations change. The Productivity Commission identified some issues that regulators should assess when choosing a regulated level of performance, if the regulation is intended to achieve an efficient outcome that maximises net benefits to society (PC 2004c, pp. 92–3):

- *The ability of individuals to voluntarily choose higher levels of performance than mandated.* While individuals typically do not have the ability to choose the precise level of building performance that they desire, the less costly it is for them to obtain and understand information about the performance of a building, the lower the optimal level of regulated building performance is likely to be.
- *The uniformity of preferences.* If preferences about the level of building performance are diverse, the regulator will have to trade off the interests of different sections of the community when deciding on a generally applicable level of building performance.
- *The type of market failure.* In the case of information asymmetries, the regulator is searching for the level of building performance that individuals would choose if they had full information about the costs and benefits of different levels of performance. In the case of externalities, the regulator is searching

for the level of building performance that would be chosen if individuals had to charge fully for, and compensate for, all costs associated with the building.

- *The costs of higher performance.* These costs may differ between, for example, safety and environmental improvements to a building.
- *The benefits of higher performance.* Similarly, the benefits of increasing safety may differ from those associated with increased environmental performance.

These issues suggest that regulating to achieve desired outcomes is a challenging task even in a well-structured regulatory framework. If, on the other hand, the objectives of regulation are not clearly articulated, then the adverse effects may include reduced accountability, variable building outcomes, confusion for consumers about the protection they receive from the regulatory framework, and enhanced incentives for those who are regulated to try to influence the regulator.

### **Finding 8.1**

Assessing the desired level of regulated performance is difficult for any regulator, even within the most well-specified regulatory framework. The difficulties are likely to be multiplied if the government does not clearly specify outcomes for the regulator to target and provides little guidance on the relative importance of different objectives. These difficulties are particularly apparent in the regulation of housing construction.

## **8.2.2 Do the objectives encourage regulation to be the minimum necessary to the scale of the problem?**

Regulation can increase the cost of housing. Information from builders, industry groups and the Building Commission's research suggests that building regulation can increase the cost of an average project by at least 4 per cent and, in some cases, considerably more (appendix C). The Victorian Government has endorsed the principle that regulation is a last resort and should not be undertaken unless it can be clearly justified (State Government of Victoria 2005b, p. 1-7). Limiting regulation to the minimum needed to address the problem is consistent with achieving an efficient outcome, which produces the maximum net benefit for society, accounting for both the costs and the benefits of regulation. Applying this principle will also avoid resource misallocation and prevent undue impacts on affordability.<sup>1</sup>

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<sup>1</sup> A regulated outcome that is efficient, in the sense of providing the maximum net benefits, may increase the cost of housing above what it would be if there were no regulation. That is, the objectives of maximising efficiency and affordability may sometimes conflict with each other.

The Victorian Government recently emphasised the importance that it attaches to the availability of affordable housing to lower income groups:

Access to affordable housing is critical to reducing disadvantage, improving Victoria's sense of wellbeing and maintaining the social fabric of our communities. Affordable housing provides the basis for completing a sound education, obtaining and holding on to employment and maintaining good health. (State Government of Victoria 2005a, p. 34)

The significance attached to housing affordability is also demonstrated by the grants that the government provides to first home buyers. Inquiry participants too highlighted affordability. Their comments tended to focus on the *Planning and Environment Act 1987* (Vic.), but also applied to the Building Act. The Housing Industry Association (HIA) pointed out that housing affordability is not an objective of Victoria's planning legislation, and suggested:

It is both necessary and appropriate for housing affordability to be incorporated as an objective of state planning legislation. (sub. 58, p. 33)

Langford Jones Homes made a similar point:

Unless there is some compulsion to change the current environment, whereby the ad hoc taxes, fees and charges and red tape, which are being added to the building process, are eradicated, the cost of housing will continue to rise beyond the level that people can afford. I refer mostly to the planning Regulations which enter the realm of building and state variations to the Building Code of Australia such as 5 Star efficiency requirements where the cost is being added to the house ... Who is keeping a watch on housing to make sure it stays within the realm of ordinary Australians? (sub. 14, p. 1)

The objectives of the Building Act do not explicitly account for the impact of interventions on the cost of housing. Nor do they encourage regulation to be the minimum necessary.

The inclusion of instruments as objectives compounds the potential effect on costs of the Act having no objective to minimise the cost of regulation to that needed to achieve the Act's other objectives. This could encourage behaviour that increases costs, by encouraging regulators to focus on the instruments as outcomes rather than a means to an end. Objectives such as 'to regulate plumbing work', 'to regulate building practitioners and plumbers', 'accreditation of building products' and 'issuing building and occupancy permits' simply enshrine regulation as an objective and are unlikely to encourage regulators to explore less intrusive alternatives. This approach is inconsistent with that recommended in the *Victorian guide to regulation*—namely, that:

To enable the appropriate response to the identified problem, careful consideration should be given to the desired outcomes. The objective should



identify the ends to be achieved, or the broad policy outcomes desired, rather than the means of their achievement. (State Government of Victoria 2005b, p. 3-4)

### **Finding 8.2**

Including regulatory instruments as objectives of the *Building Act 1993* is inconsistent with the approach recommended in the *Victorian guide to regulation*—namely, that:

‘To enable the appropriate government response to the identified problem, careful consideration should be given to the desired outcomes. The objectives should identify the ends to be achieved, or the broad policy outcomes desired, rather than the means of their achievement’. (State Government of Victoria 2005, p. 3-4)

### **8.2.3 Do the objectives promote accountability?**

Where outcomes and objectives are measurable, there is more scope to hold regulators to account and thereby improve the effectiveness of regulation. As the *Victorian guide to regulation* points out, clear objectives ‘enable more effective monitoring to assess the success of the regulation in achieving its stated aim’ (State Government of Victoria 2005b, p. 3-5). Accountability is harder to achieve if objectives are ambiguous or inconsistent, because there is then ambiguity about which is most important. In this case, regulators have difficulty developing a clear set of benchmarks against which their performance can be assessed. As noted in section 8.2.1, the failure to define key objectives of the Building Act creates ambiguity about their meaning.

There are few apparent inconsistencies among objectives in the Building Act, although there might be some inconsistency between them and the achievement of economic efficiency. While not listed as an objective, the importance of economic efficiency can be inferred from:

- the rationale for government interventions under the Building Act being largely that the market would otherwise fail to achieve outcomes that are economically efficient (chapter 3)
- the requirement that the Building Act should ‘aid the achievement of an efficient and competitive building industry’, given that the most important reason for pursuing competitive markets is to improve outcomes for consumers
- the requirement that the Act facilitate the ‘efficient application of national uniform building standards’ and an ‘efficient and effective system for issuing building and occupancy permits’.

To the extent that economic efficiency is an objective of the Building Act, tradeoffs may be required between objectives such as energy efficiency and economic efficiency. This can happen because energy efficiency is typically improved by focusing on energy use, while economic efficiency considers the use of all inputs (such as labour, land and capital, as well as energy). It is not unusual for increased energy efficiency to be at the expense of the efficiency of resource use as a whole. The requirement to make tradeoffs between such objectives means that performance assessments become as much about the tradeoffs as about the achievements of an objective.

### **8.2.4 Can the objectives be improved?**

The objectives of the Building Act are open to different interpretations, may sometimes conflict with each other and provide little guidance on what acceptable costs regulators can impose to achieve desired outcomes such as safety, amenity, public health, energy efficiency and environmental efficiency. Without such guidance, regulators have to choose between sets of costs and benefits for (possibly) competing outcomes, and may mandate too much or too little of these outcomes. This section discusses ways to improve the current objectives by:

- separating means and ends
- reducing the number of outcomes to be achieved under the Building Act
- providing more guidance to regulators.

Section 8.4 describes possible improvements to the processes for developing new obligations.

#### **Separating ends and means**

The Commission considers, consistent with the *Victorian guide to regulation*, that objectives should include desired ends and not means. The instruments included in s4(a), (b)(i), b(ii), (e), (f) and (fa) of the Building Act should not be part of the objectives section of the Act, but rather listed elsewhere. Box 8.1 indicates what these instruments might encompass.

Specifying the instruments separately would reduce the risk that regulators would focus on the form of regulation as an end in itself. It is difficult to assess whether the current formulation of the objectives has heightened this risk, because what would have happened with more clearly articulated objectives cannot be known. However, it is significant that the Commission's analysis of 11 regulatory impact statements (RISs) prepared on building regulation since 1994 (section 8.5) indicates that only three adequately examined options that involved less regulation than the proposal. Moreover, between 1990 and 2005, the number of pages of Building Regulations increased from 90 to 209.

## Box 8.1 Regulatory instruments

Regulatory instruments that could be permitted under the Building Act include:

- the adoption of standards that are, to the extent practicable, nationally consistent, based on international standards and expressed in plain language
- the accreditation of building products, construction methods, building designs, components and building systems
- building and occupancy permits
- building inspections
- dispute resolution
- the registration of building practitioners
- the provision of information to consumers.

In its draft inquiry report (VCEC 2005a), the Commission recommended that the instruments used to achieve the revised objectives of the Building Act should be set out separately from the objectives. The City of Moonee Valley supported this recommendation, because ‘specifying the instruments separately would reduce the risk of regulators focussing on the form of regulation as an end in itself’ (sub. DR99, p. 3). The Master Builders Association of Victoria commented that the proposal would provide ‘oversight and better structure for policy making’ (sub. DR151, p. 13). The Australian Institute of Business Surveyors (sub. DR130, p. 3) also supported the recommendation, while the City of Melbourne supported a ‘Building Act that delivers the desired outcomes in a clear and logical manner that is easily understood by practitioners and consumers’ (sub. DR136, p. 8).

### Recommendation 8.1

**That the instruments that can be used to achieve the revised objectives of the *Building Act 1993* be set out in the Act separately from the objectives.**

### Focusing outcomes

A smaller number of outcomes in the Building Act would reduce both the number of ‘targets’ to be achieved with the instruments permitted under the Act, and the requirement for regulators to trade off the various objectives. A number of options are feasible.

#### *Option 1: Maintain five outcomes*

A minimalist approach to change would be to remove the instruments from the objectives section of the Building Act, as recommended above, and replace the 10 objective clauses of the Act with a statement that includes all of the attributes

in the current objectives in s4(b), (c) and (h). This might be expressed in the following way:

The objectives of the Act are to facilitate the adoption and efficient application of minimum national uniform building standards, to enhance the amenity of buildings, to protect the health and safety of people who use buildings and places of public entertainment, to facilitate the cost-effective construction and maintenance of buildings and affordable housing, and to facilitate the construction of environmentally and energy efficient buildings. These should be achieved while aiding the achievement of an efficient and competitive building and plumbing industry.<sup>2</sup>

This approach would clarify the focus on health, safety, amenity and environmental and energy efficiency. Deleting the other seven objectives would reduce the mixture of instruments and outcomes that characterises the present 10 objectives.

This option reduces the mixture of instruments and outcomes, because the single proposed objective includes both an instrument (standards) and outcomes. It might be preferable, therefore, to remove the reference to standards, although the enforcement of minimum standards is so integral to the regulatory framework that referring to it in the objective statement is unlikely to lead to confusion about means and ends. If a reference to standards is retained in the objective, the Commission considers that the current requirement to improve standards should be replaced by an obligation to achieve the efficient application of minimum standards. This change would focus regulators on achieving outcomes that maximise net benefits to society, rather than simply improving standards.

The proposed objective has a substantial weakness, however, because it includes five different attributes (health, safety, amenity, and environmental and energy efficiency) and does little to reduce the obligation on regulators to trade off these attributes.

*Option 2: Remove environmental efficiency from the objectives*

A second option, which would reduce the requirement for tradeoffs, is to remove the reference to the environmental efficiency objective. The Building Act does not define environmental efficiency. If, however, this objective refers to the impact on the environment of emissions from houses and their construction, that issue is addressed by the *Environment Protection Act 1970* (Vic.). Even if the environmental efficiency objective were removed, however, four attributes would remain.

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<sup>2</sup> One object of the Building Act is to 'regulate cooling tower systems'. This is not discussed because it is outside the terms of reference of the inquiry.

*Option 3: Remove environmental and energy efficiency from the objectives*

A third option is to remove the references to both energy efficiency and environmental efficiency, while adding a new requirement that Regulations made under the Act have regard for the government's energy efficiency objectives as they relate to building. This would allow change over time, as energy efficiency objectives were re-specified. Section 221ZZZV of the Building Act already provides for such an approach for plumbing, because it gives the Governor in Council the power to make regulation that relates to energy efficiency, environmental efficiency and water efficiency. Applying the same approach to building would be consistent with the OECD's suggestion that 'when multiple objectives cannot be avoided, they could be hierarchised by law' (OECD 2003, p. 39). The minister could direct the Building Commission as to the priority to be given to different objectives (discussed below).

*Option 4: Remove environmental and energy efficiency and amenity from the objectives*

Options 1, 2 and 3 would retain 'amenity' (whose meaning is ambiguous) as an objective. A fourth option would resolve this ambiguity by removing amenity from the objectives of the Building Act. This approach would be favoured if amenity is about 'neighbourhood' issues, which may be more effectively pursued through planning legislation. It would clarify that the Building Act is aimed at achieving health and safety outcomes. Removing amenity from the objectives should not involve any changes to the circumstances under which planning permits are required (as outlined in chapter 4). Alternatively, the Act could retain amenity as an objective if it defined it in a building context, to correspond with the meaning of amenity in the BCA and the Plumbing Code of Australia.

*Define outcomes*

Whichever option is chosen, defining all outcomes remaining in the Building Act would sharpen the focus on what the Victorian Government wants to achieve, while leaving room for interpretation and flexibility to respond to changing circumstances. One way for the government to retain flexibility while providing clear direction for regulators is to use a performance reporting framework. If regulators develop performance indicators for each outcome, which the minister has to approve, they will clarify what is to be achieved over the planning period. In the next period, there would be scope, if necessary, to adjust the indicators so long as they remain consistent with the outcomes as defined in the Building Act. Performance reporting is discussed in chapter 10.

*The Commission's preferred option*

In its draft inquiry report, the Commission suggested that the objectives for the Building Act should:

- set minimum standards for health and safety in the construction, maintenance and use of buildings
- include amenity, defined to be consistent with its use in the BCA and the Plumbing Code of Australia
- promote the government's energy and environmental efficiency objectives as they relate to buildings, having regard for the costs and benefits involved
- be defined.

This proposal would both reduce the number of objectives that regulators are required to target and provide guidance on the relative importance of the objectives that remain. The Commission noted in its draft report that the proposal attaches a particular priority to different outcomes, and that the government may choose to set different priorities. It sought comments on whether:

- retaining a large number of outcomes (potentially, health, safety, amenity, environmental efficiency and energy efficiency) as objectives in the Building Act could have adverse effects, such as reducing the scope for performance monitoring and accountability
- structuring the objectives as proposed would reduce this problem by clarifying that health and safety, and amenity objectives have the highest priority
- notwithstanding this prioritisation, the government should provide more guidance on how to trade off objectives
- amenity should be removed from or retained in the Building Act as an objective.

A number of inquiry participants commented on this draft recommendation. But rather than addressing the issues raised by the Commission, the reactions mostly opposed any reduction in the number of outcomes sought under the Building Act:

- The National Association of Steel-framed Housing Inc (NASH) noted the omission of quality and durability from the recommendation and suggested that 'explicit recognition of the value of durability is needed in regulatory decisions affecting the built environment' (sub. DR122, p. 3).
- The Property Council of Australia—Victorian Division 'would welcome additional consideration to net community benefits in the event of new requirements or regulations' (sub. DR134, p. 3).

- The Australian Conservation Foundation indicated that ‘we strongly reject’ the recommendation because it would ‘narrow the range of minimum standards to exclude energy and environmental efficiency as grounds for regulatory intervention’ (sub. DR137, p. 7). The City of Melbourne had a similar perspective, suggesting that ‘sustainability should be the core objective of the Building Act’ (sub. DR136, p. 7).
- The Department of Sustainability and Environment noted that ‘one aspect that would need to be considered if the objectives were to be changed is the obligation that Victoria has to achieve nationally consistent building Regulations’ (sub. DR172, p. 16).
- The Building Regulations Advisory Committee pointed out that any change to the objectives would need to take into account the whole of the building sector and that amendments to the objectives should not alter the relationship to the BCA (sub. DR142, p. 7).

The Australian Institute of Building Surveyors and the Master Builders Association of Victoria supported the draft recommendation (sub. DR130, p. 4; sub. DR151, p. 13), although the latter pointed out that changing the Act could have ramifications for the Building Commission’s powers, and that any alterations should be considered in conjunction with the other recommendations in the report.

The Commission continues to believe there would be benefits from simplifying, reducing and defining the outcomes sought under the Building Act. It is clear from inquiry participants’ reactions that such simplification would face some opposition, although this opposition has not yet dealt with the underlying issues raised by the Commission. The choice of objectives is a government responsibility, but any objectives that the government wishes to retain in the Building Act should be defined.

### **Recommendation 8.2**

**That the Victorian Government simplify, reduce and clarify the current objectives of the *Building Act 1993*. A starting point for this process could be the following objectives:**

- (1) achieving minimum standards of buildings, to preserve health, safety and amenity in the construction, maintenance and use of buildings**
- (2) promoting energy and environmental efficiency as they relate to buildings, having regard to the costs and benefits involved.**

**If outcomes such as health, safety, amenity, environmental efficiency and energy efficiency are retained in the Act, they should be defined.**

The government will need to consider whether the rationalisation of regulatory objectives proposed by the Commission for housing construction would have useful or inappropriate consequences for building Regulations outside housing. Such an assessment is not within the inquiry terms of reference, but the Commission notes that its recommendation draws on good regulatory principles with universal application.

### **Providing more guidance**

Clearer specification of the objectives of the Building Act would still leave considerable scope for interpretation, given that the objectives would necessarily remain general. Further clarity would be provided by guidance, either in the legislation or in advice from the minister (through, for example, the second reading speech, a ministerial Direction or an agreement between the minister and the regulator), on the priority to be accorded to each objective and on how the instruments permitted under the Building Act should be applied to achieve the objectives. The legislative approach may provide additional force but at the expense of reduced flexibility. Guidance would be particularly important if the government decides to retain a large number of objectives in the Building Act.

The *Australian Securities and Investments Commission Act 2001* (Cwlth) illustrates how the minister may provide guidance on the importance of different objectives. Under s12 of this Act, the minister can give written directions to the Australian Securities and Investment Commission (ASIC) about the policies it should follow or the priorities it should adopt in performing its functions. The direction must:

- be discussed in advance with the chairperson of ASIC
- not apply to a particular case
- be published in the *Victorian Government Gazette* and tabled in each House of Parliament.

The requirement that ASIC must report each year on its goals, priorities, progress towards achieving goals, performance indicators, and progress against these indicators (s138 of the Act) provides additional transparency.

Guidance could also be provided to regulators on the way in which the regulatory instruments can be used. Consistency with the *Victorian guide to regulation* would be achieved if the guidance indicated that the use of these instruments should:

- be targeted at an identified problem
- generate benefits to the community greater than the costs (that is, net benefits)



- be imposed when there is no regulatory or non-regulatory alternative (whether under the responsibility of the entities established under this Act or not) that would generate higher net benefits
- be used to assist consumers to make informed choices.<sup>3</sup>

Regulators would be encouraged to apply instruments consistently with these principles if they were required to explain in their annual report how they have done so.

A number of inquiry participants supported the draft recommendation that the government should provide additional guidance on how regulators should apply the instruments permitted under the Building Act—for example, the Australian Institute of Building Surveyors, the Master Builders Association of Victoria and the City of Melbourne (sub. DR130, p. 4; sub. DR151, p. 13; sub. DR136, p. 8). NASH indicated that it ‘supports any measures and recommendations which have the purpose and probability of improving consumers’ ability to make well-informed choices’ (sub. DR122, p. 3). The Department of Sustainability and Environment noted that ‘the provision of additional guidance by government is consistent with the characteristics of good regulatory systems, namely, securing the clearly stated objectives sought by government in the most cost-effective way’, although the nature and extent of guidance is a matter for the Victorian Government to consider (sub. DR172, p. 16).

The Australian Conservation Foundation, however, noted that:

Victoria should reserve the right to introduce more stringent standards than the national Building Code of Australia based on the best cost–benefit analysis and spill-over benefits (environmental, social and economy-wide) for Victorians. (sub. DR137, p. 8)

The Building Regulation Advisory Committee indicated that it was uncertain about the reference to ‘regulators’ in the recommendation, noting that the Building Commission prepares draft Regulations, the committee provides advice on the Regulations and Parliamentary Counsel prepares the Regulations for ministerial approval (sub. DR142, p. 9). The Commission had in mind all of the entities established under the Building Act.

In the light of inquiry participants’ comments, the Commission considers that its draft recommendation remains appropriate. The guidance provided by the government would assist all of those involved in developing, administering and enforcing Regulations to do so in accordance with the government’s priorities.

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<sup>3</sup> These tests are based on those suggested by the Productivity Commission (PC 2004c, pp. 358–9) for the ABCB.

### **Recommendation 8.3**

**That the Victorian Government provide, where necessary, additional direction on how entities established under the *Building Act 1993* are to apply the instruments permitted under the Act to achieve the Act's objectives. This direction might indicate that the use of these instruments should:**

- **be targeted at an identified problem**
- **generate benefits to the community greater than the costs (that is, net benefits)**
- **be imposed only when there is no regulatory or non-regulatory alternative (whether or not under the responsibility of the entities established under this Act) that would generate higher net benefits**
- **be used to assist consumers to make well-informed choices.**

**Direction should be provided either in the Building Act or in a Direction from the minister administering the Act. Entities established under the Building Act should explain in their annual reports how they have applied these principles.**

Recommendations 8.1, 8.2 and 8.3 would:

- sharpen regulators' focus on outcomes
- separate outcomes from instruments, making it clear that the latter are a means to an end
- provide guidance on how these instruments should be applied and, in doing so, encourage regulatory effort to be the minimum required given the scale of the problem
- make it easier for those administering the Act to be held accountable.

The costs of implementing the recommendations are difficult to quantify. Any refocusing of activities associated with the new objectives would involve costs. Generally, however, simplification should reduce regulatory costs. Moreover, the proposed objectives are specified in a way that such changes can be made only when demonstrated to generate net benefits.

If the objectives of the Act were amended as proposed, it would be necessary to review the functions of the regulators established under the Act, to ensure consistency between these functions and the revised objectives. This is discussed in chapter 9.

## **8.3 The Domestic Building Contracts Act**

### **8.3.1 Objectives**

As pointed out in chapter 4, the Domestic Building Contracts Act (s4) has three objectives:

- to provide for the maintenance of proper standards in domestic building work in a way that is fair to both builders and building owners
- to enable disputes involving domestic building work to be resolved as quickly, efficiently, cheaply and fairly as possible
- to enable building owners to have access to insurance funds in cases where domestic building work under a major domestic building contract is incomplete or defective.

While words such as ‘fair’ and ‘proper’ require interpretation, the identified difficulties relating to the meaning, number and content of objectives in the Building Act seem less evident for the Domestic Building Contracts Act.

### **8.3.2 Linkages with the Building Act**

There are important links between the objectives of the Domestic Building Contracts Act and the Building Act. The objectives are closely linked, with the Building Act focusing on minimum building standards and the Domestic Building Contracts Act aimed at ‘proper standards’. In addition, the latter Act requires that a builder must carry out domestic building work in accordance with the requirements of the Building Act and Regulations (s8(c)) and must provide the building owner with copies of inspection notices given to the builder under the Building Act (s26(1)).

In July 2004, the Victorian Government announced a review of the Domestic Building Contracts Act, to be led by Ms Jenny Mikakos MP. The terms of reference for the review included the relationship between the Act and other legislation, including the Building Act, and harmonisation of the various Acts that affect domestic building. The review has not yet been made public. In its response to the draft inquiry report, the Department of Sustainability and Environment suggested that the Commission, to provide a more complete picture of the costs of regulation, should undertake a ‘more detailed assessment’ of the Domestic Building Contracts Act (sub. DR172, p. 1). The Commission has not undertaken a comprehensive analysis, given the review already underway, but has commented on three issues raised by inquiry participants or its own analysis.

## **Consumer awareness**

The first issue relates to consumer awareness of the way in which the two Acts relate to each other. CAV indicated that building owners frequently fail to understand that inspections by building surveyors under the Building Act do not account for any higher standards that might have been agreed between the building owner and builder. The building owner may expect that the building surveyor is monitoring compliance with the terms of the building contract, whereas this is not the case. According to CAV, ‘misunderstandings in this regard give rise to large numbers of disputes’ (sub. 91, p. vi). Underlying this problem is the fact that the distinction between the objectives of the two Acts is subtle and possibly not apparent to a person who infrequently commissions building work. As suggested in chapter 6, this problem may be addressed by improved communication to prospective consumers of building services about the respective roles of different agencies in administering the regulatory framework.

## **Clarity of roles and responsibilities**

The second issue is the clarity of the respective roles and responsibilities of the Building Commission, related entities and CAV. The following indicate a possible lack of clarity:

- As was pointed out in chapter 6, CAV indicated concern with the perceived low level of registration by building practitioners (sub. 91, p. vi; sub. DR166, pp. 11–12). This concern appears to reflect a difference in view between CAV and the Building Commission about how the registration system should be operated. The Building Act provides for the establishment of the registration system and its operation by the Builders Practitioners Board. The operation of the registration system, however, influences the achievement of both the outcomes required under the Building Act and those sought under the Domestic Building Contracts Act. The former Act requires compliance with minimum standards, as specified in the BCA, while the latter seeks ‘proper standards’, which might be specified in a contract at a level that exceeds minimum standards. As CAV pointed out, ‘the Building Regulations are focused on certification of minimum technical standards to be reached by building practitioners, whilst standards specified by plans embedded in domestic building contracts (pursuant to the DBCA) are entirely different and the product of agreement between the builder and the consumer’ (sub. 91, p. 29).

To the extent that registration of building practitioners leads to improved quality of building work, the use of the same regulatory instrument to achieve different objectives under the two Acts could lead to different views about how the registration system should be managed. Moreover, CAV pointed out that it ‘enforces conduct with professional conduct legislation

and experience has been that unregistered builders are more likely to breach this legislation' (sub. 91, p. v). Given these different perspectives, it is not surprising that CAV appears to support more extensive practitioner registration, covering all builders and subcontractors, than the Builders Practitioners Board considers appropriate for achieving the objectives with which it is charged. Thus, CAV pointed out that 'if registration was enforced more rigorously and all builders and subcontractors were registered, the ability of builders to pass these costs onto consumers would improve. The costs of registration are relatively minor in terms of the overall cost of housing construction and represent a small fraction of the overall construction costs for consumers (sub. 91, p. 30).

- CAV pointed out that:
  - ... the division of legislative responsibility between the Building Act and the DBCA also has resulted in a necessary division of administrative responsibility between CAV and the Building Commission. While regulatory issues that primarily affect consumers are the responsibility of CAV, there is some duplication of effort between the two agencies relating to information and education. Both the Building Commission and CAV produce information and education material for consumers. This could be reviewed to avoid potential duplication and unnecessary costs. (sub. DR166, p. 10)
- The Domestic Building Contracts Act specifies that a building contract must set out details of insurance that is required under the Building Act. That is, it requires disclosure of insurance (s31(l)). However, the Building Act, administered by a different minister and agencies, specifies the insurance that is required. This highlights the importance for close coordination in the administration of the two Acts.
- Building Advice and Conciliation Victoria, a joint service offered by CAV and the Building Commission, is a 'one-stop shop for consumers and builders providing free advice and assistance to resolve domestic building disputes' (BC & CAV 2004, p. 2) Disputes may, however, have a technical dimension (for example, relating to whether the building complies with a regulated standard or one agreed in the contract) or relate to breaches of warranties implied in the building contract. When technical issues are involved, CAV staff will 'refer a matter to the Building Commission in an attempt to resolve or conciliate the owner/builder dispute' (sub. 91, p. 32). Given that the dividing line between a technical and contractual dispute is often unclear, and that how issues are handled will affect both the costs faced by CAV and the Building Commission, the two agencies need to work closely together.

## Discrepancies

Third, participants pointed to some discrepancies between the two Acts. Fagan and Fagan (sub. DR123, p. 7) pointed out that the Domestic Building Contracts Act links a builder's claim for final payment for major domestic building work to the provision of the occupancy permit or final inspection documentation under the Building Act (s42), although some work could lawfully be carried out without a building permit. In such cases, the Domestic Building Contracts Act creates a difficulty for a builder to enforce final payment because an occupancy permit or final inspection documentation cannot be provided.

Another matter is the provision for building owners to opt out of the protection available under the Domestic Building Contracts Act by obtaining a certificate of consent to conduct building works as owner-builders under the Building Act. The amendments to the Building Act in respect of owner-builders came into effect in June 2005 after considerable discussion. CAV, however, pointed out that 'despite the changes to the Building Act, there are consumer protection issues remaining' for homeowners who waive their rights under the Domestic Building Contracts Act (sub. DR166, p. 11). Given these risks, the operation of the new arrangements should be monitored to determine whether there should be clearer disclosure of the risks that homeowners face or whether some modification of the Building Act is required to ensure adequate protection.

### 8.3.3 Options for closer integration

Options for improving the integration of the regulatory arrangements range from small to very large changes, including:

- removing the Domestic Building Contracts Act requirement that links a builder's claim for final payment to the provision of the occupancy permit or final inspection documentation under the Building Act in cases where there is no legal obligation for the permit or documentation to be provided (s42)
- providing more information to consumers about the roles of the two Acts
- if there is ambiguity about responsibility for managing an issue or area, the Building Commission and CAV agreeing which is the lead agency, with responsibility for achieving outcomes, albeit in consultation with the other agency
- requiring CAV and the Building Commission to negotiate a memorandum of understanding in relation to the administration of Building Advice and Conciliation Victoria
- requiring CAV and the Building Commission to negotiate a memorandum of understanding for coordinating the administration of the Building Act and the Domestic Building Contracts Act

- combining the Building Act provisions relating to domestic building and the Domestic Building Contracts Act into a single Act, administered by one agency. The Builders Collective of Australia commented that ‘the industry needs to be regulated by one body, through one minister and through one government department’ (sub. 38, p. 14).

The Commission has examined this issue only in response to submissions received since the draft inquiry report, and has not been able to seek comments on these options. However, all but the last option should deliver benefits without involving large costs. The last option is more far reaching, would be more costly to achieve and would have implications for building regulation beyond housing, but could conceivably lead to a more coordinated approach to the regulation of housing construction. But it is not clear which agency should administer a single Act: CAV, with its focus on the consumer perspective, may not be as well placed to regulate builders and building outcomes as is the Building Commission, bearing in mind the very large scale of the building sector. While the Building Commission may not have the consumer protection expertise that CAV builds up through its wider responsibilities. The welfare of both consumers and building practitioners is relevant to good public policy.

On the evidence that it has seen, the Commission does not consider that the arguments for integrating the Building Act and the Domestic Building Contracts Act are compelling. That said, the Mikakos review was asked to consider the scope for harmonising legislation relating to building regulation in Victoria, so if the review has discovered arguments for creating a single Act administered by one agency, this could be addressed with the release of the Mikakos report. However, even if the Government decided to integrate the two Acts, this would take considerable time to achieve. In the meantime, given that both Acts are complementary components of the regulatory arrangements, they need to be administered in an integrated manner.

To ensure that integrated administration happens effectively and efficiently, the Commission believes that agreements should be formalised between the Building Commission and Consumer Affairs Victoria about how they work together, when appropriate, to administer the two Acts. These agreements should cover issues such as:

- the roles and responsibilities of the Building Commission and Consumer Affairs Victoria and, in cases where there is joint responsibility, agreement as to which is the lead agency and how it will achieve outcomes, in consultation with the other agency
- responsibility for informing and educating consumers and building practitioners about their rights and obligations under the regulatory arrangements (including on all the separate matters identified in this report)

- the administration of BACV
- sharing of complaints data to inform the monitoring and enforcement of practitioner registration (as discussed in chapter 6).

To the extent that the two agencies are already operating in an integrated manner, such agreements may not generate large benefits—but in this case the agreements would be simple and inexpensive to negotiate. If, on the other hand, there are areas where integration can be improved, implementing such agreements could yield considerable benefits. Negotiations can often be more effective if conducted within a deadline, and it would seem reasonable for the agreements to be settled by June 2006. To align incentives, performance measures for both agencies should include fulfilment of integrated administration objectives.

Publication of these agreements on the agencies' websites would help to inform homeowners and practitioners about how the regulatory framework is administered and which agency they need to deal with. The agencies should report in their annual reports on how they have worked together to achieve regulatory outcomes, any problems that have arisen over the year, and how these will be addressed.

#### **Recommendation 8.4**

**That the Victorian Government direct the Building Commission and Consumer Affairs Victoria to formalise agreements on how they will work together, when appropriate, to administer the *Building Act 1993* and the *Domestic Building Contracts Act 1995*. These agreements should cover issues such as:**

- the roles and responsibilities of the Building Commission and Consumer Affairs Victoria and, in cases where there is joint responsibility, agreement on which is the lead agency and how it will achieve outcomes in consultation with the other agency
- responsibility for informing and educating consumers and building practitioners about their rights and obligations under the regulatory arrangements
- the administration of Building Advice and Conciliation Victoria
- the sharing of complaints data to inform the monitoring and enforcement of practitioner registration.

**These agreements should be completed by June 2006 and published on the agencies' websites. Performance measures for each agency should incorporate integrated administration objectives. The agencies' annual reports should detail how the agencies have worked together to achieve regulatory outcomes.**



## **8.4 Improving processes for adding regulatory obligations**

Chapter 4 outlined seven processes through which new legislative or regulatory obligations and guidelines may be imposed on those involved in housing construction. This section considers the extent to which each of those processes facilitates adequate public scrutiny of proposed obligations to assess the community costs and benefits. The benefits of such scrutiny include allowing for estimated benefits and costs to be tested and identifying unintended effects of the regulation.

### **8.4.1 Legislation**

Proponents of significant new legislation may be required to prepare a business impact assessment (BIA), which should help to ensure the legislation creates net benefits for the community. BIAs are Cabinet-in-confidence documents that are not publicly released without the consent of the Premier, Treasurer and responsible minister. Agencies are not required to test in public the costs and benefits of the options explored in a BIA, but may do so—for example, where a public review precedes the development of legislation. The parliamentary process in considering new legislation provides a forum for scrutiny.

### **8.4.2 Regulations**

Building Regulations are subject to requirements under the *Subordinate Legislation Act 1994* (Vic.). In most cases, an RIS must be prepared for proposed Regulations; stating the problem to be remedied by the Regulations, identifying alternative ways of remedying the problem, and setting out the economic, social and environmental costs and benefits of the alternatives. The RIS is then publicly circulated to invite comment on the proposed Regulations and the reasons for their adoption. The public release of RISs has been important in identifying deficiencies in their analysis.

A Building Regulation that applies, adopts or incorporates any matter in a planning scheme approved under the Planning and Environment Act is not required to be the subject of an RIS because that Act provides for review processes (Building Act s9A). The processes that must be followed in the preparation of planning schemes and their amendment (described in section 4.2.6), especially the notice requirements under s19 of the Planning and Environment Act, are rigorous in some respects but fall short of the analytical and consultative requirements of the Subordinate Legislation Act. The Planning and Environment Act does not require, for example, the publication of a document setting out regulatory and non-regulatory alternatives for remedying

the problem to be addressed by the planning amendment, public disclosure of economic, social and environmental costs and benefits, or consultation with some affected people, such as housing industry groups.

In its draft inquiry report, therefore, the Commission proposed that the exemption from the obligation to prepare an RIS should be removed by legislative change to delete s9A. RISs would then need to be prepared for proposed new Regulations, in addition to the review processes under the Planning and Environment Act (unless an exception or exemption certificate is issued). One of the grounds for an exemption is that the proposed Regulation would not impose an ‘appreciable economic or social burden on a sector of the public’ (Subordinate Legislation Act, s9(1)(a)).

The City of Moonee Valley supported this recommendation, because an RIS would ‘allow further consultation, communication and feedback from the building industry with respect to proposed regulatory changes’ (sub. DR99, p. 4). The Master Builders Association of Victoria also supported the recommendation, noting that ‘variations at local level are an impediment to the efficient operation of the building and construction sector’ (sub. DR151, p. 15). The Australian Conservation Foundation too supported the use of RISs, pointing out that cost–benefit analyses should examine the full costs of climate change (sub. DR137, p. 8). The Australian Institute of Building Surveyors, however, contended that ‘the need for a RIS should be confined to matters other than those related directly to minimum health, fire life safety and amenity regulations. Matters related to planning, energy efficiency and the like should be subject to RIS’ (sub. DR130, p. 4).

The Department of Sustainability and Environment provided a different perspective, suggesting that it is redundant for a Building Regulation that applies, adopts or incorporates any matter in a planning scheme to be subject to an RIS if it reflects what is in the planning scheme, because measures introduced into planning schemes have already been subject to the ‘extensive consultative requirements under the Planning and Environment Act’ (sub. DR172, p. 17). These include the requirement to: serve a personal notice ‘on every owner and occupier of land who may be materially affected by a proposed planning scheme amendment’; provide public notice where issuing a personal notice is impractical; and consider all submissions made (sub. DR172, p. 17).

Despite the benefits from the consultative processes under the Planning and Environment Act, the Commission considers that the process under the Subordinate Legislation Act, which requires the publication of an RIS, permits more effective public scrutiny of regulatory proposals. It is concerned with avoiding any duplication that would result if planning amendments adopted by Building Regulations were subjected to two reviews that overlapped to a substantial extent. Nonetheless, the Commission considers that any overlap

between reviews under the two Acts would not be substantial, given their different procedures. A review under the Subordinate Legislation Act would be required only if a planning amendment imposed an appreciable economic or social burden. This review would complement that conducted under the Planning and Environment Act by conducting more rigorous public assessment of costs and benefits and by facilitating comment by building and housing groups. Who should prepare RISs is discussed in chapter 9.

#### **Recommendation 8.5**

**That the exemption from the obligation to prepare a regulatory impact statement, as provided by s9A of the *Building Act 1993*, be removed.**

### **8.4.3 Building Code of Australia**

The ABCB uses RISs for major changes to the BCA where the changes are likely to have significant impacts, where the matter is of a sensitive nature, or where the economic impact needs assessment. This process is broadly equivalent to the RIS process mandated under the Subordinate Legislation Act.

#### **State and territory variations to the Building Code of Australia**

Section 5.3.3 considered whether standards referenced in the BCA should preclude the retention of widely used practices within Victoria. This section considers variations to the BCA initiated by Victoria.

The Inter-Governmental Agreement that established the ABCB allows state- and territory-specific variations to the technical content of the BCA, without an RIS or any other consultative procedure. The Building Products Innovation Council suggested:

It is confusing for industry to have a national code which can be amended by a state variance which purports to control all activity in that state which can then be altered at the will of a local council. This is far from efficient nor is it a method to promote surety in the industry. (sub. 46, p. 3)

NASH pointed out that:

The state amendments complicated the BCA and increased the cost of developing new systems ... NASH strongly believes that there should be a uniform BCA without state or local variations. (sub. 35, p. 2)

National uniformity could, however, rule out local variations that local circumstances (such as climate) may warrant. Nevertheless, it seems inconsistent that the RIS process applies to amendments to the Building Regulations but not to state based amendments to the BCA, which are called up by the Building Regulations. Requiring Victorian based amendments to the BCA to be exposed to the same scrutiny that applies to other Regulations under the Subordinate

Legislation Act, and to be triggered by the same requirements, would help to promote consistency while allowing Victorian-specific amendments when they provide net benefits. The Commission thus recommended in its draft inquiry that Victorian variations to the BCA should be introduced only after being subject to regulatory impact assessment applicable to Regulations under the Subordinate Legislation Act.

The City of Moonee Valley supported this recommendation:

Any change made to the Victorian section of the Building Code of Australia (BCA) could impact on the building industry and increase building costs. Therefore, comments should be sought from the public and the building industry for any change to the BCA. This process would allow for an analysis of the consequent costs and benefits of each proposed change (sub. DR99, p. 4).

NASH also believed the recommendation is ‘most appropriate’, given that regional variations in the standards can add complexity and cost, and may be ‘inherently anticompetitive in that they may hinder access to some markets by more efficient national manufacturers’ (sub. DR122, p. 3).

The Building Regulations Advisory Committee stated that the recommendation has ‘obvious merit’ and that ‘in an ideal world there would be no Victorian variations’. Issues that the BRAC believes would need to be considered in implementing the recommendation include the extent of a Victorian RIS that would be required for work completed at the national level; application of the requirement to variations not affecting the housing construction market; prolonged regulatory uncertainty; and whether an RIS would be required if the variation lessened the regulatory burden (sub. DR142, p. 9).

Mr Stuart McLennan, a former chair of the ABCB Housing Committee, supported the draft recommendation, but suggested the Commission should ‘consider including a recommendation to review recent changes to the national BCA requirements to identify possible amendments that could provide a cost saving to Victorian Construction’ (sub. DR145, p. 2).

The Master Builders Association of Victoria supported the recommendation, because:

Measures must be taken within legislation to make it more difficult for variations to be made to the Building Code of Australia, lest the whole system become a shambles. (sub. DR151, p. 15)

The Department of Sustainability and Environment acknowledged that technical variations to the BCA for local circumstances may be made without an RIS, and ‘that there is a lack of clarity, relative to the *Subordinate Legislation Act 1994*, for deciding when a RIS assessment is required for variations to the BCA and how such assessments should be carried out’ (sub. DR172, p. 18). It suggested that a

protocol be developed to encourage consistency with the Subordinate Legislation Act, and noted that the Act permits an exemption from the requirement to prepare an RIS if the proposed rule is not likely to impose an appreciable economic or social burden on a sector of the public (sub. DR172, p. 18).

In the light of these comments, the Commission considers that its draft recommendation remains appropriate.

### **Recommendation 8.6**

**That Victorian variations to the Building Code of Australia be introduced only after being subject to regulatory impact assessment applicable to Regulations under the *Subordinate Legislation Act 1994*.**

### **Housing standards**

The BCA calls up many standards, generally prepared by Standards Australia. The standards set out detailed technical specifications or other criteria necessary to measure that a material or method will consistently do its intended job (sub. 84, p. 12). In chapter 5, the Commission found there are legitimate concerns about the rigour generally applied to assessing the impact of standards that might be adopted with Victoria's Building Regulations.

Mr Stuart McLennan commented that each of the housing standards directly called up in the BCA has secondary and tertiary standards, increasing the number of standards in the BCA to over 1400. He pointed out that a private company, Standards Australia, develops these codes and derives profit from selling them, and that this:

... introduces a direct conflict of interest, where the private company is responsible to furthering their own interests, while building legislation is responsible to the broader community and maintaining cost effective building (including reduced reliance on compliance codes). (sub. 65, p. 4)

He recommended:

The Victorian Government must develop alternative construction standards based on the objectives of the Building Act 1993 and remove dependence on Standards Australia. (sub. 65, p. 4)

The City of Boroondara, noting that a building surveyor is expected to know 1400 standards, commented:

This is impossible for any practitioner, especially when these standards are constantly being updated and amended. (sub. 66, p. 7)

The Productivity Commission reviewed the role of Standards Australia International (SAI) in its report *Reform of building regulation* (PC 2004c). It noted that SAI is a not-for-profit organisation and that any surplus it makes must go

back into the business. Inquiry participants raised with the Productivity Commission concerns about standards, including the appropriate level of a standard in terms of performance or stringency. As mentioned in section 5.3, the Productivity Commission felt that the recently published *Protocol for the development of BCA referenced documents* (which was partly developed in response to concerns about the proliferation of standards) was welcome but did not create a clear expectation that RISs will be prepared early in the process for any proposed standard that may have non-minor impacts. It proposed that the memorandum of understanding between SAI and the ABCB should be re-negotiated and that the referenced documents protocol should be revised:

... to provide for a clearer requirement for RIS-type analysis to be undertaken at an early stage in the development of standards that are expected to be referenced in the BCA and that are likely to have non-minor effects. (PC 2004c, p. 272)

The Commission considers that this recommendation is consistent with good regulatory process and, over time, would help to address inquiry participants' concerns about standards. It proposed in its draft inquiry report that the Victorian Government support re-negotiation of the memorandum of understanding between SAI and the ABCB, and revision of the referenced documents protocol, requiring RIS-type analysis to be undertaken at an early stage in the development of standards likely to be referenced in the BCA and to have non-minor effects.

Plan Scan (Aust.) Pty Ltd argued that all new standards and changes to standards should be subject to an RIS, with minor changes subject to a 'minor RIS' (sub. DR111, p. 2). The Master Builders Association of Victoria also supported the recommendation (sub. DR151, p. 15).

The Building Regulations Advisory Committee, on the other hand, argued that substantial consultation on new standards already occurs and that proposals are sometimes 'culled at an early stage based on low benefit/cost expectations'. It suggested that the opportunity to undertake RIS-type analysis depends on the ability to identify significant issues, the relevance of such analysis at an early stage, and the potential benefits related to the cost impacts (sub. DR142, pp. 8–9). The Department of Sustainability and Environment similarly felt that the requirement that the Australian Building Codes Board undertake RISs for new standards proposed for the BCA, as well as for technical changes to the existing standards, places sufficient discipline on SAI to take into account the potential costs and benefits of new standards as they are being developed (sub. DR172, p. 18).

Stuart McLennan suggested that amending the memorandum of understanding would be only a partial solution, because most standards produced by Standards Australia do not provide a cost-effective solution. In his view, government should produce its own alternative if a standard is not suitable (sub. DR145, p. 4).

While noting that there are disciplines on SAI, the industry's concerns expressed in this inquiry about the lack of rigorous analysis of some standards at an early stage, combined with the view of the Productivity Commission that there should be a clearer requirement that RISs be prepared early in the process for proposed standards that have non-minor impacts, suggest that the recommendation in the draft inquiry report remains appropriate.

#### **Recommendation 8.7**

**That the Victorian Government support re-negotiation of the memorandum of understanding between Standards Australia International and the Australian Building Code Board and revision of the referenced documents protocol, requiring regulatory impact statement-type analysis to be undertaken early in the development of standards likely to be referenced in the Building Code of Australia and to have non-minor effects.**

#### **8.4.4 Ministerial guidelines**

The Building Act entitles the minister to issue guidelines on application and permit fees, Building Commission charges for services rendered, building surveyor functions and the circumstances in which a building surveyor should seek assistance from the fire brigade (s188(1)). The minister can issue fee guidelines and specify minimum and maximum fees for different classes of fees. He or she can also issue guidelines relating to the design and siting of single dwellings (s188(2)). Guidelines are more flexible than Regulations, because they can be introduced or amended without an RIS. They are thus exposed to less scrutiny before being introduced. Moreover, they are not subject to the 10 year sunset provisions that apply to Regulations. If guidelines have unintended effects, those parties affected can make representations to the minister for change, but this process does not involve the systematic analysis of costs and benefits that is required for an RIS.

The use of instruments such as ministerial guidelines was examined in a broader context by the Scrutiny of Acts and Regulations Committee, as reported in the Commission's 2005 draft report *Regulation and regional Victoria: challenges and opportunities* (VCEC 2005b). In its review of the Subordinate Legislation Act, the committee looked at the coverage of the legislation:

... many regulations outside the Subordinate Legislation Act 1994 are subject to little consultation, not subject to any cost–benefit analysis and are not necessarily subject to any form of review. The committee heard evidence from various organisations expressing dissatisfaction with the regulatory process for regulations not subject to the Subordinate Legislation Act 1994 ... The committee considers that the most appropriate regulatory or non-regulatory response can only be achieved after subjecting regulatory proposals to adequate consultation and cost–benefit analysis. (SARC 2002, p. 32)

The committee expressed concern that legislative instruments such as guidelines, codes of practice and ministerial Directions can affect people's rights and livelihood but are not subject to parliamentary scrutiny in Victoria. It analysed several options and recommended:

... the Subordinate Legislation Act 1994 be amended to apply to instruments which are legislative in character and that a similar definition to that contained in the Legislative Instruments Bill 1996 [no. 2] (Cwth) be adopted. (SARC 2002, p. 38)

This would extend Victoria's RIS process to cover the same legislative instruments subject to review at the Commonwealth level—that is, it would cover guidelines, codes of practice and ministerial Directions that impose an appreciable burden on business. Extending the RIS process to non-regulatory instruments that impose an appreciable burden on business would not, however, guarantee better or more cost-effective regulatory outcomes. With limited resources for preparing RISs, there is a tradeoff between the quality of assessments and the scope of the RIS process. The quality of the process of developing and reviewing regulation is as important, if not more so, than casting the RIS net more widely.

The Victorian Government rejected the recommendation of the Scrutiny of Acts and Regulations Committee, arguing:

The definition in the Legislative Instruments Bill 1996 [no 2.] (Cwth) is too wide. It would also reduce the flexibility of Parliament to determine the methodology of the scrutiny mechanism, as it deems appropriate in individual cases. The government notes that:

- s4(1)(a) of the Subordinate Legislation Act 1994 (the Act) enables the Governor in Council to prescribe an instrument or class of instruments to be a statutory rule; and



- ultimately it is a matter for the Parliament to determine the form/character of legislative instruments generally.

The recommendation would result in an overwhelming workload and increase in cost that in most cases would outweigh any benefits to the public. (SARC 2003, p. 67)

The Government's decision notes that specific instruments can be prescribed as statutory rules. Given the importance of the issues that can be included in guidelines issued under the Building Act, the Commission believes that it would be good practice for the minister responsible for the Building Act to develop a RIS for guidelines that could impose an appreciable burden and release this for public comment. An alternative, and more robust, approach would be for the government to regulate to make guidelines under the Building Act 1993 statutory rules for the purposes of the Subordinate Legislation Act 1994, to ensure that guidelines that impose an appreciable burden would be subject to the RIS process.

#### **8.4.5 Local planning schemes**

Victorian councils can apply standards different from those in the Building Regulations through local provisions in planning schemes. Section 11 of the Building Act provides, if a planning scheme that regulates the siting of buildings in a municipal district is consistent with a Building Regulation, that the planning scheme prevails. Consequently, this provision has the potential to create a myriad of variations to housing construction requirements across Victoria, unless the minister withholds approval for planning amendments that create undesirable regulatory inconsistencies.

If Building Regulations are subject to an RIS process, consistency in process would be achieved by making planning scheme provisions that override the Regulations also subject to an RIS process of the kind required under the Subordinate Legislation Act. While local variation has advantages, it can also present costs, so should be subject to scrutiny. This extension of the RIS process would, however, have implications for local government's powers and relationship with the Victorian Government that extend beyond the housing construction sector and that could alter the costs and benefits of the proposal. The Commission considers that this proposal should be considered, but in a wider context than is possible in this inquiry. This issue is discussed in section 5.5.

### **8.4.6 Local laws**

Councils can introduce local laws on a limited range of housing construction matters, after a process of public notice requirements. This process, according to the City of Boroondara, is ‘sufficiently transparent and gives opportunity for submissions to be lodged’ (sub. 66, p. 7). The Property Council of Australia, however, commented that it:

... strongly believes that the processes for introducing new regulations affecting housing construction at a local level are not sufficient to take into account the full costs and benefits involved. (sub. 69, p. 3)

Exposing new local laws to the scrutiny required by an RIS process would improve their quality. The Commission is also attracted by the Productivity Commission’s proposal that local governments should be required to seek prior approval from the Victorian Government to apply building requirements that are inconsistent with the BCA (PC 2004c, p. 184). If this were done, the Building Commission could process requests and advise on their technical significance (or even approve them under delegated powers from the Minister for Planning). However, again, such changes may have implications for local government’s powers and relationship with the state government that extend beyond the housing construction sector. These two proposals, like the previous one, should be considered in a wider context than is possible in this inquiry.

In chapter 5, the Commission noted that the government has supported a recommendation by the Scrutiny of Acts and Regulations Committee that the Minister for Local Government, in consultation with councils, consider establishing an appropriate scrutiny process for local laws (SARC 2002). The Commission recommended in chapter 5 that the Department for Victorian Communities report on a timetable for implementing the government’s intention to consider an appropriate scrutiny process for local laws.

## **8.5 The regulatory impact assessment process**

As noted, the Building (Interim) Regulations 2005, made under the Building Act, are a key element of the regulatory framework.<sup>4</sup> These Regulations are the means by which the BCA is incorporated into Victorian law, and also by which many Victorian-specific amendments or extensions to the regulation of building are introduced.

The Regulations will need to be re-made by June 2006. Given this deadline, and the increasing use of regulatory impact statements (RISs) that would occur if the

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<sup>4</sup> The Plumbing Regulations 1998 and the Building (Legionella Risk Management) Regulations 2001 were also made under the Building Act.

recommendations were accepted, it is instructive to review RISs that have been prepared in relation to the Building Regulations. This review may suggest areas for focus in next year's major review.

The Regulations have been amended 19 times since being introduced in 1994 growing from 90 pages in 1994 to more than 209 pages in 2005. RISs were prepared for 12 of these amendments. New regulation has covered areas such as cooling towers (to reduce the incidence of legionella disease) and swimming pool fences (to reduce drownings). In Victoria, all Regulations expire after 10 years, with sunset provisions intended to ensure only regulation that is still warranted and cannot be improved is re-made in its current form. Other regulation should lapse or be modified, either because there is insufficient evidence demonstrating that it has been effective, or because technological, market or other regulatory changes have made it unnecessary in its current form.

Given the current (interim) Building Regulations expire on 13 June 2006, decisions need to be made about which elements to retain and which to let lapse, and whether to add any new elements. An RIS helps inform those decisions by providing a robust basis for scrutinising regulatory proposals (including re-made Regulations) and amendments. An RIS must be prepared for all Victorian Regulations that impose an 'appreciable burden on any sector of the public' (with a few exceptions), to assess the merits of regulatory proposals. It is released with the proposed Regulations for public comment, so the analysis can be publicly tested and any potential problems can be identified.

The level of analysis required in an RIS depends on the likely impact of the regulatory proposal. Given the nature and scope of the Building Regulations—affecting every building in the state, and covering a wide range of policy objectives and regulatory requirements—comprehensive and robust analysis will be required. The Commission has assessed past RISs to:

- test the available information on the relative magnitude of the benefits and costs of the existing Building Regulations
- identify the extent to which non-regulatory or less onerous regulatory alternatives were considered when Regulations were proposed
- identify where the analysis could be strengthened when an RIS is prepared for the re-making of elements of the current Regulations that are to be retained (and for any future amendments).<sup>5</sup>

Box 8.2 lists the Building Regulations for which RISs have been prepared.

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<sup>5</sup> The analysis will be available on the Commission's website ([www.vcec.vic.gov.au](http://www.vcec.vic.gov.au)).

## Box 8.2 **Regulatory impact statements prepared in relation to the Building Regulations 1994**

- (1) Building Regulations 1994
- (2) Building (Amendment) Regulations 1995
- (3) Building (Qualifications) Regulations 1995
- (4) Building (Amendment) Regulations 1996
- (5) Building (Amendment) Regulations 1997/Building (Further Amendment) Regulations 1997
- (6) Building (Amendment) Regulations 1999
- (7) Building (Fees) Regulations 2000
- (8) Building (Cooling Tower Systems Register) Regulations 2001
- (9) Building (Single Dwelling) Regulations 2001
- (10) Building (Swimming Pool Fences) Regulations 2001
- (11) Building (Further Amendment) Regulations 2003
- (12) Building (Owner–Builder) Regulations 2005

Source: Building Commission, pers. comm., 10 May 2005.

This analysis of the 12 RISs suggested:

- the nature of problems that the Regulations were expected to address was identified in eight RISs and partially identified in two RISs
- the extent of these problems was quantified in two RISs and partially quantified in three RISs
- a good explanation of the operation of the proposed Regulations was provided in 10 RISs and partially in two RISs
- all relevant costs appeared to be quantified in four RISs and partially quantified in six RISs
- all relevant benefits appeared to be quantified in four RISs and partially quantified in six RISs
- feasible regulatory and non-regulatory alternatives to the key elements of the proposed Regulations were identified in three RISs and partially identified in two RISs. These were carefully assessed in three RISs and partially assessed in one RIS
- the proposed Regulations were compared with options involving less regulation in two RISs and partially compared in one RIS.

This review suggests areas in which RISs can be improved. These areas are broadly consistent with those identified in other areas of regulation that the Commission examined in its *Regulation and regional Victoria* draft report (p. 232) and that Parliament's Scrutiny of Acts and Regulation Committee examined in its *Inquiry into the Subordinate Legislation Act 1994* (SARC 2002).

Judged against the standards of the recently released *Victorian guide to regulation*, key areas for improvement are quantification of the extent of the problem, quantification of the relevant costs and benefits, a broader consideration of alternatives (particularly less onerous alternatives) and a more thorough assessment of alternatives. The *Victorian guide to regulation* considers it is reasonable to examine two to three alternatives in detail and good practice for the cost–benefit analysis of the most feasible alternatives to be undertaken to the same level as done for the proposal (State Government of Victoria 2005b, p. 5-20).

The step-by-step guide to the preparation of RISs in the *Victorian guide to regulation* is substantially the same as previously. However, the government has signalled that it is expecting more consistently robust analysis in a number of areas. This will provide a better assurance to the community that regulation is necessary. Before an RIS can be released for consultation, the Commission is required to advise the minister responsible for the proposed regulation that the RIS adequately meets the requirements of the Subordinate Legislation Act.

Chapter 5 of the guide points out that the Subordinate Legislation Act and its guidelines require an RIS to include:

- a statement of the objectives of the proposed statutory rule
- a statement explaining the effects of the proposed statutory rule
- a statement of other practicable means of achieving these objectives
- an assessment of the costs and benefits of the proposed statutory rule, and of any other practicable means of achieving the same objectives
- the reasons that the other means are not appropriate
- a draft copy of the proposed statutory rule.

A robust examination of the detailed and specific regulatory requirements in the Building Regulations through the RIS process will complement this inquiry's higher level review of the overall regulatory framework.<sup>6</sup> An RIS will bring together evidence of the effectiveness of existing provisions and should identify for careful scrutiny any alternatives that might be more effective or less onerous.

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<sup>6</sup> The RIS will also cover elements of the regulatory framework such as aspects related to commercial building that extend outside housing construction, and thus are outside the scope of this inquiry.



## 9 Regulators' roles and responsibilities

This chapter examines the multitude of functions prescribed for the regulatory bodies established under the *Building Act 1993* (Vic.) and the allocation of responsibilities among those bodies. It also briefly considers the functions of Consumer Affairs Victoria (CAV) in administering the *Domestic Building Contracts Act 1995* (Vic.). This examination is aimed at identifying whether these arrangements are likely to lead to the minimum regulatory effort, consistent with the scale of the problems that regulation is intended to address.

The chapter then considers whether the existing functions and division of responsibilities are appropriate, and whether changes to the current arrangements are warranted.

### 9.1 Introduction

Chapter 8 described the benefits of clarifying the objectives in the Building Act. In addition to specifying objectives, the Act sets out almost 50 functions that the regulatory bodies established under that Act are required to undertake in pursuit of the objectives. CAV, which administers the Domestic Building Contracts Act, has a much smaller number of functions.

This chapter begins by describing the functions of the entities established under the Building Act and of CAV in relation to housing construction. It considers whether the many functions carried out by the entities established under the Building Act, combined with the allocation of roles and responsibilities among these entities, are likely to lead to regulatory effort that is the minimum, consistent with the scale of the problem to be addressed.

The chapter addresses three questions:

- (1) Should the regulators not be undertaking any of their large number of current functions?
- (2) Should the regulators take on any new functions?
- (3) Is the current division of responsibilities among the regulators, and between the regulators and other agencies, appropriate?

The Victorian Competition and Efficiency Commission would have liked to answer these questions by comparing the functions of Victoria's building regulators with a best practice 'template' of functions for independent regulators, but it is not aware of such a template. In a recent report about independent regulators, the UK Better Regulation Task Force had difficulty even defining what an independent regulator is, given the 'diversity of functions they perform' (UK Better Regulation Task Force 2003, p. 5). The Commission thus addressed

the above three questions by examining functions of the building regulators and considering whether there are any tensions between undertaking these functions and achieving the outcomes specified in the Building Act at minimum cost.

This chapter outlines options for different structural arrangements and allocations of functions among regulatory entities. For all these options, the Commission presumed that the administration and enforcement of regulation remain with regulators that are independent rather than part of a government department. With the right institutional arrangements, having an independent regulator administer the regulation of housing construction at arms length from government should encourage more transparency, consistency and a longer term focus:

The expected benefits from setting up independent regulators are to protect market interventions from direct political interference and also from the influence of specific interests, such as those of the firms regulated. Independence is also expected to go hand in hand with transparency, stability and expertise. (OECD 2003, p. 5)

These benefits, however, will be achieved only if the regulator is held accountable for the pursuit of clear objectives set by government, operating independently but within a framework that specifies the extent of that independence. Regulators need independence in day-to-day regulatory decisions, but within a clearly defined framework that specifies the outcomes desired by the government and the types of activity in which the regulator should be involved. There is sufficient positive experience with the current arrangements for regulating housing construction in Victoria to support this model as the foundation of the proposed arrangements. This chapter considers, however, whether changes to some details of the current model would improve outcomes.

## **9.2 Current functions**

### **9.2.1 Entities established under the Building Act**

The Building Act specifies 17 functions for the Building Commission and 18 for the Plumbing Industry Commission (PIC). Tables 9.1 and 9.2 list these functions and also the functions for the other regulatory entities: the Building Regulations Advisory Committee (BRAC), the Building Advisory Council (BAC), the Building Practitioners Board (BPB), Building Advice and Conciliation Victoria (BACV), the Building Appeals Board (BAB) and the Plumbing Industry Advisory Council (PIAC). The Commission has not seen an organisation chart that satisfactorily depicts the relationships between these entities.



**Table 9.1 Functions of the Building Commission and related entities outlined in the Building Act**

<b>Building Commission</b>	<ul style="list-style-type: none"> <li>(a) To keep under regular review the administration and effectiveness of this Act and the Regulations</li> <li>(b) To advise the minister on amendments to improve the administration and effectiveness of this Act and the Regulations</li> <li>(c) To advise the minister on the impact on the building industry of other Acts and Regulations</li> <li>(d) To seek the views of the building industry and other interested groups on the effectiveness of this Act and the Regulations</li> <li>(e) To coordinate the preparation of draft proposals for Regulations under this Act</li> <li>(f) To conduct or promote research into matters relating to the regulation of the building industry</li> <li>(g) To promote better building standards, both nationally and internationally</li> <li>(h) To liaise with any organisation established to promote national building standards</li> <li>(i) To disseminate information on matters concerning building standards</li> <li>(ia) To disseminate information on matters relating to the registration of cooling tower systems</li> <li>(j) To provide information and training to assist persons and bodies in carrying out functions under this Act or the Regulations</li> <li>(k) To monitor the system of collection of the building permit levy and advise the minister about its effectiveness</li> <li>(l) To charge and collect fees (determined in accordance with this Act) for information and training services provided by it</li> <li>(m) To administer the Building Administration Fund</li> <li>(n) To accept any gifts or donations of money or other property by deed, will or otherwise</li> <li>(o) To advise the minister on any matter referred to it by the minister</li> <li>(p) Any other function conferred by or under this Act or any other Act or under any agreement to which the State of Victoria is a party</li> </ul>
<b>Building Regulations Advisory Committee</b>	<ul style="list-style-type: none"> <li>(a) Advise the minister on draft Regulations prepared under this Act, particularly on the extent to which they promote the objects of the Act and are cost-effective and necessary</li> <li>(b) Accredited building products, construction methods or designs, components or systems connected with building work for the purposes of this Act and the Building Regulations</li> <li>(c) Advise the minister on any matter referred to it by the minister</li> <li>(d) Any other functions conferred by or under this Act or any other Act</li> </ul>
<b>Building Advisory Council</b>	<p>Advise the minister on:</p> <ul style="list-style-type: none"> <li>(a) the administration of the Building Act and the Regulations (other than part 12A)</li> <li>(b) the impact on the Building Regulations system of Regulations made under any other Act</li> <li>(c) issues relating to the building permit levy</li> <li>(d) any matter referred to it by the minister.</li> </ul>
<b>Building Advice and Conciliation Victoria</b>	Provide free advice and assistance to help consumers and builders resolve and prevent building disputes.
<b>Building Practitioners Board</b>	<ul style="list-style-type: none"> <li>(a) Administer registration system for building practitioners.</li> <li>(b) Supervise and monitor the conduct and ability to practise of practitioners.</li> <li>(c) Make recommendations to the minister about qualifications for registration.</li> <li>(d) Undertake other functions conferred by the Act or the Regulations.</li> </ul>
<b>Building Appeals Board</b>	Determine disputes and appeals arising from the Building Act.

Source: *Building Act 1993*, ss183, 196, 208 and 211.

Table 9.2 **Functions of the Plumbing Industry Commission and the Plumbing Industry Advisory Council outlined in the Building Act**

<b>Plumbing Industry Commission</b>	<ul style="list-style-type: none"> <li>(a) To administer the plumber licensing and registration system created by this part</li> <li>(b) To promote the maintenance of adequate levels of competence among plumbers</li> <li>(c) To advise the minister on the making of Regulations under this part and plumbing technical standards (other than Regulations and technical standards relating to gasfitting work)</li> <li>(d) To advise the minister on the impact on the plumbing industry of other Acts and Regulations</li> <li>(e) To monitor and enforce compliance with technical standards applying to the plumbing industry, including standards applying to materials, installations, construction and maintenance</li> <li>(f) To promote plumbing practices that protect the health and safety of consumers and the integrity of water supply and wastewater systems</li> <li>(g) To hold, or cause to be held, examinations in plumbing work for the purposes of this part and to appoint examiners to conduct those examinations</li> <li>(h) To promote the resolution of consumer complaints about work carried out by plumbers</li> <li>(i) To seek the views of the plumbing industry and other interested groups on the effectiveness of this part and the Regulations</li> <li>(j) To coordinate the preparation of draft proposals for regulations under this part</li> <li>(k) To conduct or promote research into matters relating to the regulation of the plumbing industry</li> <li>(l) To promote better plumbing standards, both nationally and internationally</li> <li>(m) To liaise with any organisation established to promote national plumbing standards</li> <li>(n) To provide information and training to assist people and bodies in carrying out functions under this part or the regulations</li> <li>(o) To provide an information service with respect to plumbing</li> <li>(p) To accept any gifts or donations of money or other property by deed, will or otherwise</li> <li>(q) To advise the minister on any matter referred to it by the minister</li> <li>(r) Generally to carry out any other function or duty given to it, or imposed on it by this Act or any other Act</li> </ul>
<b>Plumbing Industry Advisory Council</b>	<ul style="list-style-type: none"> <li>(a) Provide advice to the minister.</li> <li>(b) Provide advice to the Plumbing Industry Commission.</li> </ul>

Source: *Building Act 1993*, ss221ZZV and 221ZZXC.

A number of the functions of the BPB, BACV and the BAB listed in tables 9.1 and 9.2 outline these entities' roles in administering the registration system for

building practitioners and plumbers, and determining disputes and appeals. The PIC also has a number of these functions—(a) (d) (e) (f) (g) (m) and (n) in table 9.2—because it undertakes for the plumbing industry the registration/licensing and dispute resolution functions that BACV and the BPB undertake for the building industry. The Victorian Competition and Efficiency Commission considers that registration/licensing and dispute resolution are ‘core’ regulatory functions that regulators should undertake. However, the regulators also take on a range of other functions, including:

- providing policy advice (functions (a)–(e) for the Building Commission and functions (c), (h) and (i) for the PIC)
- undertaking or promoting research (functions (f) and (j) for the Building Commission and PIC respectively)
- promoting improvements in standards (functions (g) and (k) for the Building Commission and PIC respectively).

With 50 functions allocated to the regulators, it is not feasible to discuss them all in this chapter, particularly because there are subtle differences between some of the functions allocated to the Building Commission and the PIC (box 9.1).

**Box 9.1 Differences between functions allocated to the Building Commission and the Plumbing Industry Commission**

- The Building Commission has an obligation to review the effectiveness and administration of the Building Act and to advise on amendments to improve it (functions (a) and (b)), while the PIC does not have a corresponding obligation. This suggests either that the Building Commission has primacy to review and advise on the administration and effectiveness of the whole Building Act (including the parts that relate to plumbing) or that this function has been specified for only some parts of the Act.
- Both the Building Commission and the PIC are responsible for providing information and training services (functions (j) and (n) respectively), but only the Building Commission can collect fees for doing so (function (l)).
- The PIC has to promote competence among plumbers (function (b)) but the Building Commission does not have a similar function. (Although the Building Practitioners Board has a function to ‘monitor conduct and ability to practise’, which may have a similar meaning.)
- The PIC is required to monitor and enforce compliance with technical standards (function (d)) but the Building Commission is not.

The last two areas of difference may be necessary as a result of differences in the approach to regulation between the plumbing and building industries and because the PIC has various roles that the Building Practitioners Board undertakes in place of the Building Commission. The reasons for the first two differences are not so apparent.

Requiring the Building Commission and the PIC to fulfil a large number of functions, many of which seem open ended, invites shortfall and complicates performance measurement (chapter 10). The Victorian Competition and Efficiency Commission has thus considered the scope for reducing the number of functions, asking in particular whether the Building Commission and the PIC should provide policy advice, fund or conduct research and promote better building standards nationally and internationally.

## 9.2.2 Consumer Affairs Victoria

CAV, a business unit of the Department of Justice, described its functions in general and under the Domestic Building Contracts Act in the following way:

- ... applying the state-wide regulatory regime, established under the *Fair Trading Act 1999*, to the sector along with the rest of the state's economy ... [This includes providing] consumer advice, [enforcing] fair trading in the market place and [administering] the machinery for resolving disputes between consumers and their suppliers. Under the DBCA [Domestic Building Contracts Act], minimum terms and conditions of a fair and equitable contract are specified.
- ... [administering] some of the elements of the industry-specific regulatory regime ... [including] the specialised mechanisms for resolving disputes between home owners and their contracted builders under the DBCA. This includes the conciliation machinery conducted through BACV, established jointly by CAV and the Building Commission. (sub. 91, pp. 1–2)

The Domestic Building Contracts Act outlines specific functions for the director of CAV—namely, to:

- publish in the *Victorian Government Gazette* details that the director requires to be provided in a domestic building contract (s122)
- provide information and advice concerning the operation of the Act to builders and building owners, and prepare and publish suggested domestic building contracts (s123)
- provide information to the Building Commission in relation to domestic building disputes (s123)
- establish the Domestic Builders Fund (s124).

Compared with the building entities, CAV is responsible for a much smaller number of functions relating to housing construction. Moreover, its functions in relation to consumer welfare in housing construction need to be perceived as consistent with much broader consumer welfare responsibilities. For these reasons, and because no changes are recommended in CAV's functions, the

remainder of this chapter focuses on the functions only of regulatory entities established under the Building Act. (Chapter 10 discusses the significance of good performance reporting to the fulfilment of functions for both CAV and the building regulatory entities.)

## **9.3 Are there any functions the regulators should not be undertaking?**

### **9.3.1 Should the Building Commission and the Plumbing Industry Commission provide policy advice?**

Providing policy advice typically involves a process, with steps that include:

- collecting information that indicates a ‘problem’ that may warrant government intervention
- clearly specifying the problem
- identifying options for addressing the problem
- evaluating the costs and benefits of these options, to suggest a preferred option
- implementing and evaluating the chosen option.

This description simplifies an iterative process that normally involves many more steps and consultation processes. Should regulators such as the Building Commission and the PIC be involved in this process and, if so, what form should that involvement take?

The Building Commission is closely involved in policy development (box 9.2). While elected governments, not regulators, should determine policy objectives, as pointed out in chapter 8, these objectives are typically identified only in general terms (for example, achieving ‘safety’ and ‘amenity’) and may evolve over time as circumstances change. Many decisions (sometimes by the regulator rather than government) influence how and to what extent policy objectives are pursued, and the development of new policies, as the UK Better Regulation Task Force pointed out:

It is too simplistic to say that government sets policy and regulators deliver. In reality, ministers/Parliament set the objective for a regulator, and the regulator develops policy and delivery mechanisms for delivering those objectives. (UK Better Regulation Task Force 2003, p. 20)

The relevant question is thus not whether regulators should be involved in providing policy advice at all, but rather the extent to which they should be involved and the channels through which this policy advice should be provided. Should the regulator have primary responsibility for developing the policy approach and instruments to give effect to the government's objectives? Or should it contribute to that process through its parent department or some other agency, which would be responsible for providing policy advice?

### **Box 9.2 Indicators of the Building Commission's involvement in policy development**

The Building Commission's 2003-04 business plan (BC undated B, pp. 6–7) listed success measures and deliverables, including:

- 'develop and implement amendments to the Building Regulations 1994'
- 'lead and facilitate the development of industry policy and practice on key industry issues including insurance and sustainability'
- 'recognition by industry of commission leadership on policy development'.

The Building Commission's 2003-04 annual report (BC 2004a, pp. 14–17) also included examples of policy development initiatives, such as:

- advising the government 'on reforms necessary to address the situation of unregistered speculative persons avoiding insurance and registration requirements, by falsely claiming to be owner builders'
- 'finding better ways to design and construct buildings to allow improved access for all people'
- reviewing the security of payment legislation
- reviewing the categories and classes of building practitioner registration
- driving sustainability initiatives in the built environment, by leading 'partnerships with industry, government and environmental bodies in order to influence the development of building codes, sustainability legislation and the behaviour of practitioners and consumers. Next steps in this area include developing energy standards for commercial buildings and examining options for disclosing the energy efficiency of existing homes when they are sold'.

The main argument for involving regulators in policy development is their first-hand expertise in policy implementation. They may be well placed to identify problems and to comment on the technical feasibility of policy options. On the other hand, combining policy and regulatory functions:

- increases the risk of regulatory 'creep', because it can be in the regulator's institutional interest to maintain and expand its role (APIA 2001; NECG 2001; Law Council 2001)

- can reduce accountability, by making it harder to assess regulators' performance. The Exports and Infrastructure Taskforce suggested that this has happened for economic regulators:
 

Part of the problem lies with the blurring of the boundaries between policy and regulation. Rather than operating within a framework in which policy goals are clearly articulated, regulators are combining functions of policy advocacy, design and implementation. Within that broad scope there is a reduced level of accountability, as there have rarely been clearly set out objectives against which their performance can be assessed. (Exports and Infrastructure Taskforce 2005, p. 41)
- increases the risk that the regulator may come to identify its own interests with those of the groups it is regulating (sometimes called 'industry capture'). If regulators are perceived to be influencing policy development, industry has an even greater incentive to develop a close relationship with the regulator (ICAC 1999; OECD 1999, 2003)
- may encourage excessive reduction of risk. As the Prime Minister of the United Kingdom pointed out:
 

A civil servant or regulator who fails to regulate a risk that materialises will be castigated. How many are rewarded when they refuse to regulate and take the risk?

Bodies set up to guard the public interest have one-way pressures. It is in their interest never to be accused of having missed a problem. So, it is a one-sided bet. They will always err on the side of caution.

It seems to be part of the DNA of regulatory bodies that they acquire their own interests and begin to grow. Max Weber famously noted the tendency of bureaucracies to tidiness. (Blair 2005, p. 2)
- can draw regulators into the political process, possibly compromising their perceived and actual independence, and their capacity to make impartial decisions
- can lead to a narrow policy focus. Policy advice about housing construction should have regard for the implications of this advice for other (but related) areas in which the government has policy objectives, and an industry based regulator is unlikely to have this broader perspective.
- confuses the roles of administering regulations and investing resources in changing regulation. Whether or not the regulator is tempted to take an institutional interest in maintaining and expanding its role, it is better to have institutional arrangements that do not rely on the 'virtue' of the regulator to deliver desired outcomes (Brennan & Hamlin 1995).

- can lead to more complex regulatory environments. Regulators may have an interest in creating complex environments, in which it becomes difficult to discern whether poor regulatory outcomes can be attributed to regulators' performance or to the complexity of regulation.
- can confuse advocacy and regulatory roles. Industry policy sometimes focuses on expanding and developing an industry. This should not be the regulator's perspective. A regulator that takes on an industry leadership role may be tempted to become an advocate for the industry, which would not sit easily with the arms length relationship that a regulator needs to perform its role with objectivity. The government's health and safety objectives, for example, might sometimes constrain industry profitability or growth.

In its draft inquiry report (VCEC 2005a), the Victorian Competition and Efficiency Commission recommended that the Building Commission and the PIC should not have primary responsibility for providing policy advice to the minister on the regulation of housing construction, but should be consulted on the implementation of regulation. While policy advice will be more relevant if informed by regulators' first-hand experience, this relevance could still be achieved if another agency were responsible for policy advice but consulted with the regulators about the technical implementation of policy options. In the case of building regulation, this agency might be expected, for example, to seek the views of the BPB about options for improving the registration system. For a wider perspective on issues to be addressed in implementing the regulatory framework, it could seek the advice of the BAC. As a product of administering the Act and Regulations, the regulator could, in its annual report, comment on difficulties or challenges in implementing regulation.

Within this confined policy role, the regulator may still undertake analysis of issues arising from the implementation of the regulatory framework. As noted, the Building Commission's 2003-04 annual report indicated that the commission would be advising the government 'on reforms necessary to address the situation of unregistered speculative persons avoiding insurance and registration requirements, by falsely claiming to be owner builders' (BC 2004a, p. 14). From its registration and other data, the Building Commission may be in the best position to develop information about the extent of a problem. It may even become aware of a problem before it becomes evident to others. It may also have views on how a problem should be addressed, which are valuable because they are informed by first-hand experience. That said, if the commission exceeds a reactive role by taking on primary responsibility for policy development, the risks outlined earlier in this section would arise.

The Victorian Competition and Efficiency Commission also suggested in its draft inquiry report that the Building Commission's functions listed in box 9.3 could be reduced in number and their meaning could be clarified, to indicate that



the commission's role is to advise on the administration and effectiveness of Regulations, in response to requests from the minister. The Commission's proposal stimulated many reactions from inquiry participants. The Housing Industry Association (HIA) pointed to its members' concerns about the rapid rate of regulatory change and indicated that it perceives 'merit in considering the separation of policy advice from implementation' (sub. DR163, p. 24). The HIA was concerned, however, that if the policy advisory role were absorbed into a large government department, development of building policy could become 'incidental' and subordinate to planning and environmental policy development.

**BOX 9.3      Functions of the Building Commission relevant to providing policy advice outlined in the Building Act**

- (a) To keep under regular review the administration and effectiveness of this Act and the Regulations
- (b) To advise the minister on amendments to improve the administration and effectiveness of this act and the regulations
- (c) To advise the minister on the impact on the building industry of other Acts and Regulations
- (d) To seek the views of the building industry and other interested groups on the effectiveness of this Act and the Regulations
- (e) To coordinate the preparation of draft proposals for Regulations under this Act

Source: *Building Act 1993*, s196.

A number of other inquiry participants opposed the recommendation that regulators should not have primary responsibility for policy advice. Their arguments included the following:

- There is not sufficient evidence that the current approach is leading to bad outcomes (Australian Institute of Building Surveyors, sub. DR130, p. 5; Plumbing Industry Advisory Council, sub. DR132, p. 14; Building Advisory Council, sub. DR154, p. 6).
- The proposal would reduce information flows from industry and industry's involvement in policy development (Plumbing Industry Advisory Council, sub. DR132, p. 15; Property Council of Australia, sub. DR134, p. 3; Stuart McLennan Associates, sub. DR145, p. 3). The BAC suggested that the involvement of itself and the Building Commission in responding to the insurance crisis illustrates the advantages of the regulator being involved in providing policy advice (box 9.4).
- There could be additional costs involved in the change (Australian Institute of Building Surveyors, sub. DR130, p. 5; Plumbing Industry Advisory Council, sub. DR132, p. 14).

- The impacts of the recommendation on the building industry as a whole need to be considered (Australian Institute of Building Surveyors, sub. DR130, p. 5).
- The PIC does not have primary responsibility for policy advice, but rather works with the Department of Sustainability and Environment on policy related matters (Plumbing Industry Advisory Council, sub. DR132, p. 14).
- The PIC would not be able to make significant contributions to policy development through its annual report (Plumbing Industry Advisory Council, sub. DR132, p. 15).

**Box 9.4      Role of the Building Commission and the Building Advisory Council in resolving the insurance crisis: the Building Advisory Council's view**

The Building Advisory Council noted the following:

There is evidence that the industry has been well served with the current arrangements. The Council and Building Commission were able to provide policy and administrative support to manage the insurance crisis in domestic building insurance that started in 2002. The Building Commission responded to the insurance crisis and took on the request of other departments to participate in, or lead, policy and product development and communication of these changes to target audiences. Target audiences included building practitioners, consumers and key industry stakeholders. The Council membership kept key industry stakeholders informed and provided feedback on industry response to the situation.

There was a need for an ongoing role to facilitate change in the insurance environment when other insurance products were also affected, for example professional indemnity insurance. Industry insurance forums were conducted by the Building Commission in consultation with Department of Treasury and Finance.

The insurance challenge, a national event, was managed to minimise the cost to consumers and practitioners by providing information and facilitating the entrance of new insurance providers in Victoria. The Building Commission and Council were in an ideal situation to work with government departments, insurers and industry to support consumers and practitioners during this difficult time.

The policy development function of the Building Commission, and the Council policy advice role to the relevant Minister, are key elements in the regulatory framework—a framework that works according to VCEC. By separating these functions access to, and understanding of, complex issues in a dynamic policy environment will be more difficult and policy outcomes will be affected.

Source: Building Advisory Council, sub. DR154, p. 6.

## **Addressing issues raised by inquiry participants**

The Victorian Competition and Efficiency Commission has comments on each of the points raised by inquiry participants.

### *Evidence*

Contrary to the view in several submissions, the Commission considers that there is considerable evidence that is consistent with the in-principle arguments against combining policy advice and regulation:

- The Regulations have grown from 90 pages in 1994 to 209 pages in 2005 (chapter 8).
- The chapter 8 examination of past regulatory impact statements (RISs) suggests the scrutiny of many new Regulations has not been rigorous.
- Chapter 10 argues that performance reporting by regulators is generally inadequate, and that this limits the capacity for regulators to be held accountable.
- There appears to be little evaluation of how well Regulations are working, beyond what happens when Regulations sunset.
- The regulatory framework itself is complicated, as chapter 4 illustrated.

It is difficult to assess the extent to which these outcomes are the consequence of the regulator also providing policy advice. Nevertheless, the experience with building regulation is at least consistent with in-principle concerns about combining policy advice and regulation.

### *Information flows*

The Commission agrees that it would be unfortunate if separating regulation and policy advice resulted in policy advice being less well informed. What is required is an appropriate balance whereby policy advisers receive sufficient information about the problems to be addressed by regulation and about the costs and benefits of regulation, but remain at arms length from both the regulator and those being regulated.

Neither the Commission's draft recommendation, nor the structural changes proposed later in this chapter, would prevent either the regulator or the industry providing advice to the department that is developing policy. In the draft inquiry report, the Commission suggested that the regulator could continue to provide policy suggestions through its annual report. The provision of advice and information could, however, be much more frequent; however, in keeping with the proposed arms length relationship between regulators and policy advisors, advice should be public—for example, through published letters to the minister.

The other information flow mentioned by inquiry participants is between the industry and policy makers. The Commission supports the maintenance of

advisory bodies (while proposing that they be separated from regulators—see below), and information flows could be maintained in a number of ways, including:

- regular meetings with the minister or the minister’s advisers
- a requirement that the BAC provide a regular public report to the minister, outlining its views on the regulatory framework
- a requirement for a senior representative of the policy department to attend meetings of the BAC.

*Building policy being given lower priority*

The HIA is concerned that building policy could become incidental to planning and environmental policy if policy advice were absorbed into a large government department. While an understandable concern, the Commission’s objective is to avoid a situation in which the regulator and the industry it is regulating believe that they need to work together—possibly to develop joint positions—to increase their influence over the government. There will often be a tension between the views of the regulator and the industry it is regulating. The Commission’s concern is with ensuring the government receives adequate, timely and *separate* views from both the regulator and the industry (as well as other relevant interest groups, such as consumers), so that it can take account of these views in choosing its policy position. Suggestions such as those outlined above should help this to happen.

As for the fear of building issues being subordinated to other policy interests, it does not seem appropriate to structure advisory processes to compensate for a fear of perceived policy inattention. The government is accountable for policy priorities.

*Additional costs*

The PIAC pointed to three additional costs from separating policy advice from regulation:

- the separation of policy development and monitoring from frontline interaction with the industry and its customers
- the problems that result from having divided accountability for the outcomes of regulation—the current more or less one-stop-shop accountability will be replaced with a divide between policy development and policy implementation
- the financial cost of establishing a new plumbing policy capability in a government department. (sub. DR132, p. 14)

The first two concerns should be addressed by the above techniques for maintaining close communication among regulators, industry and policy advisors. While developing policy capability in a government department could involve a

minor financial cost, it seems unlikely that the Department of Sustainability and Environment has vacated the policy field—after all, it chose to coordinate policy input to this inquiry. This cost would be partly or totally offset by savings from reducing the policy capability of the regulators. Moreover, the evidence in this report is that most of the costs of regulation fall on consumers and do not arise from the administrative costs of policy advice.

*The Plumbing Industry Commission's policy role*

The PIAC argued that it is an 'oversimplification' to describe the PIC as having primary responsibility for policy advice, because it already works with the Department of Sustainability and Environment and the Building Commission on policy related matters (sub. DR132, p. 14). If so, the changes proposed by the Commission may not be so extensive for the PIC as for the Building Commission. Moreover, the additional financial costs of this recommendation may not be large in the case of the PIC.

*The fact that the recommendation extends beyond housing*

The proposed separation of policy advice from regulation would have implications for the construction sector as a whole, which goes beyond the focus of the Victorian Competition and Efficiency Commission's terms of reference in housing construction. The Commission can see no reason that the advantages and disadvantages of separating policy advice from regulation would apply differently to the non-housing components of the construction sector. Nevertheless, the government would need to consider this wider perspective in reaching a view on the Commission's recommendation.

## **The Commission's view**

The Commission continues to support separating policy advice from regulation, but is mindful of inquiry participants' comments that this separation needs to be achieved cost-effectively and without unduly restricting information flows.

### **Recommendation 9.1**

**That the Building Commission and the Plumbing Industry Commission not have primary responsibility for providing policy advice to the minister on the regulation of housing construction, although they should be consulted on the practicality of policy options and the implementation of regulation. They should continue to be able to draw regulatory problems to the government's attention. The commissions' functions should be re-drafted to make it clear that they are not responsible for policy advice. The Victorian Government should seek to maintain information flows among those responsible for providing policy advice, regulators, consumers and the housing construction industry.**

### **9.3.2 Should the Building Commission and the Plumbing Industry Commission coordinate the preparation of draft proposals for Regulations?**

In its draft inquiry report, the Victorian Competition and Efficiency Commission argued that RISs supporting proposals for new Regulations should be prepared by agencies responsible for advising government about regulatory policy, rather than by those responsible for administering and enforcing regulation, although the regulator could help settle technical aspects of the Regulations. The Commission adopted this position for two reasons:

- (1) The development of RISs should be interwoven with policy development. Preparing an RIS involves the same steps for the policy advisory process outlined above (identifying the problem that needs to be addressed, assessing options for addressing the problem, and weighing up their costs and benefits). An RIS should not be developed after the policy has been settled, but rather as part of the process of developing the proposal. The agency that provides the policy advice should thus also develop the RIS, although in consultation with the regulator responsible for implementing the Regulations.
- (2) The entity that is responsible for preparing proposals may influence the identification of the problems to be addressed and the choice of proposals for consideration. For the reasons outlined, allocating this role to the regulator could encourage the expansion of regulation.

Inquiry participants did not comment on this issue, although the arguments for and against involving regulators in preparing RISs are similar to those related to regulators' involvement in policy advice. On balance, the Commission continues to hold the view that the Building Commission and the PIC should not coordinate the preparation of draft proposals for regulation, although they should be consulted.

#### **Recommendation 9.2**

**That regulatory impact statements should be prepared by agencies responsible for advising governments about regulatory policy, rather than by those responsible for administering and enforcing regulation, although the regulator could assist in settling technical aspects of the Regulations.**

### 9.3.3 Should the Building Commission act simultaneously as regulator and leader of the building industry?

While the Building Commission's statutory functions do not specify that it should 'lead' the building industry, the commission describes itself as playing a leadership role. In its corporate plan, it suggested:

The commission and its many stakeholders believe the building industry can deliver a much better product in terms of quality, safety, amenity and overall sustainability. We believe building consumers can be better informed and more satisfied with their purchases. We think building contractors and building professionals can be part of an industry that offers security and a worthwhile financial return, as well as a stimulating work environment that is attractive to workforce entrants. We want building practitioners to be proud of their industry.

The commission will work towards these outcomes by playing a much stronger leadership role in the state's building activities. (BC 2002c, p. 2)

This leadership role is also highlighted in the Building Commission's 2003-04 business plan:

In partnership with key industry stakeholders, the commission provides stronger leadership and better building control through the delivery of eight strategies. (BC undated B, p. 5)

The Building Commission provided examples of leadership initiatives in its 2003-04 business plan. Some relate to policy leadership, but others include:

- 'partnering with industry to help the community learn about and celebrate their built environment'
- positioning the Building Commission 'as a unifying force for the stakeholders of the Victorian building industry. The establishment of strong partnerships will facilitate major change in the industry. The commission, in concert with industry bodies and government, will act as a facilitator, leader and advocate in resolving industry issues'.
- identifying and producing building industry statistics to enhance decision making
- promoting BACV
- developing a communications strategy to make consumers more aware of their rights and responsibilities. (BC undated B, pp. 12–19)

That is, the Building Commission's leadership role has different facets, including promoting the industry in the broader community, resolving issues within the industry, providing and publishing industry statistics and providing information about the regulatory framework. Some of these facets seem entirely consistent with the Building Commission's role as regulator. It is part of the commission's role, for example, to ensure those it is regulating are informed about the

regulatory framework. Its recent extensive education program to explain the operation of the *Building (Amendment) Act 2004* (Vic.) is an example of how the regulator can inform the community about changes in the regulatory framework. It also seems appropriate that the Building Commission should promote BACV and develop communication strategies to increase consumers' awareness of their rights and responsibilities. These activities should assist the effective and efficient operation of the regulatory framework, contributing to an attractive industry environment.

That said, the Victorian Competition and Efficiency Commission considers that an industry leadership role that is wider than just described is not consistent with the regulator's core function of ensuring compliance with performance standards. If a regulator becomes a facilitator of change, or a broker between industry stakeholders, there is a risk of confusion between this role and the role of the regulator as the impartial administrator of the current Regulations. The risk of confusion becomes larger if the Building Commission promotes the industry while simultaneously regulating it and developing policy.

If the Victorian Government's intention in establishing the Building Commission and the PIC is to have independent regulators with the considerable power associated with the role, the two commissions should focus on that role. The industry is well established and has a broad cross-section of experienced and new participants, large and small. Where industry participants choose, they can draw on the services of well-resourced and active industry associations to promote the industry, assist in resolving issues or provide industry data. There is no reason to think the industry cannot find leadership from market outcomes and its own enterprise.

#### **Finding 9.1**

There are tensions between the roles of a regulator as the impartial enforcer of current Regulations and as a leader providing a unifying force for industry stakeholders.

### **9.3.4 Should the Building Commission and the Plumbing Industry Commission conduct and promote research?**

The Building Commission and the PIC are required to undertake or promote research into matters relating to the regulation of the industry. The Building Commission does not reveal in its annual report how much it spends on research or the benefits of that research. However, in August 2004, it produced a report (available on its website) that showed the commission spends about 8 per cent of



its total annual revenue on research, development and education (\$1.3 million in 2002-03 and \$0.85 million in 2003-04), concentrating on:

- reviewing current building legislation, procedures and codes
- responding to market trends and industry feedback
- encouraging innovation within the building and construction industry. (BC 2004e, p. 5)

The report also described some of the projects undertaken during 2002-03 and 2003-04. In 2003-04, the Building Commission was a partner in eight research and development projects with the Co-operative Research Centre for Construction Innovation. It was also a project partner in three projects with the Australian Building Codes Board, and developed work plans for other projects (box 9.5).

#### **Box 9.5 Examples of research projects funded by the Building Commission**

In 2003-04, the Building Commission was involved in a variety of projects, including: environmental assessment systems for commercial buildings; legionella control; ‘way finding’ in the built environment; sustainable subdivisions; multi-hazard risk assessment for buildings; contract planning workbench; the impact of design and documentation quality on project outcomes; project management and workforce collaboration software; research into accessible housing in Australia; and the efficiency and effectiveness of the building and occupancy permit process.

*Source: BC 2004a, p. 26.*

The PIC had a less ambitious program, using its research and development monies to fund overseas scholarships for plumbing apprentices and teachers, and to support selected candidates to complete their apprenticeship.<sup>1</sup> The PIC’s annual report provides incomplete information about research expenditure.

The usual argument for government support of research and development is that the private sector will under-invest because it cannot fully appropriate the benefits flowing from the knowledge generated by research and development.

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<sup>1</sup> Expenditure on research and development is not itemised in the Building Commission’s annual reports, but is most likely part of ‘special project expenditure’, which was \$4.4 million in 2003-04 and not further explained. The PIC’s research and development expenditure is funded from its Plumbing Industry Commission Trust no. 1, whose assets at 1 July 2003 were \$106 428 (PIC 2004a, p. 45).

Characteristics of the housing construction sector that might suggest a case for government support of research and development include the following:

- Businesses use broadly similar production processes and are likely to face common problems. An advance from research and development might thus quickly be ‘poached’ and widely applied elsewhere in the industry.
- The product is broadly homogenous, which lends itself to collective funding of research.<sup>2</sup>

On the other hand, businesses may fund research if they feel that patent or ‘natural’ protection means others will be unable to copy them. This means that the case for government involvement relies on there being insufficient market incentives to invest in research. Moreover, even if there is a theoretical argument in support of centrally funded research, such research programs may not be warranted in practice unless focused on high yielding projects with disciplined fiscal management.

It is difficult to assess whether it is appropriate for the Building Commission to spend about 8 per cent of its funds on research, development and education, or whether the PIC is right to spend a much smaller amount. One approach to this issue is to classify research and development projects into types—for example:

- *Research into matters relating to the regulation of the industry.* This is the statutory function given to the commissions. It is not defined in the Building Act, but could be reasonably interpreted as research directed at improving the functioning of the regulatory system. The Building Commission’s project on the efficiency and effectiveness of the building and occupancy permit process might be an example.
- *Research that assists policy development.* If, for example, the government wishes to reduce greenhouse gas emissions, it might commission research that helps it understand emissions from houses.
- *Research that lifts the productivity of products and processes in the building industry.* A project to boost builders’ use of information technology might be an example.

There could be a case, based on the arguments outlined, for government to support funding in any of these areas. Only the first area, however, seems to be appropriate for a regulator to fund. The agency that is responsible for policy development (which the Victorian Competition and Efficiency Commission has suggested should not be the regulator) seems a more logical ‘home’ for research relating to policy development. To the extent that the government has a role in

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<sup>2</sup> The Industry Commission suggested these arguments as possible justifications for central funding of rural research (Industry Commission 1995, pp. 708–27).

general research to lift industry productivity, this would seem to be an issue for an industry department that has general responsibility for industry research and can compare the merits of different potential projects across industries.

While classifying projects into such categories is not straightforward, and while it is always difficult to assess the returns from research projects, the Commission suggested in its draft inquiry report that more rigour could be applied to regulators' selection of projects if:

- the government gives guidance on the types of research project that the Building Commission and the PIC can support, in the context of matters relating to regulation in the industry
- the government either sets a cap on the proportion of funds received by the Building Commission that can be spent on research, or requires the commission to propose projects for funding. The latter approach has the advantage of not requiring the government to set an arbitrary cap, because funding would be adjusted depending on the government's priorities.
- all research projects are evaluated in terms of how they have contributed to the operation of the regulatory system
- the Building Commission and the PIC publicly report their research expenditure, through either annual reports or special reports. These reports should identify the objective and anticipated cost of each new project and how performance will be evaluated. For projects completed during the year, actual expenditure and the results of the evaluation should be reported.

If either the Building Commission or the PIC becomes aware of useful research projects that do not fit within the category of work that they can fund, they could bring these projects to government's attention in their annual reports.

Several inquiry participants commented on research, although often without addressing the details of the Victorian Competition and Efficiency Commission's proposal. Villa World Limited supported a partnership relationship between the Building Commission and industry in relation to research and development (sub. DR115, p. 5). Fagan and Fagan also considered that research functions should remain within the Building Commission and the PIC, but that a committee made up of industry and government representatives and private individuals should oversee research (sub. DR123, p. 16). The City of Melbourne indicated its support for funding of industry research, particularly in relation to sustainability (sub. DR136, p. 11). The PIAC noted that there is no evidence of the current approach to research and development leading to problems, and that the proposal would reduce the effectiveness of research and development (sub. DR132, p. 15–16). The Department of Sustainability and Environment noted that the Building Commission provides a separate report on its research activities and agenda and that a summary could be provided in its annual report

(sub. DR172, p. 19). The HIA argued that future research should be tied to the objectives of the Building Act, and it supported the parts of the draft recommendation relating to the evaluation and reporting of research projects (sub. DR 163, p. 25).

The Victorian Competition and Efficiency Commission considers that its position in the draft report is consistent with a number of the comments from inquiry participants. A common theme in submissions was that industry should be involved in overseeing research. But it is worth remembering that consumers pay, involuntarily, for this research through the levy system. The Commission proposes that the government should exercise its responsibility to provide guidance on the types of project that regulators should undertake; however, the government would be advised to consult with industry and other stakeholders in developing this guidance. Specific research proposals should come from the regulators, who could also consult with industry and other stakeholders in developing the proposals. Moreover, the proposed increase in public reporting on research projects would increase the capacity of industry (and others) to monitor and comment on the effectiveness of research expenditure.

### **Recommendation 9.3**

#### **That the Victorian Government:**

- **provide guidance on the types of research project that regulators can undertake, in the context of regulatory matters relating to the industry**
- **assess research proposals of the regulators and approve their funding as appropriate.**

#### **That the Building Commission and Plumbing Industry Commission:**

- **evaluate how research projects have contributed to the operation of the regulatory system**
- **publicly report any expenditure on research into regulation of the housing sector, through either annual reports or a special report. This reporting should show the purpose and anticipated cost of each new project and how performance will be evaluated. For projects completed during the year, expenditure and the results of the evaluation should be reported.**

### 9.3.5 Should the Building Commission promote better building standards both nationally and internationally?

The Building Commission's seventh function is 'to promote better building standards both nationally and internationally'. This function is one way in which the commission could achieve the objective of the Building Act 'to establish maintain and improve standards for the construction and maintenance of buildings'. In chapter 8, the Victorian Competition and Efficiency Commission suggested that the government should remove this objective from the Building Act. One reason for this recommendation is that the minimum standards are an instrument, rather than an objective. In addition, the open ended nature of the objective (to *improve* standards) places no limit on the extent to which standards can be increased and additional costs incurred. In any event, there is scope for improving minimum standards through the processes of the Australian Building Codes Board. If improving standards were removed from the Building Commission's objectives, the commission would no longer have justification to promote better building standards either in Australia or overseas. That said, the Building Commission or another entity may have a role to promote Victoria's interests in the development of national building standards. These interests include promoting national consistency and ensuring new regulation is imposed only when its benefits exceed its costs.

A less extensive option would be to remove the reference to promoting better building standards *internationally* from the Building Act. The link between improving building standards in other countries and improving building outcomes within Victoria seems remote. Accounting for this point and the possibility that Victoria's interests may be served by nationally consistent building standards, the Victorian Competition and Efficiency Commission recommended in its draft inquiry report that the Building Commission's function 'to promote better building standards both nationally and internationally' should be replaced by 'to represent Victoria's interests in the development of national building regulation' (VCEC 2005a, p. 243).

The City of Moonee Valley, the Victorian Division of the Property Council of Australia, the National Association of Steel Framed Housing and the HIA supported this recommendation (sub. DR99, p. 4; sub. DR134, p. 4; sub. DR122, p. 3; sub. DR163, p. 25). The National Association of Steel Framed Housing considered that the 'revised function proposed is completely consistent with the national regulatory framework of which Victoria has always been a strong advocate (sub. DR122, p. 3). The City of Melbourne suggested alternative wording: 'to represent the long term interest of all Victorians in the development of a (sustainable) national building regulation (sub. DR136, p. 11).

The BRAC opposed the recommendation, however, on the grounds that participation in the national and international development of building standards provides:

- Valuable opportunities to learn of regulatory options
- Currency and consistency in the national and international investment market
- Creation of opportunities for Victoria's building industry in overseas markets. (sub. DR142, p. 10)

The Commission and some inquiry participants appear to differ in their views on the inclusion of sustainability in the Building Commission's function and the involvement in international standards. The Commission considers that the promotion of sustainability—if the government specifies this as an outcome of the Building Act—should be included in the objects section of the Act rather than as a function.

Regarding involvement in promoting international standards, the Commission considers that creating overseas opportunities is a responsibility of industry, rather than government. (In any case, where the Victorian Government has international industry development goals beyond the responsibility of the Commonwealth, those goals would not be best pursued piecemeal through industry-specific regulation.) There may be some value if those framing regulations have regard for developments in international regulation, but this is not prevented by the function proposed by the Commission.

#### **Recommendation 9.4**

**That the Building Commission's function 'to promote better building standards both nationally and internationally' be replaced by 'to represent Victoria's interests in the development of national building regulation'.**

## **9.4 Should regulators take on any new functions?**

### **9.4.1 Allocating resources among the regulatory bodies**

The way in which resources are allocated among regulatory activities and bodies can affect the character of the regulatory system and its outcomes. The entity that controls resource allocation is thus in a powerful position. Inquiry

participants had different views about how resources should be divided among activities:

- CAV considered that ‘priority should be given to improving consumer information and protection services’ and that ‘resourcing for dispute resolution needs to keep pace with demand’ (sub. 91, p. 34).
- CAV also noted, however, the role of improving compliance with registration requirements in consumer protection (sub. DR166, p. 10). Similarly, the BPB suggested that more resources should be devoted to the Building Commission’s audit program (sub. DR133, p. 9).
- The Business Licensing Authority suggested that significantly increased information could be made available to the public about building practitioners and building businesses (sub. 61, p. 3). This would require additional funds.
- The National Association of Steel Framed Housing called for better training, supervision and quality auditing (sub. DR122, p.4).
- As noted, the Building Commission spends about \$1 million per year on research and development.

Section 200(5)(a) of the Building Act provides that the Building Commission can pay amounts out of the general account or the building permit levy account ‘as the commission considers appropriate’. The Auditor-General questioned the commission’s ‘total discretion’ in deciding on future initiatives and funding priorities submitted to the minister for approval, and noted:

There is no mechanism for the commission to consider the various views of the statutory bodies as part of an integrated approach to strategic planning; and

The commission’s control of the finances and staffing of the other statutory bodies means that it has a dominant position in the organisational arrangements for building control. (Auditor-General Victoria 2000, pp. 94–5)

The Auditor-General suggested that a coordinating forum, bringing together the chairpersons of the various regulatory bodies, should be established to set direction and long term policies, and to agree on final budget allocations. To make up for the lack of consumer representation, the Auditor-General recommended that an advisory body including community representation be convened to advise the coordinating forum (Auditor-General Victoria 2000, p. 95).

The Building Commission responded to the Auditor-General’s recommendation by expanding its corporate management team to improve commission-wide management representation and by establishing a new audit committee to help coordinate relevant activities of management, the internal audit function and the external auditor (Building Commission, pers. comm., 26 April 2005). In its draft

inquiry report, the Victorian Competition and Efficiency Commission commented that the BAC approved the Building Commission's budget and indicated that it had reservations about this role. The Department of Sustainability and Environment (sub. DR172, p. 20), HIA (sub. DR163, p. 26) and the Victorian Division of the Property Council of Australia (sub. DR134, p. 4) advised the Commission that the BAC reviews, rather than approves, the Building Commission's budget, although the Property Council argued that the BAC *should* have the power of approval (sub. DR134, p. 4).

The Victorian Competition and Efficiency Commission cannot judge whether expanding the Building Commission's management team and setting up an audit committee addresses the Auditor-General's concerns (which were partly motivated by a desire to increase accountability). It does not support the Property Council of Australia's view that the BAC should approve the Building Commission's budget, given that the building industry is heavily represented in the BAC.<sup>3</sup> To comply with the government's regulatory objectives, the regulator may have to undertake actions that conflict with the industry's commercial interests. The regulator may also differ from industry in its view on the emphasis given to different regulatory instruments. Given this possibility, the community seems more likely to be confident in the impartiality of the regulator if the BAC, with its strong industry representation, does not approve the Building Commission's budget. The BAC (and other stakeholders) should have an opportunity to comment, however, so the minister can consider these views when deciding whether to approve the budget. The Auditor-General's suggestion that a coordinating forum should set the direction for budget allocation remains worth considering.

The integrated approach to resource allocation sought by the Auditor-General would be enhanced if the Building Commission published (1) the funds being allocated to the various regulatory entities and (2) the rationale for the allocation. Public reporting of the funds that regulatory entities receive and how those funds are used is a significant part of an accountability framework for these entities.

Public reporting seems particularly important, given that the regulatory entities have been set up as separate statutory entities—separate from each other and separate from the Building Commission—presumably because the government perceived that this arrangement would enhance their independence. Their independence is questionable, however, if funds are allocated to them 'as the

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<sup>3</sup> Members of the BAC include the Building Commissioner; one person from each of the Royal Australian Institute of Architects, the Master Builders Association of Victoria, HIA, the Property Council of Australia and the Australian Institute of Building Surveyors; one person with experience in the building industry; a legal practitioner; and one person who can represent the interests of users of the services of building practitioners (Building Act, s207).



commission considers appropriate’ under s200(5)(a) of the Building Act. As Mr Lawrence Reddaway, a consulting engineer and mediator, commented :

The current arrangement is unsatisfactory because the BAC is serviced by the Building Commission which could, in effect, stifle any BAC criticism by starving it of secretarial assistance etc. There is a view that the Building Commission has become ‘too big for its boots’ and that the levy should be reduced. This issue—how to control the budget and the activities of the commission—is a major topic. (sub. DR138, p. 3).

#### **Recommendation 9.5**

**That the Building Commission’s annual report detail both the funds allocated to each regulatory entity and function, and the rationale for the allocation. The annual audit by the Auditor-General’s office should independently review this analysis.**

### **9.4.2 Providing advice to consumers**

A theme of this report is that regulators should assist consumers to make better decisions by providing them with more information. The Department of Sustainability and Environment supported this view:

The current range of information should be expanded to provide an adequate basis for informed consumer decisions. Information should include but not be limited to: practitioners’ insurance and dispute record, previous inquiries, prosecutions and associated results. (sub. 84, p. 64)

CAV argued that priority should be given to improving consumer information, enhancing consumers’ capacity to comply with Regulations and reducing the costs of doing so. Well-informed consumers are likely to be more confident about asserting their rights, which increases regulators’ accountability. Consumers who know their rights are more likely to maintain a robust relationship with their builder and complain if necessary, which increases the information available to the regulator and increases its ability to set priorities and detect systemic problems. Improved information also improves consumers’ ability to exercise choice, potentially reducing the need for complex and onerous regulation.

The PIC and the Building Commission are already required to disseminate information. Under the Building Act, both are required ‘to provide information and training to assist persons and bodies in carrying out functions under this Act or the regulations’. The Building Commission, for example, publishes informative brochures about builders’ and homeowners’ regulatory obligations and, as mentioned, has run an extensive education campaign about the Building (Amendment) Act. The statutory requirement that the two commissions ‘assist

persons and bodies in carrying out functions’ may, however, direct attention to building practitioners and building surveyors, who carry out most functions under the Building Act. To avoid this, the Victorian Competition and Efficiency Commission proposed in the draft inquiry report that the statutory function should be redrafted, to make it explicit that regulators should provide information to consumers as well as building practitioners.

The National Association of Steel Framed Housing (sub. DR122, p. 3), Villa World (sub. DR115, p. 5) and the City of Melbourne (sub. DR136, p. 11–12) supported this proposal. The Department of Sustainability and Environment commented that it ‘this recommendation would be consistent with the current consumer information activities of the BC [Building Commission] and the PIC’, and pointed to the extensive information that the commissions already provide to consumers (sub. DR172, p. 20). CAV also provides information to consumers about the regulatory framework, and that advice should be coordinated with the advice that the Building Commission and the PIC provide.

#### **Recommendation 9.6**

**That the Building Commission’s and the Plumbing Industry Commission’s functions be redrafted to require these entities to provide information to consumers, as well as practitioners, about their rights and responsibilities under the building regulatory framework, so as to increase consumers’ ability to understand the regulatory system and make informed choices within that framework.**

### **9.4.3 Providing advice about the costs of regulation**

Appendix C outlines that regulation adds at least 4 per cent to the cost of building a typical house and at least \$400 million to the annual cost of housing construction. For reasons explained in appendix C, these estimates are indicative only, and actual costs may vary widely across different cases.

Nevertheless, regular updates of such estimates would be useful.<sup>4</sup> They would:

- reveal how the costs of regulation are changing over time
- indicate which Regulations impose the largest costs and may warrant attention to reduce costs
- indicate whether the cost of particular Regulations is different than expected
- inform the choice of research and development projects, if the Building Commission and the PIC retain this function

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<sup>4</sup> Appendix C describes the cost components of regulation that these estimates should include.

- inform the development of policy
- inform building practitioners.

Given that any cost estimate will be influenced by the method used and underlying assumptions, these need to be made transparent when the estimates are published. This is likely to encourage public debate about the estimates, which should lead to improvements in their accuracy over time.

The costs involved in developing such estimates may fall in subsequent years, when the exercise would partly involve validating previous estimates. The estimates are unlikely to change rapidly and may need to be provided only every second or third year. The costs of new Regulations would be estimated in the relevant RISs.

Regulatory agencies—as the custodians of the necessary information—are probably best placed to prepare these cost estimates. On the other hand, confidence in the impartiality of the estimates might be enhanced if they were prepared elsewhere, because regulators may have an incentive to underestimate the costs of regulation. Requiring the publication of the assumptions and calculation method underpinning the estimates would reduce, but not remove, this concern. Having the estimates checked by an independent source would be an additional test.

The City of Melbourne suggested that any measure of regulatory costs should not be reported without reference to the long term, broader community benefits associated with the costs (sub. DR136, p. 12). The Victorian Competition and Efficiency Commission agrees that reporting benefits would be useful, but notes that the RISs it assessed in chapter 8 rarely quantified the benefits of regulation and that the Building Commission has little data on the safety, health and amenity benefits associated with regulation (chapter 2). A requirement to publish both the costs and benefits of regulation could stimulate the collection of more information about the benefits of regulation.

The Department of Sustainability and Environment suggested that publishing regular estimates of costs ‘could result in unnecessary reconsideration of issues which should be addressed through the standard RIS process’ and that concerns over the cost of administering regulation could be covered through the use of appropriate performance measures (sub. DR172, p. 21).

The Commission has attempted to improve its estimate of the costs of regulation by expanding its sample size (appendix C). The Building Commission, with its industry contacts, could probably expand this sample size considerably, which would increase confidence in the results. (The Building Commission’s survey of 601 builders on energy and water related standards, reported in appendix C, is an example.)

Other methods to assess the costs of regulation can act as a check on the survey results. The Building Commission recently did this, through its case study analysis of the cost increase, as a result of mandatory state and local government regulation, for constructing a ‘typical’ house. The costing assumptions and methods, as well as the results, should be published and fully transparent.

#### **Recommendation 9.7**

**That the Minister for Planning request that regulators publish estimates at least every third year of the extent to which building regulation adds to the cost of building houses. The estimated benefits of regulation and the estimation method and assumptions should also be published. If the Building Commission or the Plumbing Industry Commission prepares the estimates, an independent source should verify those estimates.**

### **9.5 Can the division of functions across the regulatory entities be improved?**

The following functions encourage the efficient and effective operation and evolution of the regulatory framework:

- administering and enforcing regulatory instruments permitted by legislation
- providing information about rights and responsibilities under the regulatory framework to consumers as well as building practitioners
- resolving disputes
- hearing appeals from regulatory decisions
- monitoring the functioning of the regulatory framework
- publishing information about the costs of regulation
- collecting information about the operation of the housing sector relevant to regulation
- providing advice about how to improve the regulatory framework
- promoting Victoria’s interests in national forums that set building standards
- researching ways to improve the regulatory framework.

The Commission considers that regulators should be responsible for administering and enforcing regulations, providing information to those who are affected by regulation about their rights and responsibilities, publishing information about the costs of regulation, and responding to requests from the minister about ways to improve the operation of the regulatory system. The regulators may also be best placed, given their first-hand knowledge of how the regulatory system operates, to represent Victoria’s interests in national forums. There is less clarity about which entities should undertake the remaining

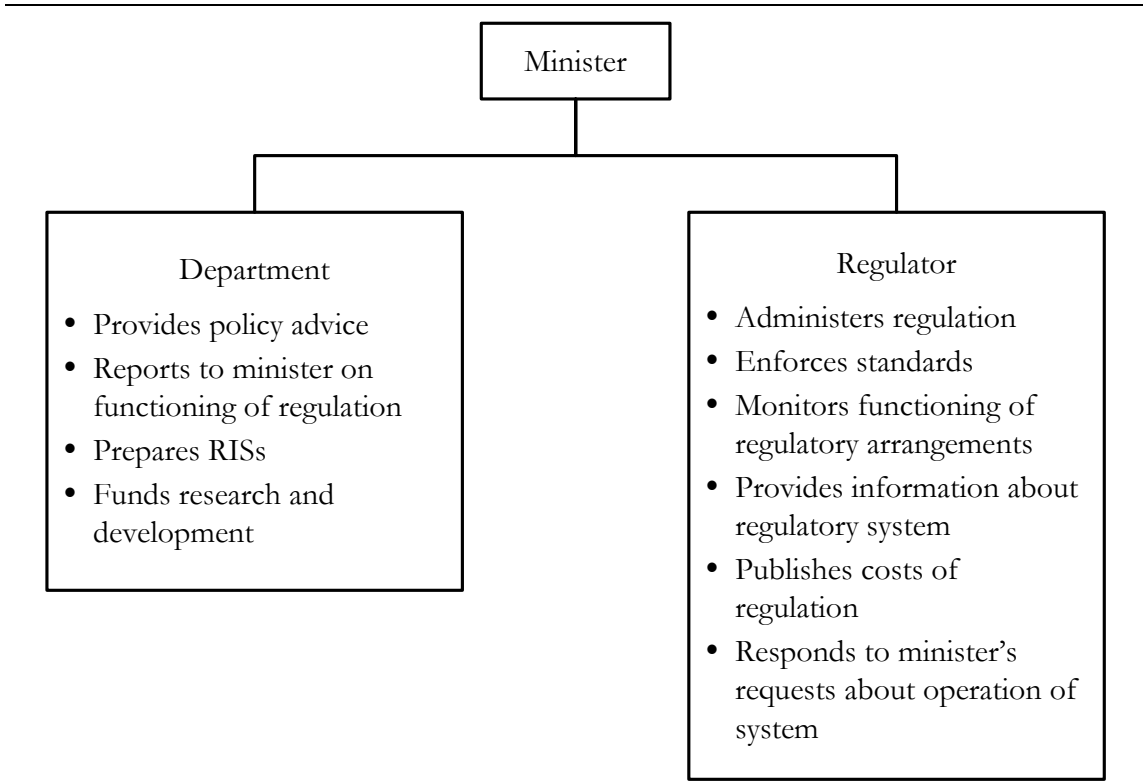
functions. The following section compares three different ways of allocating these functions across agencies.

### 9.5.1 Separating the regulatory, leadership and policy roles

#### Option 1: Abolish the BAC, the BRAC and the PIAC and have the relevant government department provide policy advice

Under this option, the BAC, the BRAC and the PIAC would be abolished and the Building Commission and the PIC would limit their activities to regulation, using the instruments defined in the Building Act (figure 9.1). The relevant government department would become responsible for policy advice (gathering intelligence, identifying problems, comparing options for addressing these problems, proposing a favoured option and developing the government’s chosen option through to implementation). It would also prepare RISs and publish estimates of the costs of regulation. In doing so, it could consult with the Building Commission, the PIC and other relevant stakeholders. If the government decided that promotional activities were needed (for example, encouraging the uptake of information technology in the building industry, encouraging people to become building surveyors or promoting energy efficiency), an appropriate department could undertake these activities.

Figure 9.1 **Role allocation: option 1**



This option would separate the roles of policy advisor and regulator, and thus reduce the risks discussed in section 9.2. However, the minister would lose the industry advice currently provided through the BAC, the BRAC and the PIAC. The relevant department would need to expand its policy capability in housing construction to ensure housing receives sufficient attention, given the wide spread of the department's policy responsibilities. The Building Commission would need to undertake accreditation, which the BRAC currently undertakes.

How significant would be the government's loss of advice from the BAC, the BRAC and the PIAC? The Victorian Auditor-General (2000, p. 96) noted that 'Given the extent of the overlap and ambiguity between the responsibilities of the Building Advisory Council and the [Building] Commission, and the minimal advice provided to the minister in recent times, we are not convinced that there is a demonstrated need for the council to exist in its current form'.

The Victorian Competition and Efficiency Commission has not received any information about the extent to which the BAC's and PIAC's advice adds value, or about what would be lost if the two bodies were abolished. But there is considerable support for them to be maintained. While this support is principally from organisations represented on the BAC and the PIAC, it suggests that they perceive some benefits from that involvement and that the government is likely to benefit from having access to stakeholders' views on the impacts of Regulations. Although there is a risk that industry members will promote regulation that benefits them, they may also question the merits of regulation more than would the regulators or the department. Adding more consumer representatives to the BAC should promote questioning. Even without an advisory body such as the BAC, the industry will want to make its views known to the minister. The question is whether the process should be institutionalised.

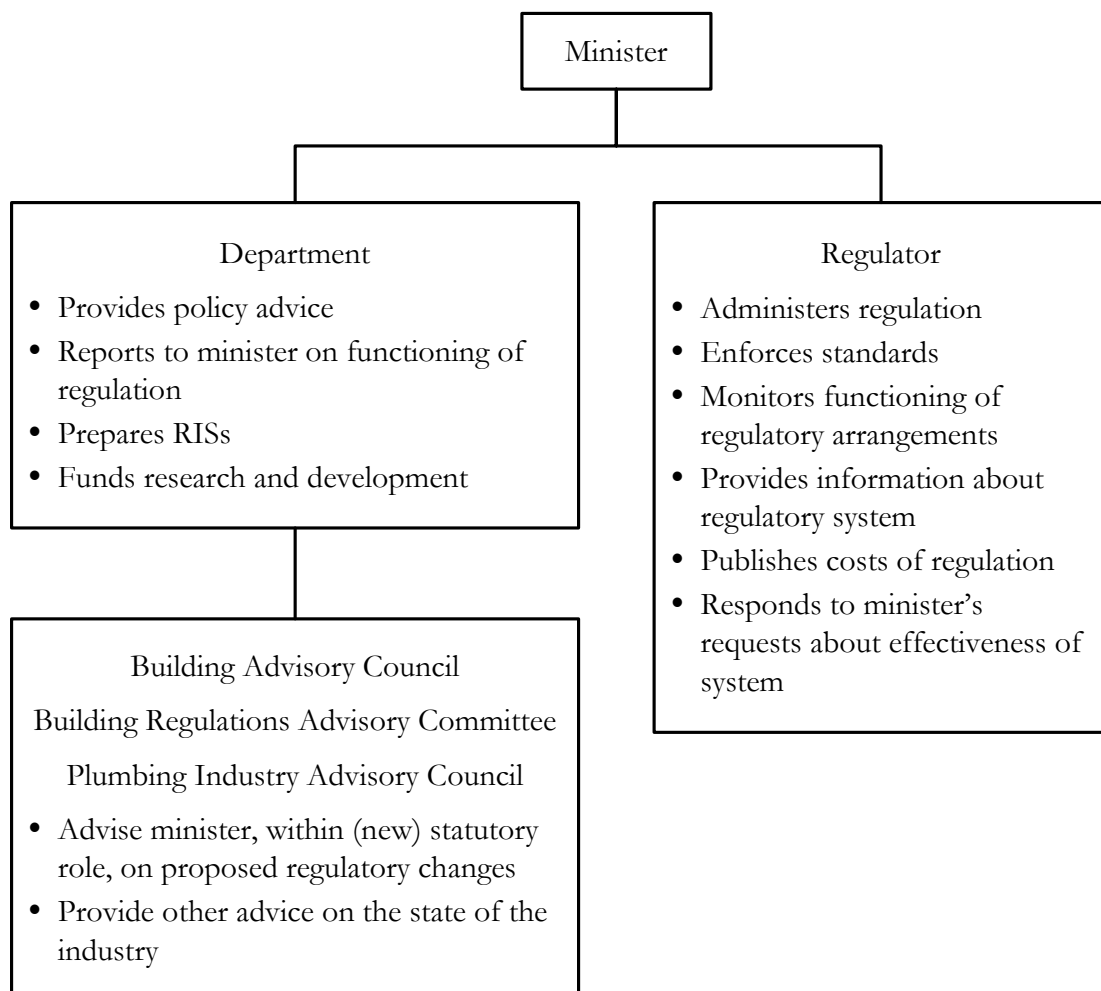
A further consideration is the potential cost savings from abolishing or merging the two entities. The Building Commission's and PIC's annual reports do not publish running costs. However, the Building Commission budgeted less than \$14 000 for the BRAC in 2004-05 (sub. DR142, p. 9). The financial costs to the commission of the PIAC and the BAC are also unlikely to be large, although they do not include other costs such as the cost to the organisations represented on the BRAC, the BAC and the PIAC. Cost savings are unlikely to be a major factor in decisions about these entities.

The important policy role that the Building Commission has performed in recent years might have reduced policy capability in this area in the department. Handing primary carriage for policy to the department would work effectively only if the department developed sufficient policy capability and industry interface mechanisms. Rebuilding this capability could involve transferring people with policy skills from the Building Commission to the department.

**Option 2: Separate the BRAC, the BAC and the PIAC (possibly merged) from the Building Commission, and have the relevant department provide policy advice**

A second option is to transfer responsibility for primary policy advice to the department, while maintaining the BRAC, the BAC and the PIAC as a source of advice to the minister on issues that its members believe need to be addressed to improve the operation of the regulatory framework (figure 9.2). The regulator would administer the proposals that are implemented. Given that the advisory bodies' membership is drawn from outside the public service, they would need to be serviced by a secretariat, which the Building Commission or the department could provide. The latter has an advantage, because it would more clearly separate the advisory function of the new body from the regulatory function within the Building Commission.

Figure 9.2 **Role allocation: option 2**



The draft inquiry report suggested that the BAC, the BRAC and the PIAC should be merged as well as separated from the Building Commission. Several inquiry participants commented on the proposed merger. Michael Fagan supported the proposal:

Stakeholder participation coupled with a level of independence from the regulators is crucial for the operation of a viable regulatory regime, thus it is my view that option 2 is the preferred model.

While there is some criticism of the Building Regulations Advisory Committee (BRAC), this is a less political body than either the Building Advisory Council (BAC) or the Plumbing Industry Advisory Council (PIAC). This is based on the opinion that BRAC operates under the chairmanship of the Building Commission with committee members nominated from industry generally experienced with the day to day operations of the regulations, whereas BAC and PIAC consist of industry executive officers with an independent chair.

Merging the dynamics of the three statutory bodies will eliminate unnecessary overlap, introduce a single minded focus on issues and more importantly provide enhancement to the transparency process. Whilst the role of BRAC is definitive, I support the view that BAC is to many industry practitioners an unknown entity and to those that have an understanding, it is a body that at times addresses issues that should be the responsibility of other bodies. For example, BAC instigated and managed the review of the building registration categories not the Building Practitioners Board. In my opinion the review should have been managed by those who have the explicit legislative role. This overlap of registration functions only serves to further confuse industry and consumers alike on who is responsible for the registration of builders, the Building Commission or the Building Practitioners Board. (sub. DR123, p. 20)

The Plumbing Industry Advisory Council had a different perspective:

PIAC's fundamental concern is that this proposal is another move that will undermine a system that has quietly and efficiently been producing outstanding results. The existence, composition and role of the PIAC are essential ingredients in the Victorian plumbing regulation strategy. Removing it will damage the regulatory outcomes achieved. Among other impacts, industry cooperation and compliance will fall away. This cost will far outweigh the theoretical benefit, if any, of reducing the number of industry advisory bodies and shifting their relationship to a government department.

At more specific level, BRAC differs greatly from BAC and PIAC in its current composition and activities. It is unclear how its technical level contributions would be continued in a new industry advisory entity. BRAC has a necessary function and VCEC's draft proposal will simply result in it being recreated under another name. (sub. DR132, p. 18)



The Property Council of Australia—Victorian Division argued that:

The Property Council believes that the current advisory bodies such as the Building Advisory Council and the Building Regulations Advisory Committee are an important link between government and industry. The membership of the advisory bodies comprises the key industry groups with high levels of technical expertise and is a vital communication channel on building regulation and broader matters.

It is important to consider that these bodies address a range of regulatory matters that affect the domestic and commercial construction sectors. A major restructure of these bodies could adversely impact on one or both of these sectors. (sub. DR134, p. 4)

The Department of Sustainability and Environment suggested that:

... the VCEC give more consideration to the different compositions, purposes and roles of the Building Advisory Council, the Plumbing Industry Advisory Council and the Building Regulations Advisory Committee.

In particular, the nature of the Building Regulations Advisory Committee is clearly different to Plumbing Industry Advisory Council. (sub. DR172, p. 22)

The BRAC provided useful advice on this point, noting that the BAC and the PIAC are strategy setting bodies that provide policy advice to the minister. The BRAC, on the other hand, is a technical advisory body, and this technical focus could cease if it were absorbed into a new BAC. The BRAC supports transferring the accreditation advice role to the Building Commission because this would create an opportunity to develop more structured assessment procedures, although costs could increase because payments would be required for advice that is currently sourced primarily through BRAC members at minimal or no cost. Applicants for accreditation might thus face higher costs (sub. DR142, p. 10).

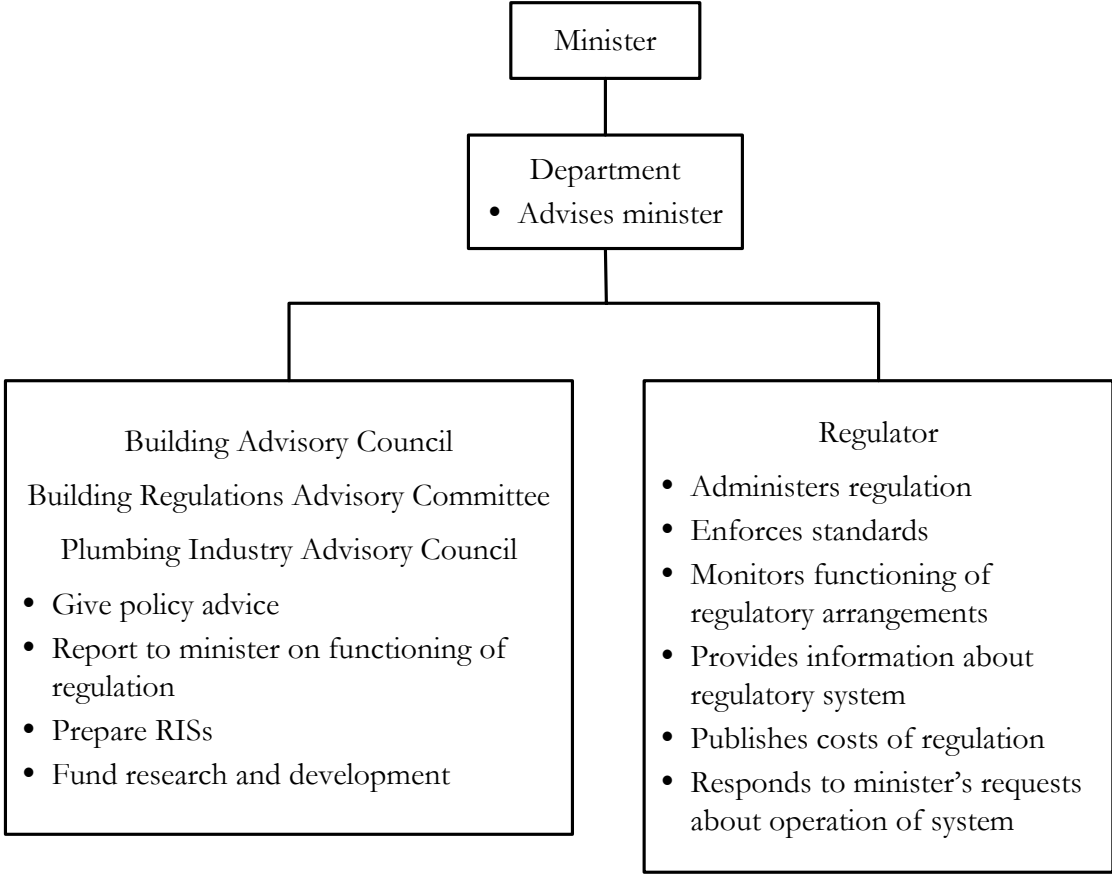
If the BRAC's accreditation role were moved to the Building Commission, the BRAC's remaining role would be to provide advice on draft Regulations (s211), which is much closer to the BAC's role of advising on the impact of Regulations on the building regulation system (s208). Nevertheless, a possible variant of option 2 would be to maintain the BAC, the PIAC and the BRAC as separate entities, separate from the Building Commission and the PIC.

### **Option 3: Have the merged BRAC, BAC and PIAC become a policy advisor**

The third option is to combine the BRAC, the BAC and the PIAC into a new building organisation that would be responsible for both providing policy advice on issues to be addressed and following through the development and

implementation of policy proposals (figure 9.3). In other words, the merged entity would undertake the roles typically undertaken by a government department.

**Figure 9.3 Role allocation: option 3**



Advantages of this option include that it:

- separates the policy and regulatory roles
- integrates external expertise into policy advice, helping that advice to be relevant and well informed
- could be implemented by transferring Building Commission staff who perform policy roles into the new organisation
- creates an organisation with a single focus.

The option also has disadvantages, however:

- Setting up an organisational structure around an amalgamated BAC, BRAC and PIAC could open up concerns that the industry dominates policy advice. In 2000, the then chair of the BAC listed several weaknesses with the BAC, including that industry interest groups nominate the members, so the council cannot make independent judgments or give impartial expert advice,

particularly given that consumers and those who pay the levy are not represented (Auditor-General Victoria 2000, p. 96). The City of Boorandara made a similar observation about the BRAC:

The perception of the BRAC is that there are too many self-interested parties involved, who are mainly interested in their own issues. (sub. 66, p. 2)

While the BAC now has a small consumer representation, the weaknesses that the then BAC chair and the Auditor-General noted in 2000 are still present. Giving the BAC a stronger role would raise the concerns about an industry dominated body also dominating regulation, as pointed out by the then Building Control Commissioner.

- This new entity would be like a new department, but with the advisory body integrated into the fabric of the organisation. If this is done for housing construction, other industries may argue that it is an appropriate approach for them too.

### **The Commission's view**

In the draft inquiry report (draft recommendation 9.8), the Victorian Competition and Efficiency Commission favoured option 2:

- merging the advisory role currently carried out by the BAC, the BRAC and the PIAC into the BAC
- assigning accreditation of products/processes to the Building Commission
- making a department responsible for policy advice relating to the regulation of housing construction. In developing its advice, the department would be expected to consult with both the Building Commission and the BAC.

The weight of opinion from inquiry participants was opposed to this recommendation. The Australian Institute of Building Surveyors:

... supports the current council, committees and boards established under the Building Act. We cannot support the changes proposed because the AIBS believe that they have been operating effectively in this capacity at least since 1981. (sub. DR130, p. 6)

The Property Council of Australia noted that:

The Building Commission is known for its extensive consultation with industry, and these bodies are a vital part of the Commission's consultation processes.

The Property Council does not endorse recommendation 9.8. The current arrangements should remain. (sub. DR134, p. 4)

The City of Melbourne pointed out that it had not seen evidence that the current arrangements fail to achieve the intended outcomes and that merging them would reduce efficiency (sub. DR136, pp. 12, 18). But the HIA, on the other hand, ‘supports in principle the streamlining of a number of “advisory” bodies’ (sub. DR163, p. 27).

The Commission continues to favour a structural change that effects and reinforces the earlier recommendation that the Building Commission and the PIC should not take on both policy advice and regulatory roles. Option 2 provides an institutional structure that separates these roles, but without creating the new ‘mini-department’ under option 3. There could be benefits from merging the BAC, the BRAC and the PIAC under option 2, but there are qualitative arguments for and against a merger, and inquiry participants did not provide quantitative information. On balance, the Commission concludes that there is insufficient evidence to support merging the three entities, provided that:

- any overlap and ambiguity in the entities’ functions and the lack of funding transparency are dealt with
- the entities’ opportunities to advise the department are formalised and predictable.

For option 2 to succeed, the relevant department would need appropriate policy capability. Some such capability should exist; to expand it, Building Commission staff who undertake this role could be transferred to the department.

### **Recommendation 9.8**

**That:**

- **a government department be responsible for providing policy advice about the regulation of housing construction, but in consultation with the Building Commission and the Building Advisory Council**
- **the Building Advisory Council, the Building Regulation Advisory Committee and the Plumbing Industry Advisory Council be separated from the Building Commission**
- **a new entity be established within the Building Commission to undertake the accreditation role currently provided by the Building Regulations Advisory Committee.**

Under all of the three options, the Building Commission and the PIC would focus on their role as regulators. The regulatory functions could be organised in a number of ways. In particular, can the registration and licensing function, currently undertaken by the PIC and the BPB, be organised more effectively? And should the Building Commission and the PIC be merged?

## 9.5.2 Licensing and registration

The Victorian Competition and Efficiency Commission has considered three issues in relation to licensing and registration:

- (1) whether one organisation should undertake licensing and registration for building practitioners and plumbers
- (2) whether an independent statutory entity or the industry regulator should undertake licensing and registration
- (3) whether the BPB, which is responsible for licensing and registration, is sufficiently separate from the BAB, which hears appeals against occupational licensing decisions.

### A single licensing and registration authority?

A number of inquiry participants supported rationalising the registration roles undertaken by the BPB and the PIC. The Australian Institute of Building Surveyors suggested that ‘registration/licensing of plumbers/electricians etc under one body would be an advantage to the building industry’ (sub. 41, p. 1).

CAV suggested:

There may be advantages in bringing licensing/registration under a single agency. Such a registration framework would provide much stronger incentives for the relevant agency to register all builders and practitioners, as it would reduce the resources it would outlay to enforce and ultimately prosecute unregistered building practitioners. A single agency model for registration would enable coordination of registration and enforcement functions. (sub. 91, p. 35)

The Department of Sustainability and Environment also seemed to favour a merger:

The registration and licensing functions associated with the BPB, BC [Building Commission] and the Plumbing Industry Commission would be relatively easily to accommodate, as both exist within the same Act and recent legislative change could facilitate a single Commissioner. (sub. 84, p. 63)

The BPB pointed out that:

The principle of rationalisation of building industry registration/licensing schemes should be explored while recognising the nature of the services provided require a level of expertise that should not be jeopardised. There may be options for improving the competitive position of the state through achieving efficiencies, economies of scale and promoting accessibility. Such arrangements could result in less confusion for building industry practitioners and consumers.

For instance, combining the registration and licensing functions associated with the Building Practitioners Board and the Plumbing Industry Commission would be relatively easy to accommodate, as both exist within the *Building Act 1993*. In

addition, the registration/licensing of building practitioners, plumbers and electricians is all based on the consistent principle of registration/licensing of natural persons. (sub. 26, p. 2)

The Business Licensing Authority submitted a recent paper on occupational regulation, in which Ms Fiona Smith (Chairperson) and Mr Stuart Ward (Member) argued that the advantages of centralising occupational regulation within the authority include:

- shared infrastructure costs across various regulatory schemes
- centralisation of intellectual expertise around consumer protection
- effective coordination between regulators. (Smith & Ward 2004, pp. 13–14)<sup>5</sup>

Merging the occupational licensing functions of the BPB and PIC could have similar benefits. But the PIC opposed amalgamation:

If an amalgamation meant the loss of PIC's integrated regulatory framework, say through the separation of technical standard-setting from licensing, the main disadvantage would be the consequent danger to the efficiency and effectiveness of plumbing self-certification.

A one-stop-shop may also have disadvantages with respect to:

- loss of industry participants' feelings of identity with an industry-specific regulator
- loss of regulator clear focus on a particular industry
- loss of a smaller organisation's better ability to quickly adapt to needed change
- the difficulty of merging different fields of knowledge and different organisational and industry cultures. (sub. 84, p. 103)

In its draft inquiry report, the Victorian Competition and Efficiency Commission indicated its support for merging the licensing and registration functions for building practitioners and plumbers, but sought further information about the costs and benefits of both this option and the option of merging the function within the Business Licensing Authority. While inquiry participants did not provide quantitative information, four submissions outlined the cases for and against a merger.

Fagan and Fagan (sub. DR123, p. 17) argued that all building practitioners, including the Architects Registration Board, the Building Practitioners Board, the Office of the Chief Electrical Inspector and the PIC, should be merged into one regulator in the long term. This merger would provide a consistent approach to occupational licensing, provide a streamlined licensing regime for individuals

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<sup>5</sup> Ms Fiona Smith, Chairperson of the Business Licensing Authority, declared a conflict of interest, because she is also the legal representative on the BPB (sub. 61, p. 1).

who hold multiple licences, ensure that legislation and policies governing professional conduct would be consistent, benefit consumers through one style of identification card, and ensure disciplinary hearings operate under the same rules and with the capacity to hold all or any practitioners accountable under one hearing.

The HIA suggested that:

HIA supports in principle a streamlining of the number of ‘advisory’ bodies. Consideration should also be given to allowing the practitioner registration model and plumber licensing model to be administered by the Building / Plumbing Industry Commission. This would have the advantages of improved consistency and efficiency whilst maintaining the ‘safety net’ of the Building Appeals Board. (sub. DR163, p. 27)

CAV, noting that New South Wales and South Australia have general rather than industry-specific licensing of domestic builders, suggested that the benefits of merging the functions into the Business Licensing Authority include:

- cost savings and efficiency gains that are ‘difficult to calculate but are likely to be significant’. These should permit reduced initial registration fees, which CAV pointed out are the highest in Australia, although re-registration fees are generally lower in Victoria.<sup>6</sup>
- centralisation of intellectual expertise around consumer protection
- effective coordination among regulators. (sub. DR166, pp. 7–8)

The Business Licensing Authority suggested some benefits from merging the functions within the authority, in addition to those in its original submission:

- if the registration system needs to be capable of registering businesses and not just individual professionals, the BLA has significant experience in this regard

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<sup>6</sup> CAV noted:

In Victoria, a domestic builder pays between \$540 (limited) and \$680 (unlimited) compared with NSW where an individual builder pays \$376. Registration fees for individual builders in Queensland are between \$217 and \$465 (depending on whether applicant is a small, medium or large builder); South Australia has a flat rate of \$125; and Western Australia has a flat fee of \$210. Companies or partnerships in all other States pay a higher fee than those mentioned above.

The same information shows that re-registration fees are generally lower in Victoria than other states. In Victoria the fee for an individual builder is \$180 compared to NSW where the fee is \$251. Re-registration fees are between \$165 and \$372 in Queensland; South Australia has a fee of either \$151 (specific building work) or \$304 (any building work); and Western Australia has a flat fee of \$238. (sub. DR166, pp. 7–8)

- the BLA governance structure and administrative arrangements would ensure that a consistent approach is applied to occupational licensing and regulation. For example, applying the BLA’s national and trans-Tasman mutual recognition scheme could be one part of a strategy to increase the skills base in Victoria. (sub. DR162, pp. 1-3)

It pointed out that if it were to undertake registration of practitioners, it would approach the task in a way that would result in benefits that outweigh the costs—for example, by:

- increasing the use of objective criteria to determine registration applications
- maintaining existing assessment procedures where objective criteria are not appropriate, either by setting up a building practitioner panel or relying on an assessment of qualifications and relevant experience by the Building Commissioner. (sub. DR162, pp. 4–5)

The BAB, on the other hand, argued that the Business Licensing Authority should not take over the registration and licensing functions of the BPB and the PIC because:

The high level of technical expertise required by building practitioners and plumbers, in conjunction with the complex inter-dependence that exists between these professional groups requires specialist knowledge and management ... The Business Licensing Authority currently licenses credit providers, estate agents, finance brokers, introduction agents, motor car traders, prostitution service providers, second-hand dealers and pawnbrokers, and travel agents. To suggest that building practitioners are analogous with these businesses is to ignore the need for qualifications, skill based competencies and industry experience. The competencies required for registration of building practitioners are constantly under review and applicants for registration must undergo an assessment by industry experts. This registration model contributes to Victoria’s high quality building standards and has recently been replicated in New Zealand and is proposed to be introduced in Western Australia. (sub. DR133, p. 10)

The PIAC (sub. DR132, pp. 16–17) also argued against a merger because:

- infrastructure costs (occupancy, rent, communications and general administration) are already minimal
- there would be no savings in staff costs
- separating the licensing function would lose the benefits from integrating consumer protection with practical expertise
- the PIC is focused on licensing *plumbers*, while the Business Licensing Authority licenses *businesses*
- there is little commonality between the businesses licensed by the authority and plumbers



- plumbing licensing and registration is a distinctly different process from the registration of building practitioners
- the outcome would be more complicated for users of government services.

While inquiry participants did not provide any quantitative information, they have strongly opposed views about the merits of both combining the registration and licensing functions of the BPB and the PIC, and transferring these functions to the Business Licensing Authority. Their arguments do not point strongly in favour of any option, so the Commission cannot identify a pressing case for change, particularly given transitional costs would be involved. Below, the Commission addresses the larger issue of whether the Building Commission and the PIC should be merged. The question of whether the PIC's licensing and registration function could be absorbed into the BPB over time, without loss of effectiveness, could be assessed as part of assessing the benefits of a merger.

### **A separate statutory entity?**

A related question, regardless of whether the plumbing and building registration functions are merged, is whether the BPB needs to be maintained in its current form or whether it could become a work group within the Building Commission. The Victorian Competition and Efficiency Commission has been unable to find reasons for having a separate statutory entity to carry out the registration and licensing functions for builders but not for plumbers. One advantage mentioned in the context of the Business Licensing Authority is that:

The BLA is a statutory body independent of both government and industry. This has many advantages for government in freeing ministers and senior bureaucrats from lobbying and licensing issues. Statutory appointees are in an ideal position to make tough decisions when needed. (Smith & Ward 2004, p. 13)

The Building Practitioners Board expressed a similar view:

An independent statutory authority such as the BPB should be at arms length, both in perception and reality, of government and the regulatory authority (Building Commission) and would be protected from external influences and interest group lobbying. (sub. DR133, p. 10)

Given, however, that the plumbers' registration function appears to work well as part of the PIC, this model may also be suitable for building practitioners. The Building Commission would still provide the degree of separation from the minister and department that the Business Licensing Authority commends. Further, registration is a core function of the regulator, which may argue in favour of not requiring a separate statutory registrar.

The Victorian Competition and Efficiency Commission has not been provided with convincing reasons for the different governance structures for registration and licensing in the two organisations. But neither has it been provided with evidence of the costs of having different arrangements. There does not appear, therefore, to be a compelling case for change.

### **Further separation of the appeals function?**

Whether or not the registration and licensing functions are merged, a further issue is whether the registration and disciplinary processes are suitably separate at the moment. The Business Licensing Authority suggested that another option is:

... separating registration from disciplinary proceedings, leaving the BPB with responsibility for registrations only and either a stand alone Building Practitioners Tribunal being responsible for disciplinary hearings and registration appeals, or giving that function to VCAT [the Victorian Civil and Administrative Tribunal]. (sub. 61, p. 4)

Under the current arrangements that apply to building practitioners, the BPB approves applications for registration, administers the registration system and investigates cases of alleged practitioner misconduct. An applicant who is denied registration or penalised as a result of an investigation can appeal the decision of the BPB to the BAB, which can consider new evidence as part of the appeal process. Both the BPB and the BAB exist in conjunction with the Building Commission, although they are separate statutory entities. The BAB is not a specialist occupational tribunal, because it also considers, for example, appeals relating to building permits, the appointment of building surveyors, determinations relating to protection work and building notices.

The Auditor-General's 2000 report on building control in Victoria examined the operations of the BAB against criteria relating to transparency of processes, procedural fairness and consistency of decision making. The report concluded that the appeal process has appropriate mechanisms in place to provide adequate transparency of its operations and procedural fairness to all parties (Auditor-General Victoria 2000, p. 71). It noted that the co-location of the BPB and the BAB staff may suggest a lack of a clear separation between the two bodies, but it found little risk with this arrangement because BPB staff are not involved in advising on appeals (Auditor-General Victoria 2000, p. 70).

The Auditor-General also noted that the large number of BPB members (32 in total) and the fact that relevant experts are not always available, may make consistency of decision making difficult to achieve; he suggested establishing a database of decisions to assist the BPB to reach consistent decisions and provide some assurance for participants and the public.

In its draft inquiry report, the Victorian Competition and Efficiency Commission commented that it has no reason to question the procedures or outcomes of the BAB when hearing appeals, but that it could perceive benefits in separating the registration and appeals procedures by assigning the appeal function to VCAT. The BAB, however, pointed to ‘the advantages of timeliness, low cost, accessibility and relevant skill base of the decision makers’ when appeals are handled in the BAB (sub. DR128, p. 4). It has 26 members with experience in a range of building disciplines, and constitutes a panel of appropriate members at each hearing. The current application cost of practitioner appeals is \$220 and legal representation is not necessary, because panel members can understand the technical details of the matter and the Building Act requires that the procedures are not formal.

The BAB also noted that VCAT reviews decisions of the PIC yet only one appeal to VCAT has been made in the seven years of the PIC’s operation, even though the commission had undertaken 83 inquiries over this period. The BAB concluded that:

... the cost and complexity of taking an appeal to VCAT has acted as a disincentive to plumbers to appeal determinations of the Plumbing Industry Commission. (sub. DR128, p. 5)

Other inquiry participants opposed changes to the BAB. The City of Melbourne noted that:

It is council’s opinion that the BAB has a proven track record as an effective and accessible vehicle for efficiently dealing with the matters under its jurisdiction.

Council would oppose any suggestion to limit the scope of matters for which the board has responsibility as such a move would adversely affect the speed at which quality decisions are made and ultimately adversely impact on the construction industry and consumers generally. (sub. DR136, p. 16)

Michael Fagan, a former registrar of the BPB, also opposed transfer of the appeals function, because:

The Building Appeals Board is one of the most cost effective and efficient appeals processes in this state ... Transferring the functions to VCAT will likely increase costs, escalate the length of hearings and introduce a level of formality that is not necessary. (DR123, p. 20)

Complete separation of appeals and registration—locating appeals within VCAT— would remove any perception of a lack of independence of the appeals function. The Victorian Competition and Efficiency Commission has received no evidence, however, that this is a material issue. Moreover, the accessibility of the BAB and the informality of its proceedings could be lost if the appeals function were moved to VCAT. The BAB has a 60 year history (sub. DR128,

p. 5) and is well known to practitioners. This suggests that the adjustment costs could be significant if a building panel within VCAT replaced the BAB. Given these costs, the Commission cannot see a case for changing the arrangements with respect to the BAB.

### **9.5.3 Should the Building Commission and the Plumbing Industry Commission merge?**

The National Association of Steel-Framed Housing Inc. suggested that the Building Commission, the PIC, the Office of Gas Safety and the Office of the Chief Electrical Inspector should be combined into one body (sub. 35, p. 2). The government recently combined the Office of Gas Safety and the Office of the Chief Electrical Inspector. Given this decision, and the fact that the responsibility of the new Office of Energy Safety extends well beyond housing construction, amalgamating the new Office of Energy Safety with the Building Commission and the PIC is unlikely to yield net benefits, at least at this time.

However, the Building Commission and the PIC both focus on the building construction sector, and the arguments for amalgamation seem potentially stronger:

- a single regulator being able to take a ‘whole of building’ perspective
- cost savings—for example, the indivisible costs of licensing functions or call centres could be spread across a larger customer base
- the possibility that building practitioners and plumbers might find it less costly to deal with a single regulator
- increased flexibility to divert resources into particular regulatory activities
- a reduced risk that a larger regulator will be ‘captured’ by those who are regulated.

Possible arguments against a merger include the following:

- Amalgamation may involve costs, such as redundancy payments or the capital costs involved in combining separate systems. Costs would be borne at the time of amalgamation, while the benefits would come later.
- The two regulators have somewhat different approaches to regulation. The Building Commission relies on licensing, inspections, low levels of auditing, and last resort insurance. The PIC uses licensing, self-certification, higher levels of auditing and first resort insurance. If the characteristics of the two sectors are sufficiently different to warrant different approaches to regulation, it seems less likely that large synergies would arise from combining the two regulators. (On the other hand, if one of the two regulators is not using the best approach to regulation, it should change its approach. But amalgamation is not required for this to happen.)

- Having two regulators provides some scope to benchmark their activities and cost structures, as a comparative check on their performance. (However, it might be possible to find other comparators of a merged organisation, if quantifiable performance indicators were developed—see chapter 10).
- Builders and plumbers could face additional transaction costs if the merged regulators decided to alter the systems through which they interact with practitioners.

The discussion in the draft inquiry report about whether to merge the two commissions stimulated a strong reaction from a number of inquiry participants, most of whom opposed a merger:

- Rinnai, while applauding any cost savings from reducing duplication, considered it is ‘absolutely vital that independent expertise and advice from PIC and the Building Commission must not be compromised to the detriment of industry and the commercial sector’ (sub. DR109, p. 2).
- The Master Plumbers and Mechanical Services Association of Australia pointed out that the Commission had not provided evidence of the benefits of merging the two organisations and questioned whether there would be significant reductions in the \$454 per registered plumber that it estimates to be the annual cost of the PIC (sub. DR100, p. 18).
- The Gas Appliance Manufacturers Association of Australia Inc. was concerned that a merger could lead to a loss of technical expertise (sub. DR118, p. 2).
- The PIAC argued that ‘loss of PIC as a separate body will remove the feeling of identification that most plumbers and plumbing industry organisations have towards the PIC’ (sub. DR132, p. 4).
- The National Fire Industry Association Victoria suggested that ‘given the different nature of the two organisations it appears appropriate for their roles to remain separate and distinct, while at an operational level cooperation will deliver beneficial outcomes’. (sub. DR144, p. 3)

The HIA, on the other hand, supported merging the Building Commission and the PIC, and suggested that the recommendation could be extended to other building regulators (sub. DR163, p. 27). The Airconditioning and Mechanical Contractors Association noted that:

... an amalgamation of some Plumbing Industry Commission and Building Commission administrative functions has taken place this year. On the surface and to date, there do not appear to be any negative consequences for our industry arising from this change. (sub. DR143, p. 4)

It also noted, however, that ‘plumbing Regulations and building Regulations are very different and we can see no reason why the overall administration of them ought to be changed’ (sub. DR143, p. 4).

In its draft inquiry report, the Victorian Competition and Efficiency Commission recommended that the government task the chairs of the Building Commission and the PIC with identifying opportunities for cost savings from merging the two commissions' activities without loss of effectiveness. The Department of Sustainability and Environment noted that the two commissions are identifying 'opportunities for shared services in accord with an alignment strategy', with areas under consideration including information and communication technology, consumer information services, human resource management services and financial management services (sub. DR172, p. 22). The Commission considers that this exercise should continue, but accepts the view of the PIAC that it is inadequate to consider only cost savings, and that a 'sufficiently comprehensive approach should be taken' (sub. DR132, p. 18).

#### **Recommendation 9.9**

**That the Victorian Government task the chairs of the Building Commission and the Plumbing Industry Commission with identifying opportunities for cost savings from merging the two commissions' activities without loss of effectiveness.**

## **9.6 Consumer Affairs Victoria: roles and functions**

As a business unit of the Department of Justice, the functions of Consumer Affairs Victoria include policy advice, service delivery and business regulation (CAV 2004, p. 6) The Commission has not analysed the policy advice and research roles of CAV, because CAV's role in housing construction is only a small part of its overall consumer protection function. However, the arguments for separating policy advice and regulation that led the Commission to suggest that building regulators should not provide primary policy advice may have relevance to consumer protection in relation to housing construction.

## **9.7 Towards an improved regulatory framework**

The Commission considers that the changes to the regulatory framework outlined in chapter 8 and in this chapter would:

- provide more sharply focused objectives for the regulators
- align the regulators' functions with these objectives
- specify how the government expects the regulators to operate
- implement organisational changes that would both sharpen the focus of regulators on specified objectives and improve efficiency.

Strengthened performance reporting would better focus the regulators' attention on the objectives set for them by government. This is discussed in the next chapter.





## 10 Performance reporting

This chapter describes the characteristics of a performance reporting framework that can be considered to be ‘appropriate’. It describes performance indicators being reported by the main regulatory bodies for the housing construction sector, summarises evidence on those bodies’ performance and discusses ways in which performance reporting could be improved.

### 10.1 Purpose of this chapter

The inquiry terms of reference require the Victorian Competition and Efficiency Commission to inquire into and report on ‘the appropriateness of performance indicators for regulatory bodies in the Victorian housing construction sector’. This issue has been previously considered. The Victorian Auditor-General concluded in 2000 that the Building Commission:

... has not given sufficient priority to monitoring and evaluating the effectiveness of the Act. We suggest that for the purpose of measuring effectiveness, an evaluative framework needs to be established in order for the commission, as the building industry regulator, to provide an assurance to the Minister and the community on the degree to which the building control system has promoted the design, construction and maintenance of safe, habitable and energy efficient buildings. (Auditor-General Victoria 2000, p. 103)

Performance reporting is an important component of an accountability framework that can be envisaged as a hierarchy of clearly defined objectives at the pinnacle (chapter 8), specified functions for those who are responsible for achieving the objectives (chapter 9) and performance measurement of the extent to which these objectives are achieved (discussed in this chapter).

The scope of this chapter is limited to Consumer Affairs Victoria, the Building Commission, the Plumbing Industry Commission (PIC) and related entities. The Office of Gas Safety and the Office of the Chief Electrical Inspector also have important functions in relation to housing construction. However, given the Victorian Government’s recent decision to amalgamate these two offices, it does not seem useful to evaluate their past use of performance indicators. The Victorian Competition and Efficiency Commission encourages the government to require the combined Office of Energy Safety to develop and report against a well-structured set of performance indicators, drawing on principles outlined in this report.

## 10.2 The role of performance reporting

### 10.2.1 Why it is done

Performance reporting is a standard management tool in the public and private sectors. Victorian, Australian and overseas authorities have identified similar reasons for undertaking performance reporting. The Victorian Government's management reform agenda, of which performance reporting is a central component, is intended to make the scope of government service provision transparent and accessible by describing outputs and performance measures in the budget papers. It will also increase accountability for government resources by linking funding to the delivery of agreed outputs (DTF 1999).

The Australian National Audit Office, in a report aimed at agencies in the Australian Public Service, also pointed to the link between performance reporting and accountability, emphasising that information should be available to a number of groups:

Accountability relies on performance information. We are accountable to Ministers, the parliament, the general public and other key stakeholders for our programs' performance. Performance information is the currency of accountability. (ANAO 2000, p. 5)

Similarly, a report by five agencies in the United Kingdom (HM Treasury, the Cabinet Office, the National Audit Office, the Audit Commission and the Office for National Statistics) suggested that performance reporting allows effective accountability by providing stakeholders with the information they need to understand the issues involved and to exert pressure for improvement (HM Treasury 2001, p. 4).

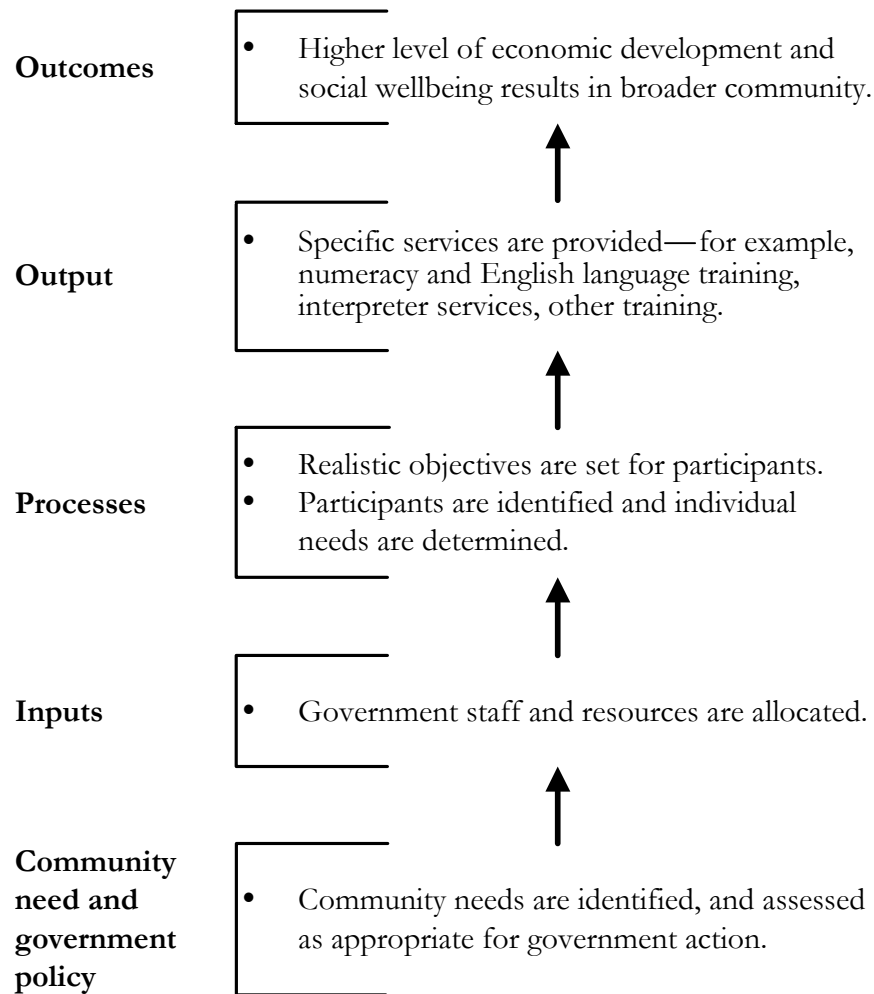
In addition to the role of performance reporting in increasing accountability, the same groups perceive it as a management tool that:

- enables managers to allocate and manage resources for delivery of specific services
- indicates how well an organisation is performing against its aims and objectives, and helps to identify which policies and processes work and why, and where they can be improved
- identifies where we are heading, how we will get there, whether we are heading in the right direction and whether we are using resources in the most cost-effective manner.

## 10.2.2 How it is done

For a work unit, performance reporting measures the relationship between its resources, its outputs and the impacts achieved (the outcomes) (figure 10.1). The development of a performance reporting system needs to be based on the underlying logic of the programs about which the information is being generated.

Figure 10.1 **Mapping program logic—an example**



Source: Adapted from ANAO 2000, p. 23.

The first requirement in developing performance measures is a clear statement of the outcomes that the organisation is trying to influence and the objectives that it is pursuing to influence these outcomes. The next step is to consider how achievement of the outcomes can be recognised, to identify the performance information required to measure that achievement. Performance information for inputs, outputs and processes is also required but is usually more readily available. Measuring the relationship between inputs and outputs indicates how

*efficient* the organisation is in using inputs to produce required outputs. Assessing the relationship between inputs and outcomes, and between objectives and the outcomes, indicates how *effective* the organisation is in achieving its desired outcomes (ANAO 2000, p. 24).

### **Characteristics of a good performance information system**

According to Her Majesty's Treasury, a good performance information system will be:

- focused on the organisation's aims and objectives, and should measure what the organisation is intended to achieve. There should be no more measures than are needed to capture the key objectives.
- appropriate to, and useful for, the stakeholders who are likely to use it. Different stakeholders will have different needs, so consultation with these stakeholders is needed.
- balanced, covering all significant areas of work. If the information system focuses on only part of the organisation's output, the unmeasured activities are likely to be neglected.
- robust to withstand organisational change and individuals leaving
- integrated into the business's planning and management processes, which will encourage managers and staff to 'own' the indicators, and will improve the indicators' reliability, through frequent use
- cost-effective, in that the cost of collecting information should be justified by the benefits that the information brings. (HM Treasury 2001, pp. 11–17)

Further, performance measures should be unambiguously defined and easy to understand. And the data required for the indicators should be able to be produced frequently enough for progress to be tracked and should be sufficiently up to date to be relevant at the time of publication. The data also need to be reliable (so users have confidence in them), comparable (with past periods or elsewhere) and verifiable (HM Treasury 2001, pp. 17–22).

### **Some tricks and traps**

If performance reporting has the features outlined in the previous section, it can lead to considerable benefits. However, as the Royal Statistical Society in the United Kingdom pointed out:

[Performance monitoring] done well is broadly productive for those concerned. Done badly, it can be very costly and not merely ineffective but harmful and indeed destructive. (Royal Statistical Society 2003, p. 1)

It is not an easy task to develop a performance system that works well. Performance measurement can lead to bad outcomes if, for example:

- performance targets drive the business strategy rather than the other way around
- those who should be influenced by the targets feel no sense of ‘ownership’ of them
- performance measurement results in simplistic approaches such as focusing on league tables, which can become demoralising for organisations not at the top of the table
- there is a tendency to focus on what is easily measurable rather than what is important.<sup>1</sup> (Briscoe 2005, p. 34)

### Using the information

Great care must be taken when developing a performance reporting framework. An organisation that does this well should find that developing the framework clarifies its objectives, encouraging it to focus on developing strategies to achieve these objectives. The information that is generated can be used to maintain pressure for continual performance improvement in a number of ways.

First, time series data can indicate how performance has been changing over time, highlighting relative weaknesses that warrant attention. Publication of the data will also create general momentum for improvement. A problem with this approach, however, is that it relies on the organisation using itself as the basis for comparison. Even if the organisation is performing better, it might still be falling behind other similar organisations, which time series data would not reveal.

A second approach (which can overcome this problem) is for the organisation to benchmark itself against similar organisations. However, public comparisons can pressure organisations to focus on indicators where they may lag behind others but which may not be the most important—that is, the ‘league table’ problem mentioned above. It is also often difficult to find organisations against which ‘like-with-like’ comparisons can be made.

A third basis for comparison is between similar processes in organisations that produce different outputs. Most organisations have accounting, human resources and information technology functions, for example, and a comparison of the

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<sup>1</sup> The Exports and Infrastructure Taskforce, commenting on economic regulators, suggested:

... it is understandable that regulatory authorities will concentrate on objectives that are readily measurable ... There is therefore a risk that lower prices will be seen as inherently good, with the regulators concentrating on securing price falls for infrastructure without sufficient consideration of the long term consequences. (Exports and Infrastructure Taskforce 2005, p. 41)

performance of these functions might be possible between organisations that are otherwise different.

Each approach has advantages and disadvantages, and a combination is generally desirable. Performance reporting needs to be implemented with great care, but it has the potential to significantly improve organisational focus, efficiency and effectiveness.

### **Performance reporting in context**

The discussion so far has focused on the desirable features of performance indicators. These indicators operate within a framework that consists of interdependent elements, with weakness in any one likely to undermine the effectiveness of the framework as a whole. For an organisation in the public sector, there needs to be:

- clarity about the outcomes (as defined in its legislation) that it is required to achieve (as discussed in chapter 8)
- the allocation of roles and responsibilities to the entities that are best placed to achieve particular outcomes (as discussed in chapter 9)
- clearly defined objectives and strategies within these organisations to achieve the outcomes specified in the legislation
- a well-defined and publicly reported performance reporting framework that measures the organisation's progress in achieving these objectives.

If, as suggested in chapters 8 and 9 for regulators of the housing construction sector, there are deficiencies in the first two elements, it will be particularly difficult to develop a best practice performance management framework.

## **10.3 Performance reporting by the Building Commission and related entities**

### **10.3.1 The framework**

While the *Building Act 1993* (Vic.) lists 17 functions for the Building Commission, it does not allocate specific objectives to it. Consequently, the Building Commission has focused on implementing the objectives of the Act, which it defines as:

- to enhance the amenity of buildings and to protect the safety and health of people who use buildings and places of public entertainment
- to facilitate and promote the cost-effective construction of buildings and the construction of environmentally sustainable and energy efficient buildings. (DSE, sub. 84, p. 6)

Chapter 4 noted that the Building Act has eight other objectives. The two that the Building Commission has selected are the closest to outcomes, because many of the other objectives in the Building Act describe instruments rather than outcomes. Chapter 8 argued that the meaning of some of the outcomes is ambiguous and that the Act would provide clearer direction if it specified and defined fewer outcomes. It also suggested that the Building Commission has taken on the roles of both regulator and industry leader, partly as a result of the breadth of the objectives in the Building Act.

One consequence of the Building Act having so many (sometimes ambiguous) objectives is that it becomes difficult to develop a clearly specified performance reporting framework that measures the achievement of these objectives. To assess the appropriateness of the Building Commission's performance indicators, as required in the inquiry terms of reference, the Victorian Competition and Efficiency Commission reviewed the Building Commission's corporate plan for 2002–07, which sets the organisation's direction over the five-year period, and the business plan for 2003-04, which specified the activities that the commission would undertake in that year, consistent with its five-year strategy.

In its five-year corporate plan, the Building Commission indicated its 'commitment to measuring and achieving improved outcomes from the Victorian building industry' (BC 2002c, p. 6). It set itself to achieve major building industry outcomes for:

- the quality of Victoria's buildings in terms of safety, habitability, accessibility and sustainability
- the satisfaction of consumers with building services
- the attractiveness of the industry for its participants. (BC 2002c, p. 7)

The Building Commission established eight objectives to deliver these outcomes—eight strategic steps that 'will deliver stronger leadership and better building control' (BC 2002d, p. 7)—and outlined performance indicators for each step (table 10.1).

**Table 10.1 Building Commission's strategic steps and performance indicators**

<i>Objective</i>	<i>Strategy</i>	<i>Performance indicator</i>
Bring together and provide leadership to all stakeholders in Victorian building	Partnership and issues leadership	Extent and operation of the partnering program Stakeholder opinion of commission partnering and contributions to resolving industry issues Achievement of new policy initiatives Government assessment of policy advice Commission profile among target audiences
Better industry management through better industry measurement	Industry outcomes measurement	Extent and effectiveness of the outcome measurements Industry leader opinion of the measurements Media coverage Adoption of comparable measurements by other jurisdictions
A better building marketplace through better buyers of building services	Informed consumers	Building consumer opinion on information available Building practitioner opinion on the impact of changed consumer information Extent and effectiveness of building consumer advisory services including dispute resolution Commission website usage
Sustainability initiatives targeting building design, construction and use	Building sustainability	Average energy rating of new Victorian housing Average energy usage by Victorian commercial buildings Proportion of building projects using sustainable design and construction practices Industry opinion on sustainability adoption
Practitioner improvement through market forces, professional development and better compliance	Continuous practitioner improvement	Industry participants registered or otherwise associated with the commission Practitioner satisfaction with commission services Commission website usage Practitioner participation in continuing professional development Level of owner–builder permits Industry adoption of leading edge technologies
A renewal of building surveying and building quality overall	Renewal of building quality assurance	Number of active registered building surveyors and inspectors in Victoria New entrants to Victorian building surveying Consumer awareness and use of building surveyors and related professions Quality and range of building surveying and related services in Victoria Availability of education and training for building surveying
Facilitate development, communication and adoption of building knowledge	Building knowledge management	Stakeholder opinion of commission contribution to building knowledge Periodic assessments of innovation in Victorian building Quality of statistics and market intelligence
Business-like pursuit of resources and a culture matched to strategies	Business-like organisation	Stakeholder support of commission proposals and resourcing Periodic assessment of commission culture and capabilities Staff opinion and attitudes Quality and efficiency of commission business processes

Source: BC 2002c, pp. 8–15.



### 10.3.2 Observations about the framework

Observations can be made about the framework, its logical coherence and the performance indicators in the corporate plan. The Building Commission has developed a hierarchical planning framework, with outcomes at the top, objectives that are intended to achieve the outcomes, strategies for achieving the objectives, and performance indicators to measure the success of the strategies. Annual business plans set out shorter term initiatives to move towards the objectives established in the corporate plan.

The logical coherence in the corporate plan should be revealed through the causal relationship between the objectives specified in the plan, the outcomes pursued by the commission, and the outcomes in the Building Act. The first of the three outcomes sought by the commission ('the quality of Victoria's buildings in terms of safety, habitability, accessibility and sustainability') is reasonably close to the two outcomes specified in the Act. However, it does not include amenity, and it refers to accessibility and habitability: these two words are not defined in the corporate plan. Further, the plan does not explain the link between the other two outcomes in the plan (consumer satisfaction and the attractiveness of the industry for its participants) and the outcomes required under the Building Act.

Only one of the corporate plan's eight objectives (building sustainability) appears to be directly related to an outcome specified in the Building Act. The plan does not explain how achieving the other seven objectives will promote the outcomes in the Building Act. Its preamble implies that there may be some links between the objectives and outcomes, but they appear indirect:

The Building Commission and its many stakeholders believe the building industry can deliver a much better product in terms of quality, safety, amenity and overall sustainability. We believe building consumers can be better informed and more satisfied with their purchases. We think building contractors and building professionals can be part of an industry that offers security and a worthwhile financial return, as well as a stimulating work environment that is attractive to workforce entrants. We want building practitioners to be proud of their industry.

The Building Commission will work towards these outcomes by playing a much stronger leadership role in the state's building activities. (BC 2002c, p. 3)

The corporate plan emerged from extensive consultation between the Building Commission, the four statutory bodies, state and local government and the private sector. It is a summary document that necessarily omits the details of these consultations. From the information presented in the plan, however, it is difficult to discern how the strategies will achieve the outcomes listed in the Building Act. This might have happened because either these outcomes are ambiguous or the dynamics of the consultation process led in a different

direction (towards the leadership role described in chapter 8), or perhaps both elements contributed. Whichever explanation is correct, a tighter link between the Building Commission's strategies and the outcomes in the Building Act would have been easier to achieve if those outcomes had been more tightly defined, as suggested in chapter 8.

### **10.3.3 Observations about performance indicators**

Developing good performance indicators becomes more difficult when the objectives against which performance is being measured are loosely defined. That said, there is room for further development of the Building Commission's performance indicators:

- None of the indicators in table 10.1 measures the efficiency of the Building Commission's regulatory processes, in terms of either the costs to the Building Commission of administering regulation or enforcing regulation, or the costs to building practitioners of complying with regulation.
- None of the indicators measures progress in achieving the desired health, safety and amenity outcomes.
- Some of the performance indicators fall short of the characteristics of good performance measures—namely, that they are influenced by the organisation; that the extent of the influence attributable to the organisation can be measured; that the meaning of the measures is unambiguous; and that data are reliable and frequently available. Indicators such as 'industry leader opinion of the measurements', 'building consumer opinion on information available', 'quality of information and market intelligence', 'industry adoption of leading edge technologies' and 'stakeholder support of Building Commission proposals and resourcing' do not pass these tests.

An important aspect of a performance reporting framework is the publication of progress against the plan. To assess this dimension of the Building Commission's framework, the Victorian Competition and Efficiency Commission reviewed the information provided in the Building Commission's annual report and quarterly reports to the Minister for Planning.

The commission's annual report details progress against each of the strategies in the corporate plan. Lists of achievements in each strategic area and some quantitative indicators are provided. Aspirations for the coming year, in relation to each strategy, are also presented. The information is not, however, explicitly linked to the performance indicators set out in the corporate plan, or presented in a form that would permit comparison with other organisations.

Mr Lawrence Reddaway, a consulting engineer, commented that:

Every annual report from the Building Control Commission and the Building Commission is increasingly glossy, self laudatory, and lacking in hard factual data. For example: how many investigations of building practitioners were undertaken in the year, category by category, month by month and region by region, and how does this compare with earlier years? Reports should contain a wealth of such tabular data. (sub.DR 138, p. 2)

In its quarterly reports to the Minister for Planning, the Building Commission lists its achievements during the quarter in its eight strategy areas, which it groups under two headings: 'providing stronger leadership for the building industry' and 'building better control'. The list of achievements is in a similar format to that in the annual report. The quarterly report provides statistics on building work, Building Appeals Board decisions, the number of registered building practitioners, Building Practitioners Board inquiries and dispute resolution. The statistics are mostly not identified as performance indicators in the corporate plan.

The Victorian Competition and Efficiency Commission has not been made aware of separate performance reporting by the Building Advisory Council, the Building Regulations Advisory Committee, the Building Practitioners Board, the Building Advice and Conciliation Victoria (BACV) or the Building Appeals Board, beyond that in the Building Commission's annual report and quarterly report to the Minister.<sup>2</sup>

### **Finding 10.1**

The Building Commission has established a corporate planning framework that does not facilitate a high level of performance assessment. The objectives specified for the Building Commission in this plan are consistent with planning and shaping the industry in addition to regulating it, but are only loosely related to the objectives of the *Building Act 1993*, which are also imprecise. The Building Commission has established a performance indicator framework but is making limited use of quantitative measurement of its performance against these objectives.

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<sup>2</sup> The Building Regulations Advisory Committee commented, in relation to performance reporting, that:

The performance of the regulations is constantly tested through the various constituencies represented on BRAC and feedback is generally swift as in the recent case when a VCAT [Victorian Civil and Administrative Tribunal] interpretation of the definition of domestic building work caused alarm among civil contractors and housing companies (see 5.3). The priority of issues and progress in resolving them is monitored through an issues register and managed by BRAC (attachment 1). Specific data for the measurement of long term impacts of the Regulations is expected to be available in the future through the *pulse*<sup>o</sup> project conducted by the Building Commission to measure industry outcomes and performance. (sub. 57, p. 4)

## 10.4 Performance reporting by the Plumbing Industry Commission

As in the case of the Building Commission, the Building Act does not specify separate objectives for the PIC but does outline its functions. The PIC decided:

The mission of the Plumbing Industry Commission is to achieve community expectations of safety, health and consumer protection through efficient and effective plumbing regulatory system. (PIC 2002, p. 6)

That is, the PIC has focused on the core outcomes prescribed in the Building Act, while committing to achieving them in an efficient way. In its annual report and draft corporate plan, it identified 11 dimensions of performance against which it can be assessed:

- (1) health and safety of Victoria's on-site plumbing
- (2) the level and efficiency of plumber and community compliance with the plumbing regulatory framework
- (3) the efficiency and effectiveness of the licensing and registering process
- (4) the overall level of competency of Victoria's plumbers
- (5) the level of consumer protection and assistance
- (6) PIC's contribution to environmental sustainability in Victoria
- (7) PIC's contribution to development of the Victorian plumbing industry
- (8) the quality and timeliness of PIC's advice to government
- (9) the national and international consistency of Victoria's plumbing regulation
- (10) the internal organisational performance of PIC, with respect to the strength of its organisational culture, efficiency, competencies, etc.
- (11) the financial performance of PIC. (sub. 84, pp. 93–4)

The PIC considered that the health and safety outcomes of Victoria's plumbing system are the 'fundamental performance measure for the PIC', but noted that it shares responsibility for these outcomes with other regulatory bodies; in particular, the Office of Gas Safety has had lead responsibility for gas safety (sub. 84, p. 39). Nevertheless:

PIC's contribution to the appropriate minimisation of the risk of death, injury, and disease arising from contamination of water, ineffective sanitary systems, poor stormwater management, dangerous provision of gas energy or other weaknesses in the plumbing system is at the heart of evaluation of the commission ...

The Annual Report of the Office of Gas Safety [OGS] reports on various measures related to gas plumbing, including:

- gas caused deaths
- gas involved injury

- investigations into compliance breaches
- number and outcome of prosecutions concerning compliance breaches
- reports of unsafe installations
- reported fires/explosions/asphyxiations caused by or involving gas
- numbers and nature of calls to gas emergency call centre
- the percentage of standard (versus complex) gas installations found defective in PIC audits
- market research concerning community awareness of gas safety issues affecting the general public.

OGS also provides more detailed reports focused on analysis of gas safety incidents, including cross-jurisdictional comparison of fatal accident frequency rates over time.

A recent independent review of gas safety administration [by Risk and Reliability Associates for the OGS] relied on OGS data and commented ‘The Victorian reporting regime was considered reliable, which provides confidence for the Victorian safety statistics’. (DSE, sub. 84, p. 95)

For other types of plumbing, the PIC noted that faults in water and sanitary plumbing systems have not caused significant health or safety issues in Victoria for many years, but could do so. The recent SARS epidemic in Hong Kong, attributed to a plumbing fault, is evidence of this risk. The PIC does not publish any indicators for health and safety outcomes of other types of plumbing.

With respect to the level and efficiency of compliance, performance indicators reported by the PIC include:

- the number of investigations and prosecutions entailing non-compliance with the certificate and/or drainage requirements
- the number of plumbing certificates lodged and the number of inspections booked per year—283 294 and 47 209 respectively in 2003-04. ‘The sheer scale of the lodged certificates and booked inspections is a good indicator of the level of compliance with these requirements’ (DSE, sub. 84, p. 95).
- the time efficiency of the certificate and drainage inspection compliance requirements, which the PIC sees as one measure of its efficiency in administering compliance certificate and inspection compliance<sup>3</sup>

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<sup>3</sup> The data come from the PIC’s interactive voice response (IVR) system, which received 215 046 calls in 2003-04. The PIC’s annual report gives response times in seconds for the system’s main functions, as shown below.

	<i>Average response (seconds)</i>
Enter licence number and PIN	22
Lodge compliance certificates	46
Book inspection	85
Purchase compliance certificates over IVR	134
Purchase certificates from a reseller	91
Change PIN	32

- the number of resellers (currently around 200) of compliance certificates, which is seen as a measure of the efficiency of the operation of the compliance certificate process
- the incidence of non-compliant plumbing work by licensed or registered plumbers, as measured by the failure rate in random sample audits and inspections
- the incidence of plumbing work by people other than licensed or registered plumbers, as revealed by cases coming to the attention of the PIC through complaints, disputes or other means. Subject to this limitation, the PIC maintains statistics on formal complaints, disciplinary hearings, prosecutions, notices and orders.

The PIC measures the effectiveness of its licensing and registering process by monitoring the number of licences and registrations and the number of individuals holding at least one licence or registration. It cannot check whether every plumbing job is carried out by the correctly licensed or registered person, so it relies on the number of licences, registrations and accredited people as a working indicator of compliance with occupational licensing requirements:

Before the PIC was established in 1997, the information available at that point suggested that Victoria had about 13 000 plumbers. Once PIC licensing and registration was fully established, it became clear that Victoria in fact had 17 000 plumbers. The number of plumbers has now grown to more than 19 000, including growth by 6.4 per cent since financial year 2000-01.

These broad figures indicate that monitoring the total number of licensed/registered people is a good proxy measure of compliance. While this total number will vary somewhat in accord with the building industry cycle and other factors, if the total experienced a large rapid drop it would clearly indicate that compliance was falling below the required 100 per cent. (DSE, sub. 84, p. 98)

The performance indicators developed by the PIC appear to measure up quite well against the characteristics of ‘appropriate’ performance indicators outlined in section 10.2. They are linked to some of the outcomes required by the Building Act, largely focus on the organisation’s aims and objectives, and have been integrated with the PIC’s planning process. Further, they broadly measure activities that can be influenced by the PIC, and the required data for a number of the indicators are reliable and produced frequently.

The PIC annual reports provide information for a number of these indicators.<sup>4</sup> If some of the data were provided on a time series basis, it would be easier to assess whether the PIC's performance is improving over time. More difficult, but worth considering, is whether there is scope to use some of these indicators (or develop new ones) in benchmarking comparisons with other agencies.

### **Finding 10.2**

The Plumbing Industry Commission has developed an extensive performance reporting framework that could be refined over time but currently provides useful information that will enhance accountability.

## **10.5 Performance reporting by Consumer Affairs Victoria**

Chapter 8 noted the objectives of the *Domestic Building Contracts Act 1995* (Vic.) (s4) are to:

- provide for the maintenance of proper standards in domestic building work in a way that is fair to both builders and building owners
- enable disputes involving domestic building work to be resolved as quickly, efficiently, cheaply and fairly as possible
- enable building owners to have access to insurance funds in cases where domestic building work under a major domestic building contract is incomplete or defective.

Consumer Affairs Victoria administers the specialised mechanisms for resolving disputes between homeowners and their contracted builders under the Domestic Builders Contract Act. The director of CAV also has specific functions relating to the provision of information to builders and homeowners.

Consumer Affairs Victoria has many responsibilities, in addition to those in relation to the Domestic Building Contracts Act. As far as the Victorian Competition and Efficiency Commission is aware, CAV does not publish a corporate plan and does not explain in its annual report how it determines its resource allocation across its responsibilities.<sup>5</sup> Similarly, it does not publish its

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<sup>4</sup> The indicators include: the time taken to perform critical functions on the PIC's computer system; the number and type of accreditations; audits completed and the proportion failed; inspections booked and the proportion failed; the results of licence-level theory examinations; and investigative data.

<sup>5</sup> Consumer Affairs Victoria does publish in its annual report income from the domestic building fund and expenditure associated with the fund, including the amount used to fund the operating costs of the Victorian Civil and Administrative Tribunal.

strategy for achieving the three objectives of the Act or information on how it allocates available resources across them.

CAV does not publish performance indicators to demonstrate the extent to which it is achieving the objectives specified in the Act, although it publishes (jointly with the Building Commission) an annual activities report on BACV. This report provides information on the number of inquiries, complaints, inspections and enforcement activities of BACV. As an activities report, no information is provided on the extent to which BACV has contributed to improved outcomes.

In its annual report, CAV (2004a, p. 95) describes initiatives undertaken over the year, such as:

- distributing 100 000 copies of BACV information for consumers
- distributing BACV information brochures to all homeowners who obtained a building permit
- launching new web pages on domestic building on the CAV website
- developing relationships with key stakeholders to provide more strategic distribution of BACV publications
- making presentations at seminars.

### **Finding 10.3**

Performance reporting by Consumer Affairs Victoria is activity rather than outcome based. CAV does not publish performance indicators to demonstrate the extent to which it is achieving the objectives specified in the *Building Act 1993*.

## **10.6 Conclusions about the performance of the Building Commission and related entities**

A crucial test of the appropriateness of the performance indicators—on which the inquiry terms of reference require the Victorian Competition and Efficiency Commission to report—is whether they permit conclusions about how well regulators are achieving the outcomes sought under the Building Act. The Commission has had difficulty drawing firm conclusions about the Building Commission’s performance from published performance information.

The Building Commission has implemented a structured performance reporting framework, but it is required, under its legislative framework, to achieve outcomes that are set in general terms and potentially conflict. In this context, it is not surprising that the commission has set quite loosely defined objectives for itself and has had scope to adopt two quite distinct roles (‘industry leader’ and regulator) potentially at odds with each other (as described in chapter 9). The



commission has developed performance indicators, but has had difficulty developing quantitative indicators that clearly measure its contributions to the broad health, safety and amenity outcomes specified in the Building Act. It is thus difficult to use the performance indicators to measure changes in the Building Commission's achievement of these outcomes over time.

While the data do not prove that the Building Commission has been performing well in terms of its contribution to the outcomes specified in the Building Act, they do not prove the converse. The Victorian Competition and Efficiency Commission has not been presented with information about health, safety, amenity or sustainability problems in the housing construction sector. Moreover, the Building Commission has been operating within an environment that has combined with strong and sustained growth in building activity, and the insurance disruption arising from the HIIH collapse, to place considerable pressure on the regulatory framework. It has administered regulation in this challenging environment without reports of major adverse outcomes, except (arguably) for the increasing burden of regulation.

Inquiry participants provided mixed comments on the performance of the Building Commission and the related regulatory bodies. They did not, however, identify major concerns (box 10.1).

**Box 10.1 Inquiry participants' comments on the performance of the Building Commission and related entities**

**General**

The Property Council believes that the regulatory bodies in Victoria such as the Building Commission and the Plumbing Industry Commission work in an efficient and open manner. (Property Council of Australia, sub. 69, p. 4)

The Victorian Building Commission is a leader in building policy and an excellent model for the state based administration of building and construction related regulation. Its capacity to minimise cross-portfolio bottlenecks ensures a whole of government approach to building regulation.

Through its leadership on issues, Victoria is contributing to a general increase in nationally consistent building regulations. (Chair, Australian Building Controls Board, sub. 9, p. 10)

It is understood that each of the four bodies are independent of each other and no significant concerns about the operation of these bodies have been raised by councils. (Municipal Association of Victoria, sub. 64, p. 2)

It is not uncommon for advice from the relevant bodies and the Building Commission to be conflicting and/or ambiguous. (AIBS, sub. 41, p. 5)

(continued next page)

## Box 10.1 **Inquiry participants' comments on the performance of the Building Commission and related entities** (continued)

Even though regulation is getting tighter, 'the perception of poor quality work in housing remains and we are led to conclude that it is primarily related to skill shortage'. (Royal Australian Institute of Architects, sub. 40, p. 7)

### **Building Commission**

The AIBS has a direct association with the Building Commission and is satisfied in principle as an industry body, with the performance of the Commission. (Australian Institute of Building Surveyors, sub. 41, p. 12)

It appears that in this climate of rampant non-compliance the Building Commission [is] impotent to either prevent or correct the situation. (Builders Collective of Australia, sub. 38, p. 7)

The final cost imposed on building permits which is of considerable concern is the Building Commission levy. What is this levy for and where is it spent? (Builders Collective of Australia, sub. 38, p. 11)

These and other similar authorities require national consistency and alignment with the BCA. This would be assisted by combining the different organisations into one body. (National Association of Steel-Framed Housing, sub. 35, p. 3)

### **Building Advisory Committee**

From the average building practitioner's perspective there is little known about the BAC, its roles, activities or responsibilities. (City of Boroondara, sub. 66, p. 1)

### **Building Regulations Advisory Committee**

The perception of the BRAC is that there are too many self-interested parties involved, who are mainly interested in their own issues. (City of Boroondara, sub. 66, p. 2)

It is considered that the BAC and BRAC should meet more frequently, their representation expanded so as to be available to provide the advice empowered to it under the law. (AIBS sub. 41, p. 1)

### **Building Appeals Board**

It is considered that the BAB provides a cost-effective and timely service to industry ... (City of Boroondara, sub. 66, p. 2)

It is considered that the BAB process for hearing disputes is successful and it may be appropriate that disputes concerning defects/contracts between builders and consumers be heard under a similar model. (AIBS, sub. 41, p. 2)

### **Building Practitioners Board**

Not enough resources are being given to the BPB to properly administer the registration system and to ensure practitioners are carrying out their responsibilities properly. (City of Boroondara, sub. 66, p. 20)

It is considered that registration/licensing of plumbers, electricians etc. under one body would be an advantage to the building industry. (AIBS, sub. 41, p. 2)

### **Finding 10.4**

Published performance information does not allow firm conclusions about the Building Commission's achievement of the outcomes specified under the *Building Act 1993*. This is partly because the broad specification of objectives in the Act provides limited guidance on how to develop specific indicators to measure the Building Commission's performance. Nonetheless, the Building Commission has administered complex regulation in a challenging environment with some broad support. There are, however, no indications of adverse performance, other than concerns about the burden of regulation.

## **10.7 Conclusions about the performance of the Plumbing Industry Commission**

The PIC's performance indicator framework is quite extensive, and a number of the indicators measure the PIC's contribution to the health and safety outcomes specified in the Building Act. To form conclusions about the PIC's performance from these data, it would be necessary to assess, for example, the appropriateness of the audit level being undertaken given the failure rates being recorded. The Victorian Competition and Efficiency Commission has not undertaken this analysis.

Inquiry participants offered few comments about the performance of the PIC, and some of those who did comment focused on the regulatory framework rather than its administration by the PIC (box 10.2).

### **Box 10.2 Inquiry participants' comments on the performance of the Plumbing Industry Commission**

We are not aware of any other regulatory bodies who have delivered industry benefit to the same level as the PIC. (Marsh, sub. 30, p. 3)

The CEPU-PD would submit that the division of responsibilities is appropriate. (Communications, Electrical Plumbing Union (Plumbing Division), sub. 25, p. 4)

This current regulatory environment is stifling the growth for all members of the RMRIAV. (Residential Metal Roofing Industry Association of Victoria Ltd, sub. 23, p. 2)

The PIC handles complaints from consumers relating to plumbing work. In our experience many consumers have not heard of the PIC, because the plumber has either not issued a compliance certificate, or the certificate has not been passed on by the builder to the consumer. These consumers can end up in costly litigation, or preferring the alternative, costly rectification work. (sub. DR127, p. 3)

## 10.8 Improving performance reporting

Given that the fundamental reason for performance reporting is to measure the extent to which an organisation is achieving its aims and objectives, a prerequisite for an effective performance reporting framework is a clear set of aims and objectives. More focused objectives and functions (as recommended in chapters 8 and 9) should provide clearer guidance for the regulators and related entities. If implemented, these changes should trigger a revision of the performance reporting framework of the regulatory bodies, to align performance indicators with the revised objectives.

It is an appropriate time for both the Building Commission and the PIC to review their performance reporting framework;<sup>6</sup> the current frameworks were implemented three years ago and the two organisations' corporate plans will expire in 2007. It is particularly important that the Building Commission has a transparent reporting framework, given that it generates most of its revenue from a levy rather than from fees for service. In addition to enhancing accountability, performance indicators that measure progress against the key outcomes of the Building Act would help to clarify what the government wishes to achieve for each outcome.

The Building Commission can draw on its new *pulse*<sup>o</sup> database to develop its performance reporting framework, although *pulse*<sup>o</sup> was not developed for performance evaluation. Rather, the commission describes it as:

... an initiative of the Building Commission to lead the Victorian building industry and enhance decision making ... Presenting this information will not only assist you, but will demonstrate to Victorians the contribution the building industry makes to Victoria's past, present and future. (BC 2004d, p. 3)

Nevertheless, the data in *pulse*<sup>o</sup> may be useful for developing performance indicators for the commission and related entities. Many of the indicators are not related to the regulators' performance; this was not the intention when they were developed. Rather, the indicators provide either general industry intelligence (for example, about building activity) or data on aspects of building performance that are not related to the objectives of the regulator. That said, the Building Commission is collecting *pulse*<sup>o</sup> information about a number of indicators that could be developed as measures of its performance.<sup>7</sup> Table 10.2 provides

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<sup>6</sup> The PIC has already identified options for improving its performance reporting, including:

...retesting plumbers, perhaps on a random sample basis, when they renew a licence or registration. The PIC retested all gasfitters when the commission was first established, but does not presently perform retesting. Retesting may be resisted by plumbers and would result in extra cost for the industry and for the PIC, but some form of it may be justifiable. (DSE, sub. 84, p. 97)

<sup>7</sup> Many more indicators are available in *pulse*<sup>o</sup> than are reported in table 10.2, but were not developed for use as performance indicators.

illustrations and indicates the regulatory body for which the indicators seem most relevant.

**Table 10.2 Possible performance indicators reported in pulse<sup>o</sup>**

<i>Regulatory agency</i>	<i>pulse<sup>o</sup> indicator</i>
Building Commission	Level of compliance with the BCA
	Percentage of building activities randomly audited by the Building Commission
	Percentage of registered builders that expect to be the subject of a random audit by the Building Commission
	Percentage of registered building practitioners that believe building standards are adequately supported by practical information and advice
	Number of major incidents related to building safety
	Number of investigations and number of practitioners investigated by the Building Commission
	Average time taken for the Building Commission to complete an investigation
	Number of prosecutions initiated by the Building Commission
	Percentage of registered building practitioners that are aware of prosecutions initiated by the Building Commission and disciplinary action taken by the Building Practitioners Board
	Consumer and practitioner satisfaction with the knowledge of and services provided by building surveyors
	Percentage of consumers that are aware of the role of the building surveyor
	Percentage of consumers that believe the building surveyor acts as an independent assessor of building standards
Building Practitioners Board	Number of illegal building activities
	Number of Building Practitioners Board inquiries and number of practitioners investigated by the board
	Percentage of consumers that have confidence in the qualifications, practices and ethical standards of registered building practitioners
	Percentage of consumers that know what a registered building practitioner is
	Percentage of domestic consumers using registered building practitioners for their building project
Building Appeals Board	Number of cases heard by the Building Appeals Board
Building and Conciliation Victoria	Number of building inquiries handled by BACV
	Number of building disputes handled by BACV
	Distribution of resolution timeframes for building disputes handled by BACV

Source: BC undated A.

The list of indicators in table 10.2 is long, but needs to be supplemented to measure, for example, the performance of the Building Advisory Council and the Building Regulations Advisory Committee, and the Building Commission's contribution to the health, safety and amenity outcomes specified in the Building Act. In addition, while some indicators provide insights into the performance of the Building Practitioners Board, Victoria's Auditor-General suggested that information should be collected about other indicators, including the registration success rate; the proportion of practitioners assessed through reference checks; the time taken to process a registration application; the work history of registrants; evidence of recurring complaint problems; the backlog in complaints; the ratio of complaints to different categories of registered practitioners; and the number and outcome of inquiries (Auditor-General Victoria 2000).

The Master Builders Association of Victoria supported the draft recommendation that performance reporting should be improved (sub. DR151, p. 21). The Building Advisory Council, while noting that 'the Building Commission has applied best practice internally to identify justifiable expenditures and met its legislated requirements in providing justification to the council and minister', also 'supports the notion that the Building Commission should increase its accountability and improve its performance reporting. The council recognises that there are opportunities for the Building Commission to become more transparent' (sub. DR154, p. 10).

The Department of Sustainability and Environment pointed out that:

The SE portfolio considers that this draft recommendation will need to be addressed in the context of the government's consideration of earlier recommendations about the legislative objectives and functions of the BC and PIC (namely, 8.1, 8.2 and 8.3) and responsibility for policy (9.1). As already stated, the appropriate time to address these recommendations is when the government responds to the VCEC's final report.

An important aspect, which will need to be addressed in that consideration, are the measures of the performance of the BC and PIC which the government can implement to monitor and evaluate the extent to which its objectives are being fulfilled. The SE portfolio recognises that the development of such measures is necessary to secure the cost-effectiveness of the regulatory framework.

From this perspective, the SP portfolio advises that the further development of performance measures is currently being pursued by the BC and PIC. However, the task of developing effective measures, and the associated information sources, is not easy and tends to be evolutionary. This task requires ongoing input from the government, which is responsible for the regulatory framework, and regulatory agencies. (sub. DR172, p. 23)

Given these comments, the Victorian Competition and Efficiency Commission considers that its recommendation in the draft report remains appropriate.

### **Recommendation 10.1**

That the Building Commission and the Plumbing Industry Commission review their reporting frameworks to ensure they indicate how well they are performing against their aims and objectives, which should be derived from the outcomes sought under the *Building Act 1993*. These indicators should satisfy criteria relating to their focus, balance, robustness, cost-effectiveness and integration into the business planning process. The two commissions should present proposed indicators for Victorian Government approval by June 2006, and provide annual public reports of their performance against these indicators, beginning in 2006-07.

## **10.9 Conclusions about the performance of Consumer Affairs Victoria**

While it is evident from section 10.5 that CAV has been active in resolving disputes and providing information to consumers, there does not appear to be published information about the organisation's efficiency in using inputs or its effectiveness in contributing to improved outcomes. CAV reporting of such indicators is less than that by either the Building Commission or the PIC. Published information thus does not permit conclusions to be reached about the performance of CAV in contributing to the objectives of the Domestic Building Contracts Act.

The difficulties in developing indicators of efficiency and particularly effectiveness should not be understated. Moreover, CAV's responsibilities are much broader than those relating to the Domestic Building Contracts Act. It administers 45 Acts, and publishing performance information about one sector could give it undue prominence relative to others. Nevertheless, CAV's responsibilities in relation to housing construction are an important part of its overall role, and improved public reporting of performance would seem no less beneficial for CAV than for the Building Commission and the PIC. From a whole-of-government perspective, improved reporting would provide a useful guide for the government when deciding where to allocate resources to achieve its objectives for housing construction.

The arguments for transparent reporting are likely to apply across CAV's responsibilities. While it may be appropriate to improve performance reporting in relation to housing construction as part of a comprehensive approach to improved reporting, this broader perspective is clearly outside the Victorian Competition and Efficiency Commission's terms of reference. The Commission

has been asked to report on performance reporting by regulatory bodies in the housing construction sector, and it considers that improved performance reporting in this area of CAV's responsibilities is warranted.

#### **Recommendation 10.2**

**That Consumer Affairs Victoria review its reporting framework in relation to its housing construction related responsibilities to ensure it indicates performance against aims and objectives. Performance indicators should satisfy criteria relating to their focus, balance, robustness, cost-effectiveness and integration into the business planning process. Consumer Affairs Victoria should present proposed indicators for Victorian Government approval by June 2006, and provide annual public reports of performance against these indicators, beginning in 2006-07.**

### **10.10 Financial reporting**

This chapter has described the use of performance reporting as an instrument for increasing accountability and encouraging performance improvement. Annual financial reporting is another performance reporting instrument—one that focuses more on the efficiency with which resources are used.

Elsewhere in this report, the Victorian Competition and Efficiency Commission suggested that transparency would be improved if more information were provided in annual reports about:

- performance against performance indicators, provided on a time series basis as the availability of data permits
- the allocation of resources among the various regulatory bodies. Information could include both the allocation of funds to these entities and the rationale for the allocation.
- details of funding for research and development projects
- the 'special projects' in the Building Commission's annual report (with \$4.4 million, or almost 25 per cent of total expenditure, being spent in 2003-04 on these projects that are not defined or explained).

The Master Builders Association of Australia noted that:

Accountability, transparency and enquiry are the key objectives that annual reports need to have regard to. Any improvements that organizations can make to their annual reports in this regard are supported. (sub. DR151, p. 21)



The City of Melbourne supported improved annual reporting to address the annual allocation of funds to statutory bodies (sub. DR136, p. 13). The Department of Sustainability and Environment commented that:

As reflected by the current reporting activities of the BC and PIC, the SE portfolio appreciates that annual reporting requirements are an essential part of a cost-effective regulatory framework. Such requirements are best specified in legislation. Accordingly, the SE portfolio considers that the nature and extent of such requirements, and hence the adequacy of the current annual reporting efforts by the BC and PIC, are matters for consideration by the government in its response to the VCEC's final report. (sub. DR172, p. 23)

### **Recommendation 10.3**

**That the annual reports of the Building Commission and the Plumbing Industry Commission provide more information about the allocation of funds to related regulatory bodies, and the rationale for this allocation and for expenditure on research and development. The Building Commission's annual report should outline its expenditure on each special project and link this to outcomes.**



# 11 Fees and charges

This chapter examines whether the level of fees and charges set by regulation is consistent with best practice principles. In doing so, it discusses whether changes to existing arrangements appear warranted.

## 11.1 Introduction

Most of Victoria's regulatory regime for the housing construction sector is funded from cost recovery arrangements. The Building Commission, the Building Practitioner's Board, the Building Appeals Board, the Building Advisory Council, the Building Regulations Advisory Committee, Building Advice and Conciliation Victoria (BACV), the Plumbing Industry Commission (PIC) and the Plumbing Industry Advisory Council are all fully funded by cost recovery arrangements. In 2003-04, the two main regulatory bodies (the Building Commission and the PIC) had combined revenues of around \$28 million, much of which was derived from cost recovery charges in the form of industry levies, registration charges, license fees and certificates of compliance. Local government also collects significant amounts of fees and charges from building related regulation.

Cost recovery involves setting and collecting fees and charges to cover government's costs in administering regulation. It is separate from the costs to industry of complying with regulation. (Appendix C discusses compliance costs.) It is also separate from decisions about whether regulation or other mechanisms, such as financial incentives, should be used to deal with identified problems. Cost recovery questions become relevant once the government has decided that regulation is the appropriate policy response and is considering how to fund the costs of administering that regulation.

Cost recovery determines how the regulator's activities will be funded and the extent to which the funding arrangements drive the regulator to operate efficiently, minimising its own costs and the costs that regulation imposes on the regulated industry. It is, therefore, a critical component of the regulatory framework. The approach to cost recovery has implications for the issues raised in preceding chapters. If, for example, cost recovery arrangements do not place appropriate financial constraints on the regulator, they can allow the expansion of regulatory activities and exacerbate problems associated with poorly defined objectives and a lack of transparent and well-structured performance reporting.

This chapter analyses the benefits of having efficient cost recovery arrangements in the housing construction sector. It draws on the framework developed in appendix B to test individual arrangements against that framework and examines how they might be improved.

## 11.2 Designing efficient and fair fees and charges

Depending on their design, cost recovery arrangements can influence the behaviour of businesses, consumers and regulators. In principle, the level of charges may affect the competitiveness of different types of business or the cost of housing for consumers. But in Victoria, the amount of money collected via cost recovery charges represents a very small share of the total value of housing construction in the state. Cost recovery charges can have a significant effect, however, in influencing the behaviour of regulators and ultimately, the costs to industry and consumers of complying with regulation.

As noted, cost recovery arrangements that do not place appropriate financial constraints on the regulator can allow the expansion of regulatory activities and exacerbate problems associated with poorly defined objectives and a lack of transparent and well-structured performance reporting. Conversely, well-designed cost recovery arrangements may lead to a number of benefits:

- ensuring the cost of the regulated product incorporates all the relevant costs of bringing that product to market, including an appropriate portion of the costs of administering regulation
- ensuring activities that require high levels of regulation, reflecting their social and environmental effects, are not given an advantage over activities requiring low levels of regulation because they do not have to meet the costs of that regulation
- avoiding the efficiency losses from collecting tax revenue to fund the administration of regulation
- greater perceived fairness from avoiding having all taxpayers pay for the costs of regulation when they have no involvement in the regulated industry.

Inquiry participants had mixed views about the appropriateness of cost recovery arrangements for housing construction regulation. Concerns were expressed about the clarity, scope and levels of cost recovery in housing construction regulation. While these concerns are outlined in more detail below, Victoria has no existing framework to objectively assess them—that is, Victoria does not have a cost recovery framework against which the Victorian Competition and Efficiency Commission could assess cost recovery arrangements in the housing construction sector. The *Victorian guide to regulation* (State Government of Victoria 2005b) and the *Guidelines for setting fees and user-charges imposed by departments and general government agencies 2005-06* (DTF 2005) comment on cost recovery charges, but are not comprehensive assessment frameworks. The *Building Act 1993* (Vic.) (s188) allows the minister to issue guidelines for setting fees and charges, but these guidelines appear to set actual fees or fee bands, rather than principles for determining fees.

In its draft inquiry report on *Regulation and regional Victoria* (VCEC 2005b), the Commission concluded that there is scope to improve the clarity of cost recovery arrangements in Victoria. It pointed to a need for regulatory agencies to receive additional guidance on how to ensure charges are set according to an efficient cost base, how to split costs between industry and taxpayers, and how to design robust cost recovery arrangements that do not generate unintended incentives.

To assess Victorian cost recovery arrangements for housing construction regulation, the Commission compiled a framework based on guidance available in Victoria, other parts of Australia and overseas. The framework consists of a series of questions that are fundamental to determining whether cost recovery arrangements are appropriate, who should bear the costs and how the costs should be designed. It applies to regulatory charges—that is, the charges that regulators use to recover the costs of administering regulation. The framework is summarised in box 11.1 and detailed in appendix B. The following sections apply the framework to fees and charges in the housing construction sector.

### **Box 11.1 Framework for assessing cost recovery arrangements**

*Question 1: Should the regulators continue to be funded through cost recovery charges?*

- Have the activities subject to cost recovery charges been clearly identified?
- Should the regulated industry meet the costs of regulation?
- Are there economic reasons that cost recovery would be inefficient and thus inappropriate?
- Is it practical to charge?
- Would charging undermine other government policy objectives?

*Question 2: Are cost recovery charges calculated on an efficient cost base?*

- Is the level of regulation appropriate?
- Are the charges based on efficient costs?

*Question 3: Are charges structured appropriately?*

- Are the charges imposed on the right group?
- Is the charging structure appropriate, with the necessary legal authority?
- Would the charge stifle competition or innovation?

*Question 4: Are there other mechanisms to ensure ongoing efficiency?*

- Do the regulatory instruments and the processes used to set charges encourage efficiency and fairness?
- Are there appropriate mechanisms for consultation, monitoring and review?
- Do governance arrangements place pressure on regulators to maintain their efficiency?

Source: Based on appendix B.

### 11.3 Fees and charges in the housing construction sector

The Building Commission manages the building administration fund to pay for its running costs and those of boards established under the Building Act. It must pay all money received (mainly from the following three sources) into this fund:

- (1) a building permit levy of 0.064 cents for every dollar of the cost of building work over \$10 000, payable to building surveyors before they issue permits. The levy funds the Building Commission and associated regulators to cover the administration and regulatory costs of building control in Victoria.
- (2) a building permit levy of 0.064 cents for every dollar of the cost of building work over \$10 000, to fund BACV
- (3) a building permit levy of 0.032 cents for every dollar of the cost of building work over \$10 000, to fund insurance liabilities from the HHH collapse.

In addition, fees are prescribed under the Building Regulations. They include fees for requests for information on building permits, lodgement fees, Building Appeals Board fees, building product accreditation fees and cooling tower system annual registration and renewal fees. Some revenue is collected on behalf of other agencies—for example, cooling tower registration fees transferred to the Department of Human Services and the building permit levy collected for the HHH rescue package is paid into the domestic building (HHH) administration fund, which the Housing Guarantee Fund Ltd administers.<sup>1</sup>

The Building Commission also transfers 50 per cent of the BACV building permit levy to the domestic building fund administered by Consumer Affairs Victoria (43.4 per cent before 1 January 2005) (sub. DR166, p. 16). The most significant use of the domestic building fund is Consumer Affairs Victoria's administration of the *Domestic Building Contracts Act 1995* (Vic.) (which includes operating BACV and conducting education campaigns for consumers and builders) and the Victorian Civil and Administrative Tribunal's domestic building list and civil claims list. Half of the registration fees for domestic builders are also forwarded to Consumer Affairs Victoria and the Victorian Civil and Administrative Tribunal to maintain the domestic building list.

The Building Act, s188(1)(a), provides that the minister may issue guidelines for fees charged under the Act: 'Guidelines relating to the fees chargeable ... in respect of domestic builders may take into account the costs and expenses incurred in the administration and enforcement of the *Domestic Building Contracts Act 1995* and the Regulations under that Act'. Fee guidelines may specify

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<sup>1</sup> The HHH levy is not considered further here because it is not a cost recovery charge and is due to expire.

maximum or minimum fees and different fees for different classes of case (s188(2)(a) and (b)). The guidelines have differing degrees of force:

- Council or private building surveyors *may* have regard for the guidelines (s188(4)).
- The Building Practitioners Board and the Building Commission *must* have regard for the guidelines (s188(5) and (6)).

As an example, the guideline relating to Building Practitioners Board fees lists 19 different application and registration fees.

Table 11.1 shows the Building Commission's sources of revenue from operating activities in 2002-03 and 2003-04. Of its total revenue of almost \$18.7 million in 2003-04, \$15 million (80.6 per cent) was raised from levies and \$1.8 million (9.6 per cent) was raised from building practitioner registrations. Miscellaneous revenue sources in 2003-04 included items such as receipts from sales of publications (\$51 576), fines (\$58 016),<sup>2</sup> permits, inspection and accreditation fees (\$82 781), contributions from the Green Building Council of Australia (\$110 000) and 'miscellaneous revenues' (\$195 000).

**Table 11.1 Building Commission revenue from ordinary activities**

	<i>2002-03</i> (\$)	<i>2003-04</i> (\$)
<b>Revenue from operating activities</b>		
Building permit levy—general levy	8 899 295	9 667 099
Building permit levy—BACV levy	3 872 188	5 370 157
Building practitioner registrations	1 657 004	1 786 626
Cooling tower registrations	222 427	324 594
Modifications and appeals	267 940	222 323
Prosecutions	238 419	76 996
Miscellaneous revenue	511 831	508 068
<b>Total revenue from operating activities</b>	<b>15 669 104</b>	<b>17 955 863</b>
<b>Other revenue</b>	<b>582 279</b>	<b>702 422</b>
<b>Total revenue</b>	<b>16 251 383</b>	<b>18 658 285</b>

Source: BC 2004a.

<sup>2</sup> The purpose of a fine is to provide an effective and fair deterrent. It is not a cost recovery charge and, therefore, is not discussed in this chapter.

**Table 11.2 Building Commission expenditure on ordinary activities**

	<i>2002-03</i>	<i>2003-04</i>
	(\$)	(\$)
<b>Expenditure on ordinary activities</b>		
Salaries and related costs (excluding superannuation)	5 501 478	5 935 304
Superannuation	687 022	732 422
General administration costs	5 922 721	7 170 762
Accommodation charges	1 235 677	1 336 206
Board and committee fees	324 104	429 001
Grant—Australian Building Codes Board	321 900	319 863
Corporate services charges	473 174	556 040
Depreciation	858 538	935 751
Written down-value of fixed assets sold	338 234	344 644
Audit fees	12 000	12 100
<b>Total expenditure from ordinary activities</b>	<b>15 674 848</b>	<b>17 772 093</b>

Source: BC 2004a.

**Table 11.3 Plumbing Industry Commission revenue**

	<i>2002-03</i>	<i>2003-04</i>
	(\$)	(\$)
<b>Fees</b>		
Registrations	642 896	665 775
Licences	1 769 531	1 880 532
Certificates of compliance	4 835 735	5 285 934
Special audits and inspections	99 147	105 177
Examinations	84 585	85 022
Other fees	57 600	65 024
Sale of publications	81 563	87 865
Other	530 587	698 670
<b>Total revenue</b>	<b>8 273 424</b>	<b>9 201 602</b>

Source: PIC 2004a.

There is no public information on how the Building Commission allocates revenue among the various statutory entities. Table 11.2 shows expenditure by the Building Commission. In addition, a substantial amount of money (\$4.4 million) was spent in 2003-04 on special projects that are reported as part



of general administration costs but not explained in the annual report (BC 2004a, p. 61). Chapter 10 discusses financial reporting issues.

In contrast to the Building Commission, 88 per cent of the PIC revenue comes from fees and charges, and none comes from levies (table 11.3). Table 11.4 lists the PIC's expenditure on ordinary activities.

**Table 11.4 Plumbing Industry Commission expenditure on ordinary activities**

	<i>2002-03</i>	<i>2003-04</i>
	(\$)	(\$)
<b>Expenses from ordinary activities</b>		
Advertising and promotion	287 567	369 580
Audit, legal and consultants fees	127 103	161 185
Cost of publication sales	60 676	66 574
Depreciation and amortisation	307 645	300 292
Electronic data processing expenses	437 450	448 758
Education and examination expenses	156 545	182 365
General administration costs	147 179	162 977
Office occupancy costs	158 111	160 668
Office rent	67 623	27 831
Postages	125 062	75 627
Plumbing inspections and audits	1 621 794	1 690 319
Printing and stationery	250 969	284 968
Salaries and related expenses	3 449 893	3 812 462
Telephone	306 082	300 926
Travelling and motor vehicle expenses	214 365	293 402
Written-down value of assets sold	437 793	460 179
<b>Total expenses</b>	<b>8 155 857</b>	<b>8 798 383</b>

Source: PIC 2004a.

## **11.4 Whether the regulators should continue to be funded through cost recovery charges**

### **11.4.1 Analysing the activities subject to cost recovery**

Some inquiry participants were concerned about the lack of clarity in the link between the building levy and the activities of the Building Commission. This lack of clarity creates scepticism about whether the revenue from charges is used appropriately. The Builders Collective of Australia said:

What is this levy for and where is the money directly spent? We would like to see a full audit into these funds as soon as possible as many builders are continually frustrated that the [Building] Commission is not managing the industry at all well. (sub. 38, p. 12)

Reddo Pty Ltd raised similar concerns (sub. 70, p. 5). Stuart McLennan and Associates argued that research and development are a major reason for introducing the building levy, but criticised the Building Commission for not giving enough attention to the development of innovative construction processes (sub. 65, p. 9). Appendix B notes that before considering cost recovery charges, it is necessary to understand the activities for which costs are being recovered.

### **11.4.2 Should industry meet the costs of regulation?**

As noted, the regulated industry meets all of the Building Commission's costs. Appendix B discusses two models—beneficiary pays and regulated industry pays—for determining how much the industry should contribute to funding the government's costs of administering regulation, once it has decided that regulation should be introduced. The appendix notes that the guides produced by the Victorian Government appear to favour a beneficiary pays approach. This section looks at cost recovery in the housing construction sector against both models and identifies the differences between the two approaches.

Analysing the Building Commission's charges against a beneficiary pays approach involves identifying whether the beneficiaries of the Commission's activities are within the housing construction sector (businesses and their customers) or outside the sector (third parties). Chapter 3 discussed the justification for regulation in the housing construction sector. It notes that some regulation is intended to benefit those in the industry, particularly consumers, and some is designed to benefit third parties, like the neighbours of those doing building work or the general community. The Building Commission is involved in a range of activities including:

- researching better ways to design and construct buildings to improve access for all people, and jointly funding research to plan for the future supply of accessible housing
- assisting the Democratic Republic of East Timor to finalise its building control system, and developing a practitioner registration system in New Zealand
- developing and implementing *pulse*<sup>o</sup> as a public, central source of industry statistics
- helping implement the 5 Star standard for new homes and the Green Building Mission to investigate emerging trends in green building design and construction

- partnering research into sustainable subdivisions and accessible housing
- managing a legislative program and funding the Building Regulations Advisory Committee to review and develop regulation, including regulation that enhances building amenity for neighbours and the local community (BC 2004a).

The amounts spent on such activities are not itemised in the Building Commission's annual report. Some beneficiaries of these activities are outside the Victorian housing construction sector. They include people in other countries, the general community, the neighbours of those undertaking building activity and people with disabilities. Under the beneficiary pays approach full cost recovery from the Victorian industry would be inappropriate. In several cases, it would also be impractical to levy charges on these other groups of beneficiaries. For this reason, alternative funding (such as taxpayer funding) may be necessary.

The alternative is to adopt a regulated industry pays model. Under this approach, if the characteristics of the industry, or the activities of businesses or consumers in that industry, generated the need for regulation, that industry should meet the costs of the regulation. This approach is justified because it ensures the costs of the products and services within the industry incorporate all the costs of bringing those products and services to market, including the costs of regulation (appendix B). Using this benchmark, a higher level of cost recovery from the regulated industry is justified, because most of the activities listed above are designed to address deficiencies or problems in the Victorian housing construction sector. Possible exceptions, however, are:

- helping develop the housing construction industry overseas
- developing new policy proposals and providing policy advice to government.

It could be argued that the Building Commission's motivation for contributing to the housing construction industry overseas does not stem from problems in the Victorian industry. In response to questions from the Victorian Competition and Efficiency Commission, the Building Commission stated that the East Timor project was undertaken at the request of the Premier in 2000-01 as a goodwill gesture and is completely funded by the Building Commission (BC 2005c). While the Victorian Government may assess that such projects are in the state's interest, funding activities directly (for example, through a direct payment to the Building Commission) would be a more transparent approach.

Whether cost recovery, under the regulated industry pays model, should fund activities related to policy development is a more complex issue. It might be argued that the need to provide advice stems from problems or emerging issues within the industry and that the industry, therefore, should pay for these activities. This approach, however, is inconsistent with that in many other industries. As discussed in chapter 9, primary responsibility for the development of new policy proposals is not an appropriate function of independent regulators.

Other industries are not required to meet the cost of policy development, which instead is typically funded from the state Budget. If the chapter 9 recommendations to reduce the Building Commission's and the PIC's involvement in policy issues were adopted, the significance of this issue for cost recovery arrangements would be reduced considerably.

### **Assessing whether cost recovery is appropriate, efficient and practical**

For most of the main regulatory activities in the housing construction sector, there do not appear to be any economic reasons that cost recovery should not be imposed. Further, given the current arrangements, charging appears to be practical. One possible exception is charging third parties if a beneficiary pays approach for cost recovery is adopted. Economic and practicality issues can also affect the type of fee or levy used (chapter 6).

### **Protecting other government policy objectives**

For most major regulatory activities in the housing construction sector, cost recovery does not appear to undermine other government policy objectives. The PIC took account of policies such as promoting self-certification, maintaining the significance of certificates and promoting compliance when it set cost recovery charges for compliance certificates. It also took compliance into account when setting licence and registration fees (sub. 84, pp. 101–2).

### **The Commission's view**

In its analysis in chapters 8, 9 and 10, the Commission concluded that:

- the objectives of building legislation need to be clarified
- the government should provide greater guidance to the regulators
- the regulators have too many open-ended functions, and their activities should be constrained
- more transparency and appropriate performance reporting are needed.

These conclusions are reinforced by the evidence that the Building Commission, in particular, does not clearly identify its cost recovery requirements based on an analysis of (a) the activities in which it should be involved and (b) the appropriate level of those activities. The lack of clarity about the basis for cost recovery could lead to the impression that the level of revenue is driving the level of activity that the Building Commission undertakes.

The annual report of the Building Commission noted:

The [Building] Commission's Reserves Policy directs additional revenue into expenditure on building industry research and the development of the [Building] Commission's services to the industry.<sup>3</sup> (BC 2004a, p. 10)

The government does not appear to have considered whether additional revenue generated by the levy in recent years would warrant reducing the levy, rather than increasing activity by the Building Commission. Such an analysis is inhibited by a lack of information on how much the Building Commission spends on various activities. The National Competition Policy review of building regulation, in its discussion of deficiencies in transparency and the effect of the building levy on efficiency, argued:

Disclosures about special projects expenditure should reveal what benefits were derived and how such expenditure is in furtherance of the legislative objectives. (Freehills Regulatory Group 1999, p. 77)

Other regulatory agencies in the housing construction sector, such as the PIC, appear to have charges that are directly linked to their activities, and potentially less discretion about the activities in which they engage (sub. 84, p. 102). The PIC claimed that the objectives of its regulatory activities were considered in the setting of cost recovery charges (sub. 84, p. 102). However, it is unclear how thoroughly the regulatory activities and the objectives of those activities were analysed before charges were set.

Overall, this lack of clarity generates a risk that regulators' activities are too broad and, therefore, that the cost recovery charges needed to fund those activities are too high. The potential for charges to be too high is exacerbated because some activities are inappropriately funded through cost recovery. The Commission considers that (a) work undertaken overseas to assist foreign governments and (b) policy development and advice should not be funded by cost recovery charges. Further, if a beneficiary pays model is adopted the extension of cost recovery to activities that benefit third parties is also questionable.

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<sup>3</sup> There is no further information about the Building Commission's Reserves Policy in its annual report other than the Building Advisory Council ratified the policy.

### **Finding 11.1**

The Commission considers that cost recovery is an appropriate way to fund the administration costs of regulatory activities in the housing construction sector. However:

- agencies, particularly the Building Commission, do not link their regulatory activities closely enough to their cost recovery arrangements
- under a beneficiary pays model, full cost recovery is inappropriate for regulatory activities that benefit third parties
- agencies should not use cost recovery to fund policy development or activities that benefit the housing construction industry overseas.

### **11.4.3 Are cost recovery charges calculated on an efficient cost base?**

#### **Considering the appropriate level of regulation**

Several inquiry participants linked concerns about the level of regulation to its impact on cost recovery charges. Plumbers Choice argued that the cost of compliance certificates is too high because the minimum limit for jobs requiring a certificate of compliance is too low and one project is required to obtain several certificates if specialist plumbers are used on different tasks (sub. 3, p. 3). The Residential Metal Roofing Industry Association of Victoria and BlueScope Steel made similar claims (sub. 23, p. 9; sub. 48, p. 5). The City of Boroondara was concerned about whether the Building Commission is using its revenue appropriately and argued that an audit is needed (sub. 66, p. 4). The Property Council of Australia argued that the use of the building permit levy, the HHH levy and the BACV levy should be transparently reported, and that the HHH levy and the BACV levy should be reviewed to determine whether they are necessary (sub. 69, p. 5).

#### **Ensuring charges are based on efficient costs**

The PIC argued that it bases cost recovery charges for its key regulatory activities (issuing compliance certificates, and licensing and registering plumbers) on efficient cost. The link between costs and charges is enhanced because 88 per cent of revenue is generated from direct fees for specific regulatory activities:

In essence, the overall level of PIC fees more or less matches the minimum operating expense required to adequately fulfil the commission's legislated responsibilities. (sub. 84, p. 102)

The PIC also argued that the efficiency of its activities is maintained because:

Sixty-five per cent of the PIC's total expenditure in 2003-04 resulted from just two expense items: the audits and inspections contract; [and] staff salaries and related expenses. The audits and inspections contract is subject to an open competitive tender process every three years and, in the view of the PIC, is performed at minimum cost. The staffing cost is fully in line with Victorian public sector standards. (sub. 84, p. 102)

When these fees were analysed in the regulatory impact statement (RIS) on the proposed Plumbing Regulations 1998, the costs of assessing licensees were considered. The RIS noted that the fees for examinations were split depending on whether the candidate undertook a theory and practical examination, because the two processes had different costs. However, the RIS did not provide a comprehensive analysis of the efficiency of the cost base on which the fees were calculated.

In response to questions from the Commission, the Building Commission stated that it ensures it is operating efficiently because it has:

Mechanisms and processes in place to develop, record, scrutinize and report on [Building Commission] activities and expenditure. Reports presented include report to the minister, the boards, the BACV steering committee, and regular internal reviews are conducted. The Auditor-General conducts an annual review, and a bi-annual VMIA [Victorian Managed Insurance Authority] risk assessment is carried out. (BC 2005c)

The Department of Sustainability and Environment was concerned about the sustainability of the Building Commission's funding:

Additional funding is sourced from the general levy collection however there are concerns about reliance on this funding source in case of a downturn in the industry and the corresponding levy contraction.

Further, in times of activity troughs it is expected that demand for complaint and dispute resolution services will increase. The [Building Commission] needs to have a method of sustainable service delivery to consumers and the industry in these low activity periods. (sub. 84, p. 33)

Other inquiry participants, such as Plan Scan, were critical of the relationship between costs and charges for activities undertaken by local government. This problem is illustrated by a lack of consistency in the charges set by different local governments for similar activities. The same information could be free from one council and cost as much as \$80 or \$90 from another:

The same matter should cost the same no matter which council is involved. There is no competition for the individual councils and at present they can set their fees at whatever level they wish. (sub. 44, p. 7)

Plan Scan argued that similar information provided by sewerage authorities costs only \$20 and that the fees charged by local councils should be regulated. One local government, however, argued that the fees set in regulation do not adequately reflect the costs of undertaking the activities. The City of Boroondara said:

The fees set in the Regulations, such as lodgement fees, or fees for providing property information, have not been reviewed in the last 10 years and have stayed at the same level since the introduction of the Building Regulations, while the cost of providing this service has increased substantially. An annual review of these statutory fees is recommended. (sub. 66, p. 3)

The Commission has not been provided with sufficient information during this inquiry to analyse whether an appropriate framework is used to calculate councils' cost recovery charges.

### **Cost recovery by the Building Commission and the Plumbing Industry Commission**

Cost recovery can compound the costs of inappropriate or inefficient regulation or activities by regulators. Chapter 9 recommends that the Building Commission and the PIC should not have primary responsibility for policy development and providing policy advice to government, and that the research they undertake or fund should be restricted to issues directly relevant to achieving best practice regulation. It also recommends that the Building Commission should not have a role in 'industry leadership' or undertake activities that promote the housing construction industry overseas. It is also inappropriate, therefore, to use cost recovery charges to recoup the costs of these activities.

In addition to the need for the level of regulation to be efficient, charges for regulation should be based on efficient costs. The PIC appears to have several strategies in place (including the use of competitive tendering) that help maintain an efficient cost base. The Victorian Competition and Efficiency Commission agrees that competitive tendering is a good way to improve service delivery efficiency.

For the Building Commission, it is virtually impossible to establish a link between the efficient costs of each regulatory activity and the level of cost recovery charges—for example:

In 2003-2004 the BACV levy was \$9.462 million with the [Building Commission] receiving \$5.354 million and CAV/VCAT \$4.107 million. The [Building Commission and] BACV related expenditure was \$3.362 million and \$0.85 million was allocated to a BACV Reserve ... The additional BACV revenue was allocated to building industry and community projects in accordance with the [Building Commission] Reserves Policy. (BC 2005c)



The Building Commission predicts that expenditure on building industry and community projects will fall as a result of an ‘anticipated decline in the levy due to the projected downturn in building activity and projected increase in BACV expenditure’ (BC 2005c). This statement might support the impression that expenditure on these projects is driven by the availability of funds, not by an assessment of the relative worth of the projects. The National Competition Policy review of building regulation argued that cost recovery in the housing construction industry is not based on costs and should be based on a cost-reflective formula (Freehills Regulatory Group 1999, p. 77).

Even for Building Commission activities that are subject to direct fees, the relationship between the fees and activity costs is weak. The Department of Sustainability and Environment argued that the most significant fees (charges for registering building practitioners) do not cover the costs of the registration system:

Fees for registration renewal have not increased since the regime was introduced in 1993 despite substantial increase in services. Small increases for assessment were introduced some years ago to strive for better cost recovery. However services provided by the [Building Commission] related to registration have increased substantially since that time.

The registration fee structure was set on a fixed basis historically, and has failed to keep pace with inflation and these expanded services. Current registration fees are well under the market rate and represent the lowest industry registration costs in the nation. This signals a need for a review to bring fees more in line with costs to ensure a sustainable system. (sub. 84, p. 75)

These fees are, however, above licence fees in some other industries. The annual licence renewal fee charged by the Building Practitioners Board (\$180) is high compared with those for some other occupations. According to information from the Victorian Institute of Teaching, the annual registration fee for a teacher in Victoria is \$60, compared with the annual registration fees for nurses (\$80), architects (\$150) and medical practitioners (\$375) (Victorian Institute of Teaching 2005). The Department of Sustainability and Environment, however, presented data showing that licence fees for Victorian builders (at least for renewals) are generally less than those for builders in other states (sub. 84, pp. 31–2).

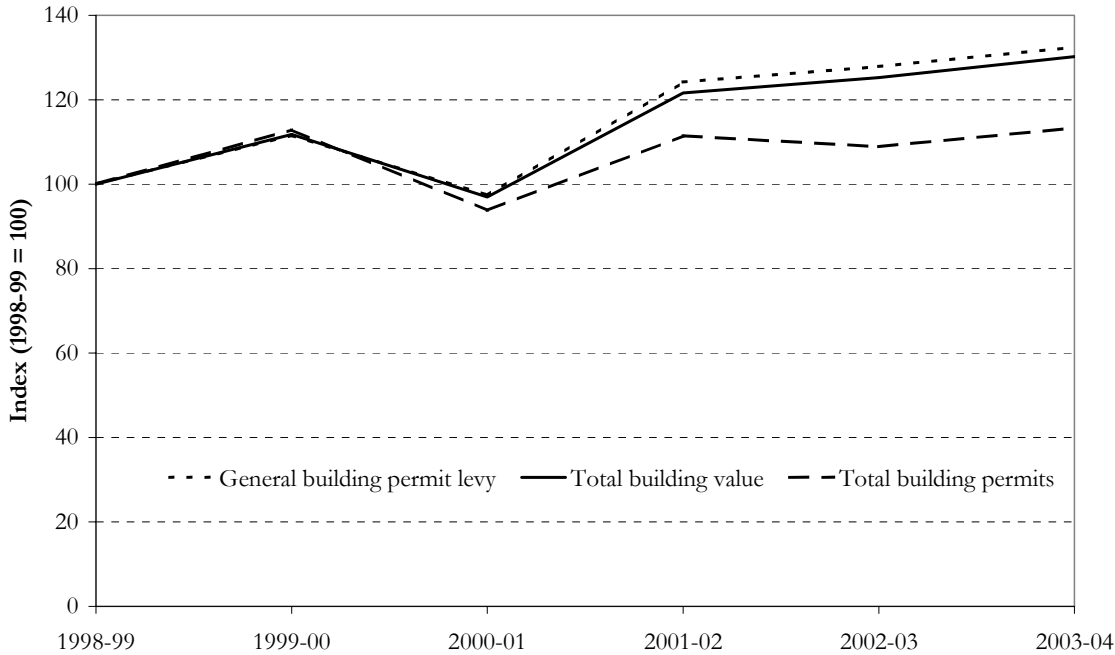
The levy used to collect the majority of the Building Commission’s funding is linked to the value of building work. There does not seem to be a strong link, however, between the Building Commission’s activities (at least as indicated by the total number of building permits issued each year) and the total value of building activity. Over time, the amount collected through the building levy has increased significantly, with levy revenue rising by about 33 per cent (in real terms) since 1998-99 (figure 11.1). In comparison, the total number of building permits has risen by around 13 per cent.

While some analysts predict a fall in building activity, it is unclear whether this fall would put the financial viability of the Building Commission at risk. If building activity were to decline, the effect on the levy would be at least partly offset by any increase in the price of housing construction.

The Reserve Bank of Australia expects that the average value of new dwellings will continue to grow:

The downturn in dwelling investment that appears to be in train is likely to be mild by historical standards. While the fall in medium-density building approvals from their peak is within the range of previous experience, the fall in approvals for houses, which make up the bulk of dwelling investment, has not been as rapid or as large to date as those observed in previous cycles. Furthermore, underlying demand is at a relatively high level and employment conditions remain favourable. Work yet to be done also remains at a high level and the continued growth in the average value of new dwellings is likely to temper further the expected fall in new dwelling investment. (RBA 2005b, pp. 29–30)

**Figure 11.1 Real value of building construction,<sup>a</sup> the general building permit levy and building permits**



<sup>a</sup> Building construction includes housing and commercial construction as defined by the Building Commission (box 2.1). The values of building construction and the building permit levy were deflated using the ABS price index for the value of total building work done.

Sources: ABS 2004b; BC 2004a, 2002a, undated A.

In addition, the second reading speech for the Building Bill in 1993 anticipated that the level of resources available to the Building Commission would fluctuate with the level of activity in the building industry:

[The Building Commission] will be funded from a levy on building permits, also introduced under this legislation. To properly carry out its function the commission must have the resources to ensure that it can fulfil its role effectively and so that its responsiveness to the building industry can be maximised.

The Bill will allow staff to be employed either as public servants or outside the Public Sector Management Act. That will give the commission greater flexibility in the recruitment and management of its staff. In particular, it will enable the staffing numbers of the commission to respond when the building industry is buoyant and to be reduced when activity is slow. (Maclellan 1993, p. 1689)

Rather than fluctuating with the level of building activity, the general building permit levy has been rising because the levy is based on the value of building construction, and increases in the value of building construction have exceeded increases in the level of activity. Some increase in levy revenue may also be due to an increasing proportion of projects falling over the levy threshold, as the costs of building materials and labour rise. Combined with the Victorian Competition and Efficiency Commission's concerns about (a) the lack of clarity in the Building Commission's objectives and (b) insufficient constraints on the Building Commission's activities, this suggests there is potential to reduce cost recovery charges in the housing construction industry and to review the threshold for payment of the general building levy.

### **Recovery of collection costs incurred by building surveyors**

Several inquiry participants questioned whether cost recovery charges should compensate surveyors and local government for collecting industry levies on behalf of the Building Commission (see, for example, the Australian Institute of Building Surveyors—Victorian Chapter, sub. 41 p. 3; Macedon Ranges Shire Council, sub. 50, p. 4; Reddo, sub. 70, p. 5). While such an approach would increase transparency, the additional costs to administer it may not be justified, particularly given that surveyors would, presumably, already pass on to consumers the cost of collecting levies (via the cost of the surveyor's services). It is less clear how councils recover these costs.

### **Finding 11.2**

The links between the cost of regulatory activities and the level of cost recovery charges for the Building Commission, in particular, are weak. There is a significant risk that charges are based on inefficient costs and include the costs of inappropriate activities being undertaken by the regulator. Also, the costs of some regulatory activities are not well understood or directly linked to charges.

## **11.4.4 Are charges structured appropriately?**

### **Levying charges on the right groups**

The PIC has a relatively disaggregated charging mechanism, with charges linked to different types of activity and levied on those who access each activity. Many local government fees are also linked to specific activities. In contrast, the building permit levy is a percentage of the value of building work across all building permits. Because the levy is divorced from the activities of the Building Commission, there is a greater risk of it being charged to groups that are not responsible for, or do not benefit from, the regulatory activities. Cross-subsidies are a further risk, whereby one group pays for costs that should be imposed on another group.

Similarly, the BACV levy, imposed on all building permits over \$10 000, lacks a clear nexus with those who might use the services that the levy supports. On this issue, the Master Builders Association of Victoria noted ‘commercial builders cannot make use of the BACV system for dispute resolution and so are paying for a service they cannot access’ and recommended that ‘the additional 0.064 per cent [BACV levy] not be applied to non-residential projects’ (sub. 49, p. 16). The Property Council of Australia, too, noted that ‘A large portion of the levy is collected from commercial builders who would receive little, if any benefit from the service’ (sub. 69, p. 5).

It is anomalous that a levy to finance a dispute resolution service—introduced to substitute for consumer protection when so-called ‘first resort’ home warranty insurance was removed—should apply to non-residential building activity. The Victorian Competition and Efficiency Commission considers that it is inappropriate for the BACV levy to apply to permits for activity not formerly subject to that warranty insurance. In its draft inquiry report, it thus recommended that the BACV levy should apply only to those permits for residential construction. A number of inquiry participants supported this recommendation (see, for example, the Australian Institute of Building Surveyors, sub. DR130, p. 3; City of Melbourne, sub. DR136, p. 13; Macedon Ranges Shire Council, sub. DR146; MBAV, sub. DR151, p. 21; Property Council of Australia–Victoria Division, sub. DR134, p. 5).

### **Finding 11.3**

The application of the Building Advice and Conciliation Victoria (BACV) levy is not linked to activities to which the BACV services are related. It is inappropriate for the BACV levy to apply to all building activity rather than just that formerly covered by so-called ‘first resort’ home builders warranty insurance.

Consumer Affairs Victoria, however, opposes the limitation of the BACV levy to domestic building activity:

The potential negative impacts of the changes on both consumers and the industry outweigh any advantages in removing the application of the levy to commercial building projects...

The DBF [domestic building fund] requires a substantial reserve to ensure that it will be able to continue to meet expenditure on domestic building related activities to safeguard against any future downturn in building activity ... if funding of the DBCA [Domestic Building Contracts Act] administration and enforcement is to be maintained, the levy would probably need to increase from its current level for domestic building projects. This is likely to increase the cost of domestic building projects and may have unintended negative impact on domestic building activity at a time when the industry is experiencing a downturn. (sub. DR166, pp. 6, 16–17)

A number of other inquiry participants also pointed out that an implication of the Commission’s recommendation is reduced funds for the BACV services (sub. DR134; sub. DR151; sub. DR172). The Department of Sustainability and Environment noted that there would be a \$3.37 million shortfall and, given the likely increase in demand for the service as consumers become better informed, that alternative sources of funds are required to maintain the current level of service provision (sub. DR172, p. 24). The Building Advisory Council also shared this concern (sub. DR154, p. 9). Increased funding would also be required if the service were to be made available to domestic builders (MBAV, sub. DR151, pp. 21–2). Suggested options to recover the shortfall include increasing the levy on domestic building permits, using other revenue sources to cross-subsidise the service or introducing service fees for users (DSE, sub. DR172, p. 24).

The Master Builders Association of Victoria also suggested that saving administrative costs, charging a progressive fee (where complex claims are charged more) and obtaining government funding are alternative ways to make up the shortfall (sub. DR151, pp. 21–2). The HIA, however, was concerned about additional costs that this recommendation may impose on the industry, and it suggested that all levies and expenditure activities be examined (sub. DR163, p. 29). The National Association of Steel-Framed Housing, on the other hand, considered that a levy would not be necessary if defects did not

occur in the first place; it thus called for better training, supervision and quality auditing (sub. DR122, p. 4).

Consumer Affairs Victoria suggested ‘that the levy could be rebalanced and possibly reduced but the base of the levy continue to apply to both commercial and domestic building permits’ (sub. DR166, p. 17). This option, however, is inconsistent with the Commission’s assessment that it is inappropriate for a group to pay for costs if it does not benefit from the regulated activity.

The Commission notes that a shortfall may not be imminent, given that the domestic building fund had surplus equity of \$3.3 million in 2003-04 (CAV 2004a, p. 135). If there is a shortfall as a result of the BACV levy applying only to domestic building permits, and if the level of the BACV levy remains unchanged, the Building Commission, Consumer Affairs Victoria and the Victorian Civil and Administrative Tribunal may need to reassess the levy level. Alternatively, a fee could be charged for consumer and builder complaints, as suggested by some inquiry participants. But this should be done only after a thorough assessment of the efficiency of service delivery, using the principles outlined in appendix B.

#### **Recommendation 11.1**

**That the Building Advice and Conciliation Victoria levy apply only to building permits for residential building activity, corresponding with building activity formerly covered by so-called ‘first resort’ builders warranty insurance.**

#### **Developing well-structured charges with the necessary legal authority**

As noted, the PIC uses fees as its primary funding mechanism, whereas the Building Commission uses levies. The Office of the Chief Electrical Inspector also relies heavily on fees for specific regulatory activities. While 74 per cent of its activities are funded through fees, these fees cover all of its housing construction related work. The remaining 26 per cent of activity is funded by a levy on electricity suppliers, which is used to ensure compliance with the *Electricity Safety Act 1998* (Vic.) and Regulations (OCEI 2004).

There is a range of views on the appropriate charging structure. The Municipal Association of Victoria and the City of Boroondara supported the use of a levy to fund the Building Commission (sub. 64, p. 7; sub. 66, p. 8). The Communications, Electrical Plumbing Union—Plumbing Division argued that the fee for compliance certificates should vary based on the size of the building (sub. 25, p. 6). As discussed in appendix B, cost recovery charges should be imposed wherever practicable using fees on those who access specific regulatory activities. That appendix also discusses the case for using a levy.

## **Avoiding charging structures that stifle innovation and competition**

The Commission has not been made aware of any significant problems with fees and charges that are stifling competition or innovation. In its RIS on the proposed Plumbing Regulations 1998, the PIC concluded that its fees would be 'unlikely to restrict entry into the market place' (PIC 2004b, p. 41).

### **The Commission's view**

Cost recovery should link the charge as closely as possible to the groups that benefit from the regulation or the groups that are regulated. This means that an industry-wide charge is appropriate where regulation applies to the whole industry, and where the level of regulatory activity (or the benefits of that activity) are similar across all groups in the industry. The provision of information to consumers about their rights and responsibilities, for example, is likely to have broad application, so funding from an industry-wide charge would be one option. Other types of regulation would have less uniform effects. Different levels of regulation may be required, for example, for different types of registered builder. This context should be considered when designing registration fees, to determine whether differentiated fees are appropriate.

The risk of charges being imposed on the wrong group is increased the more aggregated is the charging system used. This risk is particularly high for the Building Commission because it relies on levies on the value of building activity. Without detailed information on cost recovered activities and their costs and objectives, it is difficult to analyse these charges fully. However, there is evidence that funding for the Building Commission relies too heavily on industry levies. As noted, the levies are not transparently linked to Building Commission costs or regulatory activities. This arrangement generates problems (many of which have been discussed) that could include:

- reducing the incentives to maintain and improve the efficiency of the level of regulation and the costs of delivering that regulation, because the levy is separated from the activities of the Building Commission. The group that pays the levy, consumers, has little ability to put pressure on the Building Commission to improve its efficiency.
- reducing the accountability that would result from linking charges to the Building Commission's use of the revenue
- increasing the risk that the levy is not targeting the right groups within the industry
- generating a level of funding that does not reflect the legitimate needs of the Building Commission, so over-recovery and under-recovery are both a risk. The current evidence indicates that over charging is more likely.
- reducing transparency and increasing confusion and concerns about the appropriateness of the level of cost recovery.

As noted, a levy will be the only practical way of charging in some cases because those who are responsible for, or benefit from, the regulation are spread broadly across the industry, and because the level of regulatory activity, or the benefits from that activity, are similar across all groups in the industry. These activities appear to be much narrower, however, than those the Building Commission currently funds through levies.

Reducing reliance on the levy appears to be practical. Both the PIC and the Office of the Chief Electrical Inspector rely more heavily on fees, and their regulatory activities are similar to those of the Building Commission. The National Competition Policy review of Victorian building regulation also recommended changing funding for the Building Commission so there is greater reliance on cost-reflective registration fees (Freehills Regulatory Group 1999, p. 77).

#### **Finding 11.4**

The Building Commission relies too heavily on the industry levy. The levy is not transparently linked to the Building Commission's costs or regulatory activities, reducing the efficiency and effectiveness of the charge.

### **11.4.5 Are there other mechanisms to ensure ongoing efficiency?**

#### **Using regulatory instruments and processes that encourage efficiency and fairness**

Fees and charges in the housing construction sector are set through a range of instruments. For the Building Commission, levies are set in legislation, fees for appeals to the Building Appeals Board and product accreditation fees are set in regulation, other fees (such as charges for new and renewed builder registrations) are set by ministerial guidelines, and more minor fees are set at the commission's discretion. Fees for the registration and licensing of tradespeople involved in plumbing and electrical installation work are set in Regulations. Some local government charges too are set in Regulations (such as fees for requests for information relating to building permits and lodgment fees), while individual councils set other charges.

The only fees that are subject to clearly defined assessment processes—which require a comprehensive cost–benefit analysis with mandatory consultation (RISs)—are those set in Regulations. Those set by ministerial guidelines or at the discretion of the regulatory agency are not required to comply with any specified process. The requirement to subject new or amended legislation with a significant impact on competition or business to a business impact assessment (BIA) is relatively recent. The existing fees were introduced before this



requirement, so were not subject to a BIA. In addition, a BIA is a Cabinet-in-confidence document and public consultation is not mandatory.

As a result, most of the significant fees levied in the plumbing and electrical sectors would have been subject to an RIS, and future changes to these fees will be subject to that process. In contrast, most cost recovery revenue for the Building Commission is not required to undergo such a process, because it is not set in Regulations. The National Competition Policy review of building regulation expressed concern about the transparency of building permit levies:

Our opinion is that the provisions governing the funding of the legislation's administration should be framed to offer greater efficiency incentives and to provide greater transparency. (Freehills Regulatory Group 1999, p. 2)

### **Undertaking ongoing consultation, and monitoring and review of arrangements**

As noted in the previous section, the level and structure of charges for only a small amount of Building Commission revenue have been subject to an RIS process. Chapter 8 discussed the Victorian Competition and Efficiency Commission's concerns about the use of transparent review processes to scrutinise building regulation. The Building Commission's approach to consultation and review is important to achieving efficient and effective cost recovery arrangements.

Only those fees and charges set in Regulations are subject to sunseting and the need for regular review. The building levies have not been subject to a substantive review since their introduction. The processes for ongoing monitoring focus on auditing collection and compliance but not on the use of the revenue. While the Building Commission's annual report reveals the level of revenue collected, the lack of detail on (a) the commission's activities and (b) the allocation of funding to those activities makes assessing the efficiency of the cost recovery arrangements virtually impossible.

### **Adopting good governance arrangements**

Good governance is important in agencies funded through cost recovery. The reduced budget scrutiny that accompanies independent funding means other mechanisms are necessary. In chapter 10, the Commission analysed performance reporting by the Building Commission, the PIC and Consumer Affairs Victoria. It noted deficiencies in the current arrangements and recommended that the Building Commission and the PIC's annual reports include more information about the allocation of funds to related regulatory bodies and the rationale for this allocation, and about expenditure on research and development. The Commission also recommended that the agencies review their frameworks for reporting performance and have performance indicators linked to the outcomes sought in relation to their housing construction responsibilities.

## **The Commission's view**

The Commission has concerns about the processes for assessing the costs and benefits of cost recovery arrangements, particularly the levies. While the levies are not subject to the requirements to undergo an RIS process, the Commission considers that alternative mechanisms are needed to scrutinise these levies.

Several inquiry participants argued that building levies should be reviewed or audited (see, for example, sub. 32, p. 12; sub. 66, p. 4; sub. 69, p. 5). The National Competition Policy review of Victorian building regulation also stressed the need for regular reviews. It concluded that 'the levy is not cost reflective as it is fixed by the legislation without a mechanism for review' (Freehills Regulatory Group 1999, p. 77). The Department of Sustainability and Environment also noted that fees for the registration of builders have not changed in 12 years (sub. 84, p. 33). Similarly, only minor modifications have been made to the general building permit levy set in the legislation in 1993.

This failure to review cost recovery charges regularly, combined with the Commission's other concerns about the transparency of reporting and performance measurement (chapter 10), significantly increases the risk that charges will become increasingly inefficient as the links between the level and structure of the charges and the activities of the regulator break down. Adopting the recommendations on performance reporting in chapter 10 would help address governance issues in relation to cost recovery arrangements.

### **Finding 11.5**

There are no formal processes in place for transparently and independently assessing the costs and benefits of many significant cost recovery arrangements of housing construction regulators, or for regularly reviewing those arrangements. Further deficiencies in the governance arrangements are increasing the risk that cost recovery will be inefficient or ineffective, or that the revenue raised will not be used appropriately.

## 11.5 Summary

The Commission has identified several deficiencies in the setting of cost recovery fees and charges:

- Agencies, particularly the Building Commission, have not linked their regulatory activities closely enough to their cost recovery arrangements.
- The links between the cost of regulatory activities and the level of cost recovery charges are weak for the Building Commission and local government. There is a significant risk that the building permit levies are too high.
- The Building Commission relies too heavily on the building permit levies.
- There are no formal processes for transparently assessing the costs and benefits of many significant cost recovery arrangements, or regularly reviewing those arrangements.
- Governance arrangements are deficient.

One option would be to move away from cost recovery and fund the administration and regulatory costs of building control from revenue raised from Victorian taxpayers. However, as noted in finding 11.1, there is justification for using cost recovery in the housing construction sector. Moving away from cost recovery would mean forgoing the benefits of well-designed cost recovery arrangements outlined in section 11.2. The Commission thus considers that the Victorian Government should look at ways of improving the current cost recovery arrangements.

The Commission's draft inquiry report *Regulation and regional Victoria* (VCEC 2005b), concluded that there is scope to improve the clarity of cost recovery arrangements in Victoria. The Commission pointed to a need for the government to give regulatory agencies additional guidance on how to ensure charges are set according to an efficient cost base, the principles for splitting costs between industry and taxpayers, and how to design robust cost recovery arrangements that do not generate unintended incentives.

The findings of this final report reinforce the need for cost recovery guidelines. The Commission's framework in appendix B should assist in developing such guidelines. A set of cost recovery guidelines would provide a basis for ensuring recovery arrangements in the housing construction sector are efficient, effective and consistent with government policy.

## **Recommendation 11.2**

**That the Department of Treasury and Finance be responsible for developing more extensive Victorian cost recovery guidelines that better impart (a) how to ensure charges are set according to an efficient cost base, (b) the principles for splitting costs between industry and taxpayers, and (c) how to design robust cost recovery arrangements that do not generate unintended incentives. These guidelines should be developed using a consultative process and publicly released within 12 months.**

The Commission has not analysed the size of the potential reduction in building permit levies, or the best mix of levies and other charges. Such analysis is not possible without guidance from the Victorian Government on the model it wishes to use for cost recovery, and without substantially more information on the Building Commission's activities and their costs. However, there are some indications of scope for a significant reduction in the building levies.

If the Building Commission reduced its revenue requirement by 20 per cent, for example, by making efficiency gains and discontinuing some of its activities, the revenue required would fall by around \$3.7 million to \$15 million, based on 2003-04 levels. This is still above the real value of the Building Commission's revenue before 2002-03. Restructuring funding so 50 per cent of revenue is derived from direct cost recovery charges (the proportion for the PIC is 88 per cent) would allow the combined revenue from levies<sup>4</sup> to be halved.

The Commission also identified deficiencies in local government cost recovery arrangements in its report *Regulation and regional Victoria*. It recommended:

That the Food Safety Unit of the Department of Human Services, in conjunction with the Municipal Association of Victoria, work with councils to develop guidelines for setting registration fees. These guidelines and the fees charged should be reported publicly. (VCEC 2005b, p. 169)

Overall, the Commission is concerned that the use of full cost recovery, particularly for independent regulators, potentially reduces scrutiny of the agency's expenditure. In industries such as housing construction, where cost recovery is generated from levies on consumers and charges on small business, it is difficult to use industry pressure to maintain efficiency.

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<sup>4</sup> Excluding the HIIH levy, which is not a cost recovery charge but is anticipated to expire.

### **Recommendation 11.3**

**That the Victorian Government, following the release of new cost recovery guidelines, amend the Building Commission's cost recovery arrangements to make them consistent with the new guidelines, with a focus on:**

- clearly identifying the costs of the regulatory activities and designing efficient charges that are linked to those activities**
- investigating avenues to reduce the cost and range of activities undertaken by the Building Commission (consistent with the Victorian Competition and Efficiency Commission's recommendations on the objectives and activities of the Building Commission), and to reduce the size of levies and fees accordingly**
- where consistent with the application of the cost recovery guidelines, moving towards more fees for specific regulatory activities and reducing the building permit levy accordingly**
- specifying all major fees in the Building Regulations or providing an equivalent mechanism to ensure the costs and benefits of these fees are fully analysed**
- establishing a program to independently monitor and review the effectiveness and ongoing appropriateness of the charging arrangements.**

Two approaches could be used to increase the scrutiny of agencies funded by cost recovery charges. One is to require all fees and charges to be paid into consolidated revenue, so the benefits of charging are still achieved but the regulator needs to bid for funding through the budget process. Another is to set up formal review and reporting mechanisms whereby a central agency is responsible for monitoring the efficiency of services provision and the use of cost recovery. The former approach has some theoretical attraction because it places the regulator under closer government scrutiny. However, such an approach is not common, and its benefits may be difficult to substantiate. It is unclear whether the efficiency of the regulator would be scrutinised fully, given the regulator's ability to use cost recovery to offset its call on the Budget.

In Western Australia:

Each year, agencies prepare submissions to the Department of Treasury and Finance (DTF) outlining fee, revenue and cost recovery information as part of the annual budgetary process. DTF review proposals for new fees and increases to existing fees and use this information to prepare the annual State Budget.

In 2003, the Joint Standing Committee on Delegated Legislation, which can recommend to Parliament the disallowance of a Regulation that sets a new fee, imposes a higher or lower fee or deletes a fee expressed concerns about the extent of government oversight of agency fee submissions. (Auditor-General for Western Australia 2004, p. 6)

In response to these concerns, the Auditor-General recommended that the Western Australian Department of Treasury and Finance should:

... continue to improve the information agencies are required to provide and so enable DTF to enhance its review of costing and fee setting practices, with particular reference to the over recovery of costs. (Auditor-General for Western Australia 2004, p. 5)

A similar approach could be adopted in Victoria to increase scrutiny of the significant cost recovery arrangements of housing construction regulators. The information reported to the Department of Treasury and Finance and published in the budget papers should be reconcilable against the information provided in each regulatory agency's annual report.

#### **Recommendation 11.4**

**That the Department of Treasury and Finance formally monitor the implementation of its cost recovery guidelines as they impact on housing construction regulators. Relevant housing construction regulators should report annually on their cost recovered activities and revenue, and on the implementation of the Victorian Government's cost recovery guidelines.**

In general, inquiry participants supported recommendations 11.2, 11.3 and 11.4 in the Commission's draft inquiry report (see, for example, City of Melbourne, sub. DR136; HIA, sub. DR163; MBAV, sub. DR151; Moreland City Council, sub. DR158). The HIA emphasised the importance of industry involvement in developing the new cost recovery guidelines (sub. DR163, p. 29). The Moreland City Council considered that there would be benefits in reviewing 'where the regulatory costs are going and whether the money received is being directed to the appropriate use for which it was intended' (sub. DR158, p. 4). The Building Regulations Advisory Committee (sub. DR142, p. 11) considered that an investigation of ways to reduce the size of the Building Commission's fees and levies (recommendation 11.3) should consider a fee structure that is consistent, easy to understand and administer; it was concerned, however, that a user pays approach would introduce variation and uncertainty. The City of Melbourne emphasised the need for services to be priced so they are accessible to all consumers (sub. DR136, p. 14). These concerns of inquiry participants highlight the need for clearer guidance by the Victorian Government on cost recovery arrangements (recommendation 11.2).

## 12 Victoria's development contributions system

This chapter outlines recent changes in regulation affecting Victoria's development contributions system. It identifies concerns addressed in recent reviews and where (recent changes notwithstanding) regulation may not be operating well. Where shortcomings are identified, the chapter discusses how they might be addressed.

### 12.1 What are development contributions?

The Department of Sustainability and Environment noted that development contributions are:

... payments or in-kind works or facilities provided by developers towards the supply of infrastructure required to meet the future needs of a particular community, of which the development forms part. (DSE 2004)

These contributions can be raised for a range of state and local government provided infrastructure, such as roads, stormwater systems and community facilities. They are imposed to provide for local level infrastructure.

The development contributions system is part of a broader range of developer charges. Information from the department suggests that charges under the system, where they apply, account for about 10 per cent of the total cost of developer charges (table 12.1). The broader charges include land and development charges such as stamp duties, and utility charges such as levies on the provision of reticulated water, sewerage and drainage facilities under the *Water Act 1989* (Vic.). Only the development contributions system, however, is within the Victorian Competition and Efficiency Commission's terms of reference for this inquiry.

Development contributions have long been an important instrument to facilitate the timely delivery of planned infrastructure to local communities, particularly those on the urban fringe (DSE, sub. 84, p. 109). They emerged in the 1950s when local councils, faced with a shortfall in funds, began to require developers to provide sealed roads, footpaths and gutters, and to donate a portion of their land for open space (Neutz 1997, p. 117). Councils used their authority to refuse development applications under their planning powers, to coerce developers to either provide the services or pay council to do so.

Over time, these contributions were extended to cover a wider range of economic and social infrastructure (such as drainage schemes and recreational facilities), with the result that their cost to developers has increased substantially.<sup>1</sup>

## 12.2 Basis for the current development contributions system

Urban economic and social infrastructure is an area subject to substantial ‘market failure’—that is, left to itself, the market is unlikely to provide an efficient level of supply. This is generally due to the existence of externalities in consumption or the public good characteristics of the infrastructure (HIA 2003a, p. 10). This market failure underpins the intervention of government to ensure the provision of such infrastructure.

The basis for the development contributions system—whereby local councils in particular levy contributions from developers—is contained within the *Planning and Environment Act 1987* (Vic.). The Act authorises three methods for raising development contributions:

- (1) Planning permit conditions—s62 enables the application of conditions on a planning permit for development to recover the cost of the impact of that development where it necessitates a need for works, services or facilities.
- (2) Negotiated voluntary agreements—s173 enables the responsible authority (which is usually the relevant council, but might also be a state government authority) to enter an agreement with a landowner to provide works, services or facilities, or a contribution to providing these.
- (3) Development contribution plans—ss46H–46QC enable development contribution plans, which provide a system for levying contributions from multiple landowners for the provision of works, services and facilities.

Development contribution plans are expected to be the main method used to levy new development for contributions (DSE 2003a, p. 3). However, the Commission is unable to quantify the relative importance of each method because no comprehensive data on the incidence or total value of development contributions are collected.

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<sup>1</sup> A trend of increasing reliance by local government on such charges is evident in other Australian states (see The Allen Consulting Group 2003) and also overseas. In the Greater Vancouver district, for example ‘communities have become increasingly dependent on development cost charges to finance the requisite local services and infrastructure (i.e. roads, drainage, water, sewers and parks) required by new development’ (James Taylor Chair 2001, p. 1).



The Victorian system is broadly similar to the system in New South Wales, although Victoria has a narrower range of social infrastructure for which development contributions can be charged (HIA 2003a, p. 46).

## 12.3 Evolution of Victoria's development contributions system

Victoria's development contribution system has been the subject of comprehensive reviews and significant changes over the past decade. This section provides an overview of those reviews and associated changes introduced to improve the operation of the system.

Originally, developer contributions were levied under the general conditioning powers of s62 of the Planning and Environment Act. However, the landmark administrative appeals tribunal case of *Eddie Barron Constructions Pty Ltd v Shire of Pakenham* [1990] 6 AATR 10 challenged the emerging practice of levying development on a per lot basis in the late 1980s, and established the common law tests of need, nexus, equity and accountability as the basis for such contributions (DSE, sub. 84, p. 109). These tests mean that development contributions must satisfy the principles of:

- *need*—identifying the infrastructure need generated by a development
- *nexus*—demonstrating a connection between the development and the infrastructure generated
- *equity*—ensuring the contributions are a fair and reasonable apportionment of cost
- *accountability*—ensuring the money collected is spent on the infrastructure for which it was levied.

In 1995, major changes were introduced to the Planning and Environment Act to resolve long running difficulties with the operation of development contributions in Victoria (DSE 2003a, p. 1). These difficulties had developed through the ad hoc application of planning permit conditions. The 1995 amendments to the Act sought to make development contribution plans the sole and necessary means for obtaining development contributions in Victoria, except for minor works associated with small or one-off developments (DSE, sub. 84, p. 109). The amendments were intended to provide a more predictable and fair system for developers and councils alike.

However, the 1995 initiatives proved to be complex, unclear and impractical:

Generally speaking the results from this initiative have been disappointing. Many councils, and indeed other agents in the planning system (for example, planning panel members) have pointed to a lack of guidance regarding cost apportionment principles and methods. There is also a widespread view that the

current system is cumbersome and lacks flexibility. Only a handful of development contribution plans (DCPs) have been incorporated into planning schemes since the new legislation was promulgated. (DCRSC 2000, p. 1)

Against this background, in mid-1999 the Department of Infrastructure commissioned a review of the underlying principles and practice of levying development contributions in Victoria. The aim of the review was to improve the workability of the development contributions system, with emphasis on the operation of development contribution plans. The review, which embodied extensive consultations,<sup>2</sup> got underway in December 1999 after endorsement under the Victorian Government's State Planning Agenda (DSE, sub. 84, pp. 109–10).

The review was undertaken in two phases. The first considered the problems with the existing system, the principles that should underpin a revamped system, and appropriate methods for cost apportionment. The review steering committee released a report on the first phase in December 2000, which outlined new methods for preparing and applying development contribution plans and for using the new principles.

The second phase of the review involved 'road testing' the principles, strategic directions and methods set out in the report on phase one. The centre-point of the road testing was the production of whole-of-municipality development contribution plans for four councils representing a cross-section of development conditions across the state (DSE 2003a, p. 1). The review steering committee subsequently released a report for public comment—*Review of the development contributions system* (DCRSC 2001)—containing its recommendations for the reform of Victoria's development contributions system. Box 12.1 summarises the problems that the review identified with the then existing system.

After considering the findings and recommendations of the review, the Victorian Government announced a package of reforms to enable the development contributions system to operate more efficiently and effectively. Those reforms left the key elements of the system fundamentally intact (DSE 2003a, p. 2). This approach was supported by many of those affected by the system, including the Property Council of Australia—a long time critic of developer charges.

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<sup>2</sup> The review included comprehensive consultation via submissions and workshops across metropolitan Melbourne and regional Victoria. Consultations involved local government, state government departments and agencies, servicing authorities/utilities, land development companies, housing development companies and professional associations (including the Urban Development Institute of Australia, the Property Council of Australia and the Planning Institute of Australia).

## Box 12.1 Problems identified by the 2001 review

- **The system did not clearly differentiate between use nexus** (sharing costs across all users where infrastructure demands can be reasonably anticipated) **and impact nexus** (recovering additional costs caused by development where its impacts cannot be anticipated or reasonably incorporated into a pre-notified schedule of charges).
- **Uncertainty surrounded leviable items.** For example, the appropriateness of including discretionary items (such as social housing or community buses) in a development contribution plan, and the appropriateness of including recurrent costs in development contribution plans.
- **No definitive advice was provided on cost apportionment.** While departmental guidelines provided useful examples of cost apportionment, there was no endorsed generic method.
- **'Unfair' distinctions were made between development and community infrastructure.** Councils noted that the upper limit on community infrastructure contributions (\$450 per dwelling) presupposes that hard infrastructure (for example, drains and roads) is more important than social facilities to community wellbeing. Councils also noted that legislative provisions limiting enforcement of community infrastructure contributions to the building permit stage created an 'administrative nightmare'.
- **Administration was cumbersome.** Many councils considered the development contribution plan process was data hungry and often not warranted if development streams were small or sporadic. The need to amend the planning scheme every time a council wished to change its development contribution plans was also a concern.
- **The power to condition approvals for the recovery of additional costs where appropriate was diminished.** Where it was not possible to anticipate the relevant costs to include in a development contribution plan (such as off-site environmental impacts or bringing forwards costs caused by out-of-sequence development), the off-site impacts would normally be retrieved by way of a planning permit condition. However, councils did not appear to have the power to condition developments to pay for any off-site works if these were not included in an approved development contribution plan.
- **Difficulties arose in projecting infrastructure costs and demands.** Many councils struggled with the demands of review bodies to justify the data included in cost apportionments. Some councils were discouraged from preparing development contribution plans because uncertainty surrounded the pattern and timing of development.
- **The application of the user pays treatment of non-rateable land was inconsistent.** There was confusion as to whether land uses exempt from municipal rates should also be exempt from development contributions.
- **Difficulties arose regarding the imposition and collection of development contributions for state infrastructure.** The legislation allowed contributions for state infrastructure, but councils had to act as the collection agency.

Sources: DCRSC 2001, pp. iii-iv, p. 9; DSE, sub. 84, pp. 111-12.

The Property Council of Australia noted at the time:

The PCA endorses the proposed retention of many features of the existing contribution system ... The PCA's position throughout the review process has been that the real problems lie in implementing the contributions system, rather than the system itself. (PCA 2002)

The package of reforms included:

- detailed guidance on the use of development contribution plans
- a simpler method of preparing the plans using a pre-set schedule (off-the-shelf) of infrastructure levies to make the plans accessible to all Victorian communities, not just designated growth areas
- a clearer framework for the use of planning permit conditions
- a change to the current levying arrangements so developers are required to pay earlier for facilities providing essential family and children community facilities
- the removal of the \$450 cap on community infrastructure levies so a wider range of necessary community services and facilities can be funded
- clearer and more efficient administrative practices for state agencies to prepare and administer their own development contribution plans, removing the administrative burden from local government
- the improved collection of community infrastructure levies at the building permit stage. (Delahunty 2002a, p. 2).

The Minister for Planning began implementation of the reforms in May 2003. To assist the introduction of the new arrangements, the minister released:

- on-line *Development contributions guidelines* (DSE 2003b, 2003c, 2003d) to provide simpler and clearer guidance for preparing development contribution plans
- a ministerial Direction under the Planning and Environment Act (dated 15 May 2003), which facilitates the early delivery of essential family and children's facilities to new neighbourhoods
- a building practice note (BC 2003c) that provides guidance to building surveyors to improve the collection of community infrastructure levies.

In December 2004, Parliament approved the Planning and Environment (Development Contributions) Bill 2004. The Bill amended the Planning and Environment Act to implement the second stage of reforms to the Victorian development contributions system. In summary, the amendments:

- increase the community infrastructure levy cap to \$900 per dwelling
- enable state agencies, in addition to municipal councils, to directly collect and administer development contribution levies

- provide for the simpler preparation of a development contribution plan using a pre-set schedule of levies that are to be set under a ministerial Direction
- clarify the use of planning permit conditions for the provision of, or payment for, works, services or facilities necessitated by a development proposal.

These reforms became operational in late December 2004. As with the earlier reforms, the new arrangements will be supported by updated *Development contribution guidelines*.

The changes made to the development contributions system have left intact the cornerstone principles of need, nexus, equity and accountability. In this regard, the basis for the Victorian system remains, in principle, consistent with recent Productivity Commission findings and recommendations relating to development contributions (PC 2004a, pp. 155–77). The Productivity Commission concluded in its report that developer contributions should be:

- *necessary*, with the need for the infrastructure clearly demonstrated
- *efficient*, justified on a whole-of-life basis, consistent with maintaining financial disciplines on service providers by precluding over-recovery of costs
- *equitable*, with a clear nexus between benefits and costs, and only implemented after industry and public input.

The report also noted that those imposing developer contributions and charges should:

- follow guidelines based on these principles and be subject to independent regulatory scrutiny
- provide for out-of-sequence development if developers are prepared to meet the cost consequences
- be open to proposals for alternative infrastructure arrangements to meet the needs of the households concerned
- be accountable for how the money raised from charges is spent. (PC 2004a, p. 155)

In general, and reflecting the comprehensive consultation involved, the reforms have been positively received. Following the passage of the *Planning and Environment (Development Contributions) Act 2004* (Vic.), the Municipal Association of Victoria noted:

The new legislation represents a much-needed common sense solution, offering greater flexibility and accountability for the provision of social and community infrastructure in a more transparent manner than is currently available. (MAV 2005)

Similarly, the Department of Sustainability and Environment considers that the package of reforms deliver the necessary changes to the development contributions system to address issues raised by local government and industry over a long period (sub. 84, p. 115).

## **12.4 Concerns about the development contributions system**

Submissions to the inquiry and the Victorian Competition and Efficiency Commission's discussions with inquiry participants identified concerns about the nature and operation of Victoria's development contribution system. These concerns generally cover:

- funding alternatives to developer contributions
- transparency and accountability
- levy collection arrangements for state agencies
- affordability
- implementation.

### **12.4.1 Funding alternatives to developer contributions**

Various inquiry participants criticised development contributions as fundamentally inappropriate for financing infrastructure. That criticism had two main elements:

- (1) specific criticism about the justification for contributions to provide community infrastructure
- (2) general criticism that development contributions are an inferior financing option for providing urban infrastructure.

Regarding the first of these, the Housing Industry Association (HIA) stated:

Upfront development charges for social and community infrastructure should be abandoned. Social infrastructure should be funded by the whole community from the broader tax base. (sub. 58, p. 33)

The HIA considered that it is totally inappropriate for developer contributions to finance local level infrastructure where its users are a broader group than those in the development levied to fund it. Instead, the whole of the community should pay for that infrastructure through, for example, general taxation. The development company Villa World Ltd held the same view (sub. DR115). This issue of equity was raised in the Productivity Commission report into first home ownership, with industry representatives expressing concerns about 'charges inappropriately imposed on individual developments, when they should be spread more widely' (PC 2004a, p. 165).

In its report (which had a national focus), the commission noted that for ‘communal-type’ infrastructure—benefiting a wide group across the community—some mechanism for allocating costs across dispersed beneficiaries is required. It also noted, however, that the dispersion of benefits across the community will vary considerably for individual items of communal infrastructure. This variance creates complexities in apportioning costs in an efficient and equitable manner over time (PC 2004a, pp. 166–7). The commission concluded on this issue that ‘Developer charges for those items of social or economic infrastructure that provide benefits in common across the wider community ... should desirably be funded out of general revenue sources.’ (PC 2004a, p. 76)

However, the Victorian development contributions system already takes account of this principle, because it is based on the principles of need, nexus, equity and accountability. In this case, the principle of equity requires that the amount charged must be a fair and reasonable apportionment of the cost. And on this matter, much has been done to establish the method for an appropriate apportionment of costs. The Department of Sustainability and Environment noted:

The review consultation process developed and road-tested a clearer full cost apportionment (FCA) methodology for determining development contribution levies. The government has accepted this methodology as being fair, transparent and accountable and released new development contributions guidelines detailing this methodology. This methodology can be used by councils, State Government agencies and other public authorities authorised to prepare a DCP [development contribution plan]. (sub. 84, p. 113)

Arising from the review process, the reforms regarding the apportionment of benefits and costs partly address the HIA concerns, although they are unlikely to completely resolve them. The situation reflects the real world complexity in apportioning costs, and the tradeoffs that governments must make among efficiency, equity and administrative costs (PC 2004a, p. 167).

The Victorian Competition and Efficiency Commission would expect that annual auditing of the operation of the development contribution system (proposed below) would help reveal how well the reformed arrangements address the HIA’s concerns in this area.

The second area of criticism embraces the current policy debate about the efficiency of instruments for financing infrastructure generally. This criticism was linked to the issue of local government financing by the claim that inadequate financing by the state government has forced councils to rely on contributions to provide local infrastructure. The Property Council of Australia, for example, argued that using developer contributions to provide infrastructure delivers economic benefits that are vastly inferior to those delivered by alternative

measures. Based on work it had commissioned, the council considered that the state and local governments—if their objective is to increase economic output, employment and community wellbeing in the long run—should eschew developer levies and choose a better instrument. It noted:

The increasing infrastructure demands placed on local councils are significant. The Property Council recently commissioned research by The Allen Consulting Group into financing Victoria's infrastructure. The report found development contributions were the least economically beneficial option to fund infrastructure. The Property Council's position on funding infrastructure is that governments should look to options other than recurrent expenditure and developer levies. The use of debt and public private partnership should be investigated. (sub. 69, p. 5)

The HIA also argued that development contributions are an inferior financing method for providing urban infrastructure, and suggested other measures be used instead:

HIA believes that governments (both local and state) should identify alternate and more equitable funding models than development contributions and that these models must have a genuine regard for housing affordability.

Recent studies have shown, for instance, that government borrowing, if transparent in process and linked to a legitimate pay-back method (e.g. user charges or rates), is not contradictory to good public management. Indeed government borrowing is the most efficient and equitable means of financing long lived community-wide infrastructure assets. Public borrowing spreads the repayment burden further across time and generations. (sub. 58, p. 31)

The HIA also referred to the danger of a growing dependence of local government on development contributions as a source of financing for local level infrastructure:

It is imperative that Victoria not follow NSW's lead in abandoning public investment in urban growth infrastructure and allowing the scope for and extent of development contributions to increase, to the point that local government (and now state government) is almost solely dependent on them. (sub. 58, p. 31)

Implicit in the HIA view is that councils' fiscal environment is driving councils' incentive to use (and abuse) development contributions (box 12.2). An important component of this fiscal environment will be the scale of financing that councils receive from the state government.

The Commission acknowledges a broader consideration of financing public infrastructure might find other instruments, such as government borrowing, to be efficient and cost-effective, possibly more so than developer contributions in some circumstances. However, addressing this issue would require a dedicated and comprehensive review of financing options for public infrastructure—a



matter outside the Commission’s terms of reference for this inquiry. Similarly, to address the implication that a more appropriate (and lower) reliance on development contributions would occur if councils had access to other sources of finance would involve a general review of local government financing. That, review, too, is beyond the scope of this inquiry.

### **Box 12.2 The general problem of local government access to finance**

Across Australia, local governments face a common difficulty in accessing sufficient finance to meet their infrastructure needs. This difficulty occurs despite the financial assistance provided to them by the Commonwealth through financial assistance grants, specific-purpose funding and direct program funding.

The National Office of Local Government clearly stated the cause of this problem: ‘Local government capacity to fund infrastructure is constrained by its general revenue raising capacity’. The Australian Local Government Association highlighted the scale and persistence of this problem. In a submission to a Senate Committee inquiry, it noted the declining significance of rates relative to other taxes, and that total rate collections by local government fell by 27 per cent in real terms between 1966 and 2002. This fall has forced councils to place increasing emphasis on other sources accessible to them—notably user charges, developer charges or impact fees.

Source: The Allen Consulting Group 2003, p. 36.

## **12.4.2 Transparency and accountability**

A number of inquiry participants considered the development contribution system is open to abuse by councils, and that recent reforms have not adequately addressed this shortcoming. Particular concerns were that:

- councils are not subject to sufficient controls to ensure contributions are spent on the infrastructure against which the levies were ostensibly raised
- contributions raised are not sufficiently ‘linked’ to the development activity
- contributions raised might not be spent in a timely manner.

The Property Council of Australia noted:

The recent amendments to legislation governing the development contributions system have not been in place long enough to determine their impact. [However] industry has expressed doubt that the new controls will adequately ensure development contributions are spent on related infrastructure.

The Property Council believes the current system does not provide adequate protection against home buyers paying twice (or multiple times) for infrastructure. (sub. 69, p. 4)

The Department of Infrastructure also considered that the issue of whether the funds raised are being spent as intended remains unaddressed by recent reforms (sub. 63, p. 2). It did not, however, provide examples of where this had occurred.

Langford Jones Homes criticised the imposition of many developer charges by local councils, claiming the charges were often not justified. It gave the example that:

We are required to install water tapping and stormwater connections in areas where largely the existing homes have no requirement. We should not as developers be totally exempt from reasonable requirements, but many of the requests from local government are well above regulation and what should reasonably be required. The cost falls squarely at the feet of the home buyer. (sub. 14, pp. 3–4)

The Master Builders Association of Victoria warned that local councils in metropolitan and regional Victoria are abusing the developer contributions system—a claim that implies the system does not embody sufficient controls to prevent this occurring:

Darebin is clearly diverting some of the revenue collected on private, non-public infrastructure projects to public infrastructure which developers should not be required to fund. (MBAV 2004, p. 2)

However, not all who commented on the development contribution system viewed the current system as having inadequate mechanisms to prevent abuses by councils. The Municipal Association of Victoria considered the reforms introduced by the Victorian Government were adequate to address concerns that contributions would not be spent as hypothecated, that they would not be spent in a timely manner or that home buyers would pay twice for infrastructure:

Provided that councils follow the development contribution guidelines, it is considered that the development contributions will not result in the sort of problems identified above [in the issues paper released by the Commission]. (sub. 64, p. 7)

At the individual council level, the representative of the Macedon Ranges Shire Council indicated that councils have internal mechanisms designed to facilitate transparency and accountability:

The guidelines for operation [of the reformed development contribution system] will need to address the effective use of funds to ensure transparency. The shire has an Audit Committee in place which will assist with this process. (sub. 50, p. 3)

In addition, the Department of Sustainability and Environment stated that the current arrangements contain adequate controls to guard against contributions not being spent as hypothecated or in an untimely manner. It noted that the

Planning and Environment Act includes clear provisions to ensure development contribution levies are applied for the purposes for which they are collected, and expended in a timely manner. Section 46K of the Act, for example, requires that a development contribution plan must:

- set out the works, services or facilities to be funded under the plan, including the staging of the provision of those works, services or facilities
- specify who is responsible for the provision of the works, services or facility.

The department also noted that before a minister, public authority or municipal council is able to have a development contribution plan approved, each item of infrastructure proposed to be included must be clearly identified, and that item's cost, timing and catchment must be itemised and justified. This requirement provides a basic benchmark to ensure any proposal to charge for infrastructure is transparent, accountable and fully funded (DSE, sub. 84, p. 116).

In addition to these requirements, the development contribution plan is subject to a planning scheme amendment process under the Act before it can be approved (DSE, sub. 84, p. 116). This process involves the usual steps of:

- an exhibition of the proposed amendment in the area to which the proposed plan will apply
- receipt and consideration of submissions
- a review of submissions by an independent panel appointed by the Minister for Planning
- council's adoption of the amendment to the development contribution plan
- submission to the Minister for Planning for approval.

Further, to ensure accountability for the levies collected, the Act requires that if a development is not to proceed, then any levy paid in respect of that development is to be refunded (ss46Q(3) and 46QB(5)). Accordingly, the Department of Sustainability and Environment maintained that these legislative provisions provide appropriate controls to ensure levies are collected, accounted for and spent on the infrastructure items for which they were collected. The *Development contributions guidelines* supplement these provisions by providing detailed guidance on their interpretation and implementation (sub. 84, p. 117).

These arrangements provide grounds to believe the system, in theory, embodies sufficient transparency and accountability to prevent it being abused. But the changed arrangements are still in their infancy, with little evidence on how they are working. What is more, the Commission received no information about the adequacy of arrangements to monitor actual performance, either at the individual council level or across the system more generally. The current and historical paucity of information in this area does not give confidence that traditional

auditing systems will necessarily be applied with the vigour needed to give confidence in the new system.

Accordingly, the Commission considers it would be sensible to introduce some monitoring arrangements to ensure the controls operate as intended (in line with the best practice principles of regulation set out in chapter 3). The City of Boroondara endorsed this approach when it noted that the Victorian Government only recently introduced the new development contributions system. It considered that audits of councils' behaviour are needed to ensure councils are following the development contributions guidelines (sub. 66, p. 9).

One way of monitoring the system might be for the Victorian Auditor-General to audit regularly a random sample of councils to assess their adherence to the conditions of their development contribution plans. Alternatively, the Department of Sustainability and Environment could undertake this monitoring and auditing role. Villa World Ltd (sub. DR115, p. 4) suggested that the Essential Services Commission could be another possible auditor, although this role may be outside the commission's mandate. Audits would provide an independent check that levies are properly accounted for and spent on the infrastructure for which they were collected (and in a timely manner). In the case where levies are not so spent, these audits would also verify whether levies are refunded or otherwise expended in a manner consistent with the provisions of the Act.

Independent monitoring along these lines, with public reporting of the results, has benefits. It would provide:

- an added discipline for the system to work as intended
- early warning signals to those administering the system about aspects that need attention and reform
- ongoing evidence about the integrity of the system.

A subset of concerns about transparency and accountability was the worry that councils would use the development contributions system to 'double dip' (that is, to levy developers for infrastructure being paid for by rates or taxes). The Property Council of Australia commented that:

... the current system does not provide adequate protection against homebuyers paying twice (or multiple times) for infrastructure. To prevent or reduce this incidence, a fundamental shift in the way the state and local governments fund infrastructure must take place. (sub. 69, pp. 4–5)

The HIA expressed the same sentiment in other venues. In a submission to the Productivity Commission's inquiry into first home ownership, it stated:

Upfront development charges result in significant 'double dipping' by councils. New home buyers are paying twice for the same infrastructure: through the up front charges and through property rates. (HIA 2003b, p. 38)

The Department of Sustainability and Environment argued that concern about double dipping is not warranted, claiming the revised arrangements have addressed this issue. It noted that a fundamental premise when levying for development contributions under a development contribution plan is that levies are not duplicated through rates or other funding mechanisms (sub. 84, p. 118).

A development contribution plan cannot include existing infrastructure that was wholly funded through general taxes or rates or other mechanisms. Projects associated with the acquisition or development of open space, for example, can be included in such a plan provided that open space has not already been provided through either:

- the *Subdivision Act 1988* (Vic.), or
- clause 52.01 of the Victoria Planning Provisions.

The department noted that a minister, public authority or municipal council, in seeking to have a development contribution plan approved, is required to make explicit all assumptions about the cost, timing of delivery, catchment served and justification for including each item of infrastructure in the plan. These requirements provide a measure of accountability to ensure double charging for an infrastructure item (for example, via rates or general taxes) does not occur. The department concluded that ‘The requirements of the Act for such information about each infrastructure item help ensure that ‘double dipping’ is not problematic’ (sub. 84, p. 118).

The Victorian Competition and Efficiency Commission acknowledges the Act embodies requirements that are intended to prevent abuses of this nature. At issue, however, is not whether those requirements exist, but whether they are being appropriately followed and, if so, whether they are effective in preventing double dipping. The Commission received no information on existing arrangements to monitor the extent to which these requirements are followed or are effective. This suggests vital feedback on the operation of the development contribution system is missing. The Commission considers that this operational aspect should be monitored to ensure the system operates as intended, and that annual audits (for example, by the Auditor-General) would be an appropriate means of doing so.

Most inquiry participants supported the Commission’s draft recommendations to improve the accountability and transparency of the development contributions system through (1) annual disclosure of councils’ compliance with the guidelines and (2) independent auditing of councils’ adherence to the conditions of their development contribution plans (City of Melbourne, sub. DR136; Macedon Ranges Council, sub. DR146; MBAV, sub. DR151; Moreland City Council, sub. DR158; PCA, sub. DR134; VicUrban, sub. DR129). Macedon Ranges Council,

for example, considered that the recommendations are ‘aimed at improved due diligence monitoring and reporting’ (sub. DR146, p. 4).

The Master Builders Association of Victoria viewed that:

...disclosing the collection and expenditure of development contribution funds for infrastructure will assist the community to see what value it is getting for its money. (sub. DR151, p. 24)

The City of Moonee Valley, however, considered that the process of preparing a development contribution plan was adequate to:

...ensure appropriate nexus between the funding raised through this plan and the expenditure on the designated projects ... [because] this usually involves consideration of the proposal by an independent panel and ultimately consideration by the Minister for Planning. (sub. DR99, p. 4)

The Commission considers that this process promotes accountability but does not monitor the extent to which the plans are followed or are effective.

The City of Moonee Valley further opposed additional auditing, however, because an existing annual audit process accounts for a council’s revenue and expenditure in accordance with the development contribution plan (sub. DR.99, p. 5). Where auditing exists, there may be scope to combine independent auditing with existing arrangements.

The Department of Sustainability and Environment considered that disclosure of council’s collection and disbursement of development contributions in the council’s annual report is consistent with the legislative requirements for developer contribution plans under the financial requirements of the *Local Government Act 1989* (Vic), which the Department for Victorian Communities oversees (sub. DR172, p. 25).

It also considered, however, that annual audits would be excessive and thus suggested that an audit every five years, combined with annual reporting of compliance with the guidelines (recommendation 12.1), would provide sufficient discipline on councils:

The development contributions system, as implemented through DCPs, was established in 1995. Given that these plans can have a life of up to 20-25 years, the plans are still in their early stages. Furthermore, some items of the infrastructure may not be required for periods of up to 10 years. Under these circumstances, an audit of a sample of councils every five years may provide sufficient additional discipline to augment other ongoing reporting requirements, such as that suggested in draft recommendation 12.1. (sub. DR172, p. 26)

The City of Melbourne emphasised the importance of a simple and efficient reporting and auditing system, being concerned that the additional burden may contribute to the risk that:

...councils will be further reluctant to utilise DCPs [development contribution plans] if they are overly complex to administer, particularly in comparison to other less transparent infrastructure funding mechanisms. (sub. DR136, p. 15)

While auditing every five years may be appropriate once the system has bedded down, the Commission considers that more frequent audits are warranted in the early stages. Regular audits within a five year timeframe should be required.

### **Finding 12.1**

The *Planning and Environment Act 1987* embodies requirements that could be expected, if adhered to by councils, to ensure development contributions are levied only for infrastructure linked to the development, that levies are spent as hypothecated, and that double dipping does not occur. There appears to be no independent, comprehensive monitoring or public disclosure of local governments' adherence to the requirements designed to prevent abuses of the development contributions system. Independent monitoring of councils' adherence to the requirements embodied in the Act and related guidance material is needed to identify the effectiveness of those requirements, and if and where reform might be needed.

### **Recommendation 12.1**

**That local councils provide, in their annual reports, a statement of compliance with the *Development contributions guidelines* and ensure internal governance arrangements facilitate the monitoring of contributions for compliance with these guidelines. Within their reports, local governments should disclose the collection and disbursement of development contributions to facilitate transparency and accountability.**

## Recommendation 12.2

**That a random sample of councils be regularly audited to assess their adherence to the conditions of their development contribution plans and to the relevant requirements in the *Planning and Environment Act 1987* and related guidance material (such as that contained in the *Development contributions guidelines*). A suitable body to undertake this audit might be the Victorian Auditor-General or the Department of Sustainability and Environment.**

### 12.4.3 State agencies' levy collection arrangements

Prior to the latest round of reforms, the development contribution system imposed a cumbersome and unnecessary burden on local government to impose and collect development contributions for state infrastructure. The reforms introduced in December 2004 provide greater flexibility to state agencies by:

- enabling councils to continue to implement development contribution plans and collect levies on behalf of state government agencies and other public authorities
- enabling state government agencies and other authorised public authorities to administer the plans through planning schemes and to collect infrastructure levies directly.

The Department of Sustainability and Environment considered that these reforms address the shortcomings of the former system and will successfully relieve local government of their previous burden (sub. 84, p. 115). However, the HIA expressed concern that these reforms significantly broaden the potential for state agencies to seek upfront contributions for a wide range of infrastructure items, and that agencies will use these new powers to make ambit claims on developers. It noted:

HIA is not reassured by the state government's response that the principles of nexus, equity and accountability, will be applied to agency demands. At the end of the day, the new Act will detrimentally impact on housing affordability in Victoria. A broader consideration of how infrastructure is funded in the state could have avoided this outcome. (sub. 58, p. 33)

The Commission considers that these reforms would be unlikely to lead to such an outcome, for a number of reasons. First, the changed arrangements introduce an administrative efficiency only in an existing provision for state agency development contribution plans; they do not *create* a power for state agencies to levy.

Second, the use of the provision appears limited. At the time of the reforms, for example, only one state agency was using development contribution plans to levy



developer contributions. That agency (the Public Transport Division) had three plans in effect, to provide for rail related infrastructure. Moreover, since the reforms were introduced in December 2004, no other state agencies have proposed using a development contribution plan.

Third, while the limited use of state agency development contribution plans might reflect the pre-reform difficulties in implementing them, it is more likely that most state agencies have no need for the plans because they have their own heads of power to impose developer charges. VicRoads, for example, now has power to raise developer levies under the *Road Management Act 2004* (Vic.).

Fourth, the reforms allowing agencies to directly collect and administer levies have left intact the former institutional arrangements designed to prevent agencies from abusing their power to levy developers. The Department of Sustainability and Environment considered these arrangements are adequate to ensure state agencies are accountable for development levies they introduce:

As recipients of infrastructure levies, State Government agencies and other public authorities are also subject to the same responsibilities and accountability measures as councils in relation to accounting for and refunding infrastructure levies. (sub. 84, p. 115)

Moreover, the Commission notes that development contribution plans imposed by state agencies must be reported in the agencies' annual reports and that the management of levies is subject to the provisions of the *Financial Management Act 1994* (Vic.).<sup>3</sup> These requirements provide some transparency and public scrutiny of state agencies' use of the plans. Additionally, the *Development contribution guidelines* outline good practice for the administration of development contribution plans—in particular, good practice for account keeping to collect and track development contributions received.

Because the reforms allowing state agencies to directly administer development contribution plans (through planning schemes) and collect infrastructure levies are so recent, the Commission has no evidence to judge how well the arrangements are working.

#### **12.4.4 Affordability**

A number of inquiry participants, such as the HIA (sub. 58, p. 31), argued that payments required from developers under the development contributions system directly contribute to a reduction in the affordability of housing. This argument

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<sup>3</sup> Levies collected and managed by state agencies are required to be paid into the consolidated fund, and are appropriated for the purposes of the development contribution plan. Monies paid out of the fund via special appropriations are reported in the state budget papers and the annual financial reports.

presumes that developer charges are primarily borne by consumers (home buyers) rather than developers, or are passed back to land owners in the form of lower prices for land. The Building Appeals Board expressed this view, noting that the consumer ultimately pays for developer levies (sub. 74). This view is also supported by an extensive body of economic literature (box 12.3).

### **Box 12.3 Who ultimately pays for developer contributions?**

Although the legal incidence of developer charges falls on the developer, the economic incidence (that is, who actually pays) is likely to fall elsewhere. Neutz, writing about the Australian experience, noted the general view that such charges are passed forwards as higher prices for serviced land.

He noted that tax incidence theory suggest that such a charge will be passed forwards or backwards depending on the relative inelasticity of supply and demand: backwards if the supply of raw land is less elastic and forwards if the demand for serviced land is less elastic. The demand for serviced land is likely to be inelastic because servicing costs are only part of the cost of land, land is only a part of the cost of housing, and the demand of households for separate dwellings is relatively inelastic. The supply of raw land is likely to be elastic. Owners of land that can be connected to urban service networks recognise that the supply of such land is limited, and that if they defer sale for development then eventually the price will rise.

The only situation in which development charges seem likely to be passed back to owners of raw land in the short term is when developers have stocks of land at the time they are introduced and when demand is relatively slack relative to supply. This conclusion echoes the growing consensus among economists that almost all of any developer contribution is passed on to the ultimate consumer in the long run.

Sources: The Allen Consulting Group 2003, p. 62; HIA 2003a, p. 35; Neutz 1997.

The Department of Sustainability and Environment indicated the average impact of developer charges levied within and outside the development contributions system (table 12.1). That information suggests that charges under the development contributions system would account for an average of about \$3980 for a new residential lot, and that this would constitute about 12 per cent of the average total land and development charges applicable to that lot.

One significant change since the data in table 12.1 were collected (2001) has been the \$450 increase in the cap for community infrastructure (from \$450 to \$900)—a change approved in December 2004. This amount represents an increase of less than 0.2 per cent to the cost of a \$250 000 house and land package.

Table 12.1 **Average land and development charges for a new residential lot, 2001**

<i>Development contributions—local government</i>		<i>Total (\$)</i>
Levied under the <i>Planning and Environment Act 1987</i>	Roads	3 980
	Drainage	
	Community services	
	Parks	
<i>Property transfer fees and charges—state government (on a property valued at \$250 000)</i>		
Charged under other legislation	Stamp duty	11 365
	Fee for registration on a transfer	
<i>Utilities—state authorities</i>		
Charged under other legislation	Water	17 162
	Sewerage	
	Drainage	
	Gas	
	Electricity	
	Telephone	
<b>Total</b>		<b>32 507</b>

Source: DSE, sub. 84, p. 120.

The Productivity Commission recently found that while infrastructure charges (a much broader set of charges than those encompassed under the development contributions system being considered here) have increased over time, they cannot explain the surge in house prices since the mid-1990s (PC 2004a, p. 176). Other factors (such as shortages in land supply, and cheaper and more accessible finance) have played a much larger role in increasing housing costs. The Productivity Commission (PC 2004a, p. 155) found, with respect to developer charges generally, that:

- most charge categories are both justified and desirable on efficiency/equity grounds
- housing affordability should not be significantly affected by greater reliance on upfront charging as opposed to charging over time.

While the average cost per residential lot raised by levies under Victoria's development contributions system is small relative to other factors, it still represents many thousands of dollars.

Such headline average costs are, however, a simplistic measure of the impact on housing affordability. It is more appropriate to ask (but harder to answer) about the extent to which development contributions add to the cost of housing (and diminish affordability), or whether they are just a different form by which that cost would have been incurred anyway. If development contributions did not 'pay' for a local park, for example, would homebuyers still bear the cost of providing that park, albeit via a different mechanism such as higher taxes or rates? On this issue, the Productivity Commission noted that 'Reduced reliance on developer contributions would bring a requirement for similar dedicated charges to be collected from home buyers' (PC 2004a, p. 176).

Measuring the impact on affordability also requires determining the marginal cost of providing infrastructure under the development contributions system relative to other financing instruments (such as debt, rates or taxes). As noted, the Commission has not pursued this issue, because it requires consideration of matters beyond the inquiry terms of reference.

Moreover, it is hardly appropriate to attach the odium of higher costs (and diminished affordability) to the instrument used to raise the money to pay for infrastructure. More relevant are the factors that affect those higher costs, such as the level and quality of that infrastructure. In part these factors will reflect a community's general expectations to which local governments are responding via the infrastructure they embody in their development contribution plans. Logically, they would also depend on the presence (or lack) of broader state level infrastructure plans that might otherwise alleviate (create) the need for local level infrastructure.

It is clear that the cost represented by development contributions is not an adequate measure of the extent to which they affect housing affordability. Taken alone, it is at best a crude and misleading measure.

#### **12.4.5 Implementation issues**

Reforms to the development contributions system introduced in 2003 were supported with accompanying guidance notes, a building practice note and a ministerial Order to provide certainty and to facilitate implementation. Definitive guidance on cost apportionment issues, for example, has allowed councils to apply the agreed method to urban infill developments, leading to greater certainty about, and thus greater use of, developer charges. This has been the case for the City of Darebin, the Manningham City Council (for the Doncaster activity centre) and the Monash City Council (for the Glen Waverley activity centre parking) (DSE, pers. comm., 22 September 2005). To facilitate the implementation of the reforms introduced in December 2004 they were to have been accompanied (where appropriate) by similar revised instruments. However,

the Commission received evidence that not all the necessary revisions are available and that this issue is impeding the implementation of the reformed system. The Macedon Ranges Shire Council noted:

The current position is that local government is awaiting the release of a ministerial Direction relating to the preparation of development contribution plans under the Planning and Environment Act and a Building Practice Note from the Building Commission. (sub. 50, p. 3)

For most of the recent reforms, the information in the supporting instruments provides up-to-date guidance. However, this is not the case for support on setting standard levies under off-the-shelf development plans; the Department of Sustainability and Environment is still finalising this guidance material. Given that the lack of guidance material is impeding the implementation of aspects of the reformed system, the Commission recommended in its draft report that this material should be produced and made available as soon as possible. A number of participants—including the Property Council of Australia (sub. DR134), the City of Melbourne (sub. DR136) and the Master Builders Association of Victoria (sub. DR151)—supported this recommendation. The HIA further considered that the revised guidelines should outline councils' reporting requirements (sub. DR163, p. 33). The department has since informed the Commission that it expects the schedule of standard levies with the accompanying guidelines (which were delayed because the schedule required further analysis), to be available by October 2005.

### **Finding 12.2**

Recent change to the development contributions system has not been accompanied by the timely supply of revised guidance material. The lack of this material is impeding the implementation of aspects of the reformed system (notably the use of off-the-shelf development contribution plans).

### **Recommendation 12.3**

**That the Department of Sustainability and Environment produce revised guidance material needed to support the December 2004 reforms to the development contributions system, and make it publicly available by June 2006.**

## 12.5 Concluding comments

The development contributions system has recently been the subject of a prolonged and comprehensive review. That review led to the staged implementation of changes (beginning in May 2003) to address shortcomings in the previous system, but left that system fundamentally intact. The most recent of these changes were approved in December 2004, although supporting guidance material—along the lines of the building practice note or guidance notes released in 2003—has yet to be updated.

For the most recent reforms, the current development contributions system is short on performance history. It is premature, therefore, to judge whether the changes are ‘working’. Despite the absence of a performance history, however, some conclusions are possible:

- The Victorian system appears to accord with best practice principles for developer contributions as described in the Productivity Commission report on first home ownership (PC 2004a, p. 155).
- The system needs a formal mechanism to monitor/audit how it is operating. This would increase the likelihood that the system will perform as expected and would provide timely warning of where further reform might be needed. Formal monitoring/auditing should be achieved by improved council governance arrangements, greater public disclosure and independent audit reviews.
- Councils have yet to receive revised guidance material on setting standard levies under off-the-shelf development contribution plans. This issue, which appears to be impeding some councils from implementing aspects of the new system, needs to be addressed immediately.

# Appendices





## **Appendix A: Consultation**

### **A.1 Introduction**

This appendix describes the consultations undertaken by the Commission during the inquiry.

In keeping with its charter to conduct extensive consultations during public inquiries, the Commission—following the Treasurer’s announcement of the terms of reference in November 2004—published an issues paper for the inquiry into regulation of the housing construction sector and related issues in December 2004 (VCEC 2004). The issues paper sought to:

- provide inquiry participants with background information on the inquiry
- describe the Commission’s processes
- guide inquiry participants in framing submissions.

The issues paper invited inquiry participants to make submissions; and the Commission received 91 submissions before the release of the draft report. A further 85 submissions were received after the publication of the draft report, bringing the total number of submissions to 176 (section A.2).

The Commission held public hearings in Melbourne on 7 and 9 March 2005. The hearings were advertised in major metropolitan and regional Victorian newspapers. The hearings attracted 23 participants, representing a diverse range of industries and interests in the housing construction sector (section A.3).

Throughout the inquiry process, both before and after the publication of the draft report, the Commission met with a range of interested parties, such as industry and government representatives (section A.4).

### **A.2 Submissions**

The invitation to make submissions was open to any member of the public, including businesses, employees, industry associations, community groups, Victorian Government departments and agencies, and local governments. Submissions received after the publication of the draft report have the prefix ‘DR’ (table A.1).

**Table A.1 Submissions received**

<i>Participant</i>	<i>Submission no.</i>
Action for More Independence & Dignity in Accommodation	11
Airconditioning & Mechanical Contractors' Association	04, DR143
Alternative Technology Association	73
Architeam Cooperative Limited	39
ARROW	24, DR116
Australand Property Group	05
Australian Building Codes Board	DR113
Australian Business Council for Sustainable Energy	32, DR119
Australian Conservation Foundation	54, DR137
Australian Glass & Glazing Association	77
Australian Institute of Building Surveyors–Victorian Chapter	41, DR130
Australian Liquefied Petroleum Gas Association Limited	90, DR156
Australian Owner Builders and BuildSafe	62
Australian Steel Institute	21, DR104
Australian Wood Panels Association Incorporated	DR 120
Baglin, John/Plumbers Choice National Trade News	03
Beston SMD Ltd	07
BlueScope Steel & Stoddart Building Products Victoria	72
BlueScope Steel Limited	48, DR107, DR65
BMG Plumbing Pty Ltd	27, DR121
Bruce Hamer Homes Pty Ltd	20
Builders Collective of Australia	38, 79, 87, 92, DR147
Building Advisory Council	DR154
Building Appeals Board	74, DR128, DR173
Building Designers Association Victoria	43
Building Ethics Australia Pty Ltd	34, DR114
Building Practitioners Board	26, DR133
Building Products Innovation Council	46, DR150
Building Regulations Advisory Committee	57, DR142
Business Licensing Authority	61, DR162
Cement Concrete & Aggregates Australia	DR110

**Table A.1 Submissions received (continued)**

<i>Participant</i>	<i>Submission no.</i>
CGU Insurance Limited	15, DR135
Chiwest Investments Pty Ltd	67
City of Boroondara	66
City of Melbourne	45, DR136
City of Moonee Valley	DR99
City of Wodonga	89
Civil Contractors Federation	47, DR108
Clark Homes Pty Ltd	06
Clarke, Travis	02
Colmac Homes	80
Communications, Electrical Plumbing Union–Plumbing Division	25, DR125
Connection Magazines Pty Ltd	DR157
Construction Planning and Economics Pty Ltd	DR141
Consumer Affairs Victoria	91, DR166
Country Fire Authority	DR148
Cronin Builders	51
Department of Infrastructure	63
Department of Sustainability and Environment	84, 93, DR172, DR174
Disability Resources Centre Inc	42
Disability Support and Housing Alliance	59, DR149
Energy Safe Victoria	DR112
Equal Opportunity Commission Victoria	75, DR102
Fagan and Fagan	DR123
Fulton, J	DR94
Gas Appliance Manufacturers Association of Australia Inc	DR118
Geelong & District Section of the Master Builders Association of Victoria	76
Gilbert, Barry	01
Glenvill Pty Ltd	08
Hammond Pty Ltd	DR103
Housing Industry Association	58, DR163
Insulation Council of Australia & New Zealand	28, DR124
JMS Home Builders Pty Ltd	82

**Table A.1 Submissions received (continued)**

<i>Participant</i>	<i>Submission no.</i>
Johnstone, Valerie	55
Langford Jones Homes	14, DR126
Lawson, Jeffrey	DR97
L & F Holdings Pty Ltd	83, DR140
Macedon Ranges Shire Council	50, DR146
Marsh Pty Ltd	30, DR131
Master Builders Association of Victoria	49, 88, DR151
Master Plumbers' & Mechanical Services Association of Australia	12, DR100, DR159, DR176
Maughan, Mark	DR152
McCormick Building Pty Ltd	33
Metropolitan Fire and Emergency Services Board and Country Fire Authority	53
Moreland City Council	DR158, DR175
Moreland Energy Foundation Ltd	13, DR117
M R Constructions	78
Mt Gisborne Plumbing and Drainage	10
Municipal Association of Victoria	64
Narromine Plumbing Co	DR95
National Association of Steel-Framed Housing Inc	35, DR122
National Builders Group	DR101
National Electrical & Communications Association–Victorian Chapter	16
National Fire Industry Association Victoria	DR144
Norris, Michael	DR168
Office of Gas Safety	31
Office of the Chief Electrical Inspector	18
Plan Scan (Aust) Pty Ltd	44, DR111
Plumbing Industry Advisory Council	DR132
Plumbers Choice	DR105
Port Phillip Constructions	81
Property Power	85

**Table A.1 Submissions received (continued)**

<i>Participant</i>	<i>Submission no.</i>
Property Council of Australia	69, DR134
Property Owners' Association of Victoria Inc	DR98
Reddaway, Lawrence	DR138
Reddo Pty Ltd	70
Residential Metal Roofing Industry Association of Victoria Ltd	23, DR106
Rinnai	DR109
Robert Knott & Co Pty Ltd	37, DR139
Romauld, Andrew	DR167
Roofing Tile Association of Australia Inc	60
Shepherd, Mike	DR96
SITA Environmental Solutions	17
Small Business Commissioner	DR155, DR170
Stewart, Chris	68
Stoddart Victoria	22
Stuart McLennan and Associates	65, DR145
The Chairman of the Australian Building Codes Board	09
The Royal Australian Institute of Architects & Archicentre Limited	40, DR164
The Victorian Local Government Disability Planners Network	56
Timber Promotion Council	52
VERO Insurance Ltd	71, DR171
Victorian Council of Social Service	29
VicUrban	DR129
Villa World Limited	DR115
Wenning Technical Services Pty Ltd	DR127, DR161
Yarra City Council	36, DR160
Yarriambiack Shire Council	19

### **A.3 Public hearings**

The Commission held public hearings at the Mercure Hotel, Spring Street, Melbourne, on Monday 7 March and Wednesday 9 March 2005.

Advance notice was provided in the issues paper, on the Commission's website and via print media advertisements. A total of 23 individuals appeared at the public hearings (table A.2). The hearings were recorded and transcripts made available on the Commission's website.

**Table A.2 Public hearing participation**

<i>Public hearing</i>	<i>Name</i>	<i>Business/organisation</i>
7 March 2005	Mr Brian Welch	Master Builders Association of Victoria
7 March 2005	Mr Craig Madden	Master Builders Association of Victoria
7 March 2005	Mr Graham Wolfe	Housing Industry Association
7 March 2005	Mr Michael Fagan	Housing Industry Association
7 March 2005	Mr Phil Dwyer	Builders Collective Australia
7 March 2005	Mr Phillip Graf	Australian Owner Builders
7 March 2005	Mr Rob Davies	Clark Homes Pty Ltd
7 March 2005	Mr Gary Workman	Master Plumbers & Mechanical Services Association of Australia
7 March 2005	Mr Peter Jensen	Master Plumbers & Mechanical Services Association of Australia
7 March 2005	Mr Glen Driscoll	Australian Institute of Building Surveyors
7 March 2005	Mr Riccardo Brazzale	Australian Business Council for Sustainable Energy
7 March 2005	Mr Tristan Edis	Australian Business Council for Sustainable Energy
7 March 2005	Mr Greg Campbell	Shire councillor (retired)
7 March 2005	Mr Paddy McCrudden	Communications, Electrical, Plumbing Union (CEPU)–Plumbing Division
7 March 2005	Mr Justin Cooney	Communications, Electrical, Plumbing Union (CEPU)–Plumbing Division
9 March 2005	Mr Euan Williamson	Moreland Energy Foundation Ltd
9 March 2005	Mr Charles Krivaci	BlueScope Steel Ltd
9 March 2005	Mr Chris Michie	Stoddart Building Products
9 March 2005	Mr Mike Norris	Building Ethics Australia
9 March 2005	Mr Tim O'Callaghan	Building Ethics Australia
9 March 2005	Mr David Eynon	Air Conditioning and Mechanical Contractors' Association of Victoria
9 March 2005	Mr Rod Spitty	Macedon Ranges Shire Council
9 March 2005	Mr Bob Seiffert	Civil Contractors Federation

## A.4 Stakeholder consultations

To obtain further information on issues raised during the inquiry, the Commission held discussions with a large number of individuals, businesses and government agencies and regulators. This included the Commission's attendance at the Geelong and district section meeting of the Master Builders Association of Victoria in February 2005; and a roundtable of builders that was jointly organised with the Housing Industry Association in March 2005 (table A.3). In addition to these consultations, the Commission surveyed building practitioners to better understand the cost of housing regulation. Information on that survey is contained in appendix C.

Table A.3 Stakeholder consultations

<i>Organisation</i>	
Archicentre Limited	Insurance Council of Australia (Southern Division)
Australian Building Codes Board	Janvac Constructions
Australian Institute of Building Surveyors	Ken Weir and Associates
Australian Owner Builders (Victorian Branch)	Master Builders Australia Inc
Mr Edward Baillieu, Shadow Minister for Planning	Master Builders Association of Victoria
Bellemore Homes	Master Plumbers and Mechanical Services Association Australia
Building Advisory Council	May Constructions
Building Appeals Board	Municipal Association of Victoria
Builders Collective of Australia	Plumbing Industry Advisory Council
Building Commission	Plumbing Industry Commission
Building Practitioners Board	Plan Scan
Building Regulations Advisory Committee	Productivity Commission
Business Licensing Authority	Property Council of Australia (Victorian Division)
Clay Brick and Paver Association of Victoria	Royal Australian Institute of Architects (Victoria)
Consumer Affairs Victoria	Simonds Homes
Department of Sustainability and Environment	Spacemaker Home Improvement Company
Gumleaf Design Builders	The Honourable Christopher Strong, Shadow Spokesperson for Finance
Housing Institute of Australia (Victorian Branch)	Vero Insurance Limited





## Appendix B: Cost recovery framework

In the housing construction sector, agencies such as the Building Commission, the Plumbing Industry Commission, the Office of the Chief Electrical Inspector, the Office of Gas Safety and local government all use cost recovery to fund the administration of their regulatory activities. Cost recovery arrangements could be adopted for several reasons:

- *equity*—to avoid all taxpayers paying for the costs of the regulation when they may not receive any benefits
- *efficiency*—to ensure the cost of a regulated product incorporates all of the costs of bringing that product to market, including the administration costs of regulation (PC 2001a, p. xli). Appropriate levels of cost recovery mean that activities that require high levels of regulation, given their broad social and environmental effects, are not favoured over activities that require low levels of regulation.<sup>1</sup> In addition, to the extent that cost recovery reduces the call on general taxation, it avoids the efficiency losses of collecting tax revenue to fund activities that are more appropriately funded from cost recovery.
- *revenue raising*—to provide a transparent way for an agency to identify and meet its running costs, without having to rely on obtaining other revenue through the budget process.

In many cases, cost recovery delivers both equity and efficiency benefits, which is why the *Victorian guide to regulation* states ‘general government policy is that fees should be set on a full-cost recovery basis’ (State Government of Victoria 2005b p. 3-10). However, poor cost recovery arrangements can undermine equity and efficiency objectives. Cost recovery charges that are too high disadvantage some industries, raising prices to consumers or reducing their choice of service providers. Excessive charges also reduce the incentives for the cost recovered agency to decrease its costs and improve its efficiency. Overcharging is inequitable because one group is forced to pay excessive amounts for the cost recovered activities.

As a result, cost recovery should not be introduced for revenue raising only. It needs to have equity and efficiency benefits that outweigh the costs of

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<sup>1</sup> Suppose, for example, two competing tourist ventures operate next to each other. One offers bungee jumping and the other offers bird watching. If the bungee jumping operation requires regular safety inspections, recovering the costs of those inspections from the operator would involve incorporating these costs into the cost of bungee jumping. The costs of both bungee jumping and bird watching would then reflect all of the community’s resources spent in allowing those activities to take place. They would compete on an equal basis.

administration. The Victorian Competition and Efficiency Commission's framework for analysing cost recovery arrangements, therefore, assesses whether cost recovery is both economically efficient and consistent with other government policy objectives such as equity. To do this, it is necessary to establish that:

- charging is appropriate and practical, and does not undermine other government objectives
- cost recovery is based on the right level and types of costs
- the charging structure is efficient and the charges are levied on the right people
- the cost recovery arrangements include mechanisms to maintain ongoing efficiency.

Some argue that cost recovery increases scrutiny on an agency because industry has a direct financial interest in its level of efficiency and the associated level of charges. This pressure works best when those paying the cost recovery charges have a well coordinated lobbying voice, bargaining power with the regulator and a clear incentive to express their views. However, cost recovery arrangements alone are unlikely to pressure the regulator to operate efficiently if:

- those paying the charges are a diverse group and not well coordinated (for example, an industry dominated by small business, or a group of consumers, like those paying the levy on building permits), or
- the regulation is mandatory (such as a licensing scheme) so those in the industry must comply and pay the charge. Industry participants may be reluctant to raise concerns because they rely on the regulator agreeing to renew their licence to continue their business.

By taking the regulator outside the budget process where central agencies and Cabinet would scrutinise its expenditure and revenue claims, cost recovery can reduce the level of pressure on the agency to operate efficiently. Given the structure of the housing construction industry and the nature of its regulation, reduced pressure to maintain efficiency is a potential risk of its cost recovery arrangements.

The rest of this appendix outlines the framework that the Commission used to analyse regulatory agencies' cost recovery arrangements in the housing construction sector. The framework could be used by any regulatory agency reviewing existing cost recovery arrangements or considering new arrangements. The principles are relevant to regulatory charges (the charges used by regulators to recover the administration costs of regulation); they do not apply to:

- user charges where the government is providing products or services such as water charges or childcare

- the provision of information such as data from state statistical collections or advisory services
- fines or pecuniary penalties
- charges between government agencies
- decisions on who should bear the compliance costs of regulation (the costs to business or individuals of meeting regulatory standards).

## **B.1 Question 1: Should cost recovery be introduced?**

While the adoption of cost recovery will often have equity and efficiency benefits, this is not always the case. Consequently, any assessment of existing or new cost recovery proposals should consider whether there are economic, legal, practical or other policy reasons for not introducing cost recovery. The following questions could form the basis of such an analysis. They are important threshold questions: they may indicate that further consideration of the costing and design of charges is unnecessary because cost recovery is inappropriate and the activity should be funded from other sources, such as general revenue.

### **B.1.1 Have the activities subject to the cost recovery charges been clearly identified?**

It is necessary to understand the activities that are being subject to cost recovery charges, including the objectives of those activities. This information informs the discussion of the economic characteristics of the activities, who is regulated, the cost of regulation and how ongoing efficiency is maintained. A precise analysis of cost recovery is impossible without clearly understanding what activities are being costed and charged for.

In Canada, before a regulating authority fixes, increases or expands coverage of a user fee, the *User Fees Act 2004* requires the minister to table a proposal that:

- explains what service, products or regulatory process the charge is to cover
- states the reason for the proposed change. (c .4(2)(a) and (b))

In Australia, the Commonwealth Government recognises the benefits of linking cost recovery charges to identified activities:

Where possible cost recovery should be undertaken on an activity (or activity group) basis rather than across the agency as a whole. Cost recovery targets on an agency-wide basis are to be discontinued. (DoFA 2002, p. 3)

The Commonwealth guidelines for implementing cost recovery in regulatory agencies commence with a policy review, which identifies the objectives of the

regulatory and non-regulatory activities that the agency undertakes (Commonwealth Government 2002, pp. 12–13).

### **B.1.2 Should the regulated industry meet the costs of regulation?**

Any assessment of cost recovery arrangements needs to start from clear guidelines on the extent to which the regulated industry should be responsible for meeting the administration costs of regulation. In Victoria, agencies appear to use a different starting point to determine whether the regulated industry should meet cost recovery charges. In its draft inquiry report on *Regulation and regional Victoria*, the Commission concluded that ‘the principles that agencies use to justify cost-recovery arrangements do not clearly align with the Department of Treasury and Finance guidelines’ (VCEC 2005b, p. 255). While Victoria’s guidelines on cost recovery seem to favour a ‘beneficiary pays’ approach, the housing construction industry appears to be subject to an approach based on the regulated activity paying all of the administration costs of the regulation. Thus, there is scope to clarify the basis on which cost-recovery arrangements should apply in the housing construction sector.

Both the *Victorian guide to regulation* (State Government of Victoria 2005b) and the *Guidelines for setting fees and user-charges imposed by departments and general government agencies 2005-06* (DTF 2005) note that partial cost recovery may be appropriate in some cases, and this decision should be based on identifying the beneficiaries of regulation:

There may be circumstances in which fees should be set at levels entailing subsidies (i.e. less than full-cost recovery). This may occur, for example, where the benefits of the activity are not fully restricted to the entity being charged the fee. (State Government of Victoria 2005b, p. 3-11)

Regulatory activity is intended to elicit a particular behaviour and generally produces some form of public benefit. Recovering the full cost of administering the regulation from the regulated industry (and thus its customers) may be inappropriate where the benefits of the regulatory activity flow to unrelated third parties. (DTF 2005, p. 3)

This approach differs from the one that the Productivity Commission developed for Commonwealth regulatory agencies. The Productivity Commission started from the basis that:

The price of regulated products should incorporate all of the costs of bringing them to market, including the costs of regulation. (PC 2001a, p. 2)

This implies that those activities that generate the need for the regulation should meet the costs of administering that regulation, regardless of who benefits.<sup>2</sup> In the housing construction sector, the high level of cost recovery (often 100 per cent) indicates that regulators are probably using an approach similar to that proposed by the Productivity Commission: that is, the regulated industry is expected to meet all of the costs of administering regulation. This is consistent with the comments from the Department of Sustainability and Environment:

In a broad sense, the building levies provide a user-pays framework in that they are only imposed upon users of the services of the Building Commission to perform its specific functions under the Building Act, rather than the wider community, even though the wider community benefits from safer building. (sub. 84, p. 75)

In practice, the differences between the ‘beneficiary pays’ and ‘regulated activity pays’ approaches to cost recovery are probably fewer than they first appear, but they can still be significant. To understand the similarities and differences between these approaches, it is useful to look at:

- if it matters whether the charge is imposed on producers or consumers
- when both approaches result in full cost recovery
- how the two approaches differ if there are third party beneficiaries that are not part of the regulated industry.

### **Does it matter whether charges are imposed on producers or consumers?**

Sometimes regulation will benefit both producers and consumers—for example, licensing builders will benefit producers because it increases the perceived quality of their services, providing marketing advantages, and also consumers, because it reduces the risk that they will engage a poor quality builder. The need to regulate an industry can also stem from the activities of either producers or consumers. Building standards may be necessary because there is a risk that some builders could construct an unsafe house, and consumers do not have the knowledge to ensure they engage tradespeople who will build to the standard they expect. Building standards may also be necessary because some consumers choose to build a house that affects their neighbours by reducing the amount of sunshine on adjacent properties, or reducing their level of privacy.

In both cases, it does not matter whether cost recovery charges are imposed on producers or consumers. Charging either group would factor the costs of regulation into the cost structure of the regulated industry. How much of this

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<sup>2</sup> This is sometimes called the ‘impacter pays’ approach.

cost consumers pay and how much businesses absorb would depend on the characteristics of the market. If, for example, the cost of administering building licences was imposed on consumers intending to engage a builder, it would reduce the demand for builders. Building businesses would usually reduce their prices to maintain sales, effectively compensating consumers for some of the cost recovery charge. Similarly, a charge levied on builders would usually result in them passing on some of the charge to consumers and absorbing some of the charge in reduced profit.

In summary, because there is a commercial relationship between businesses and their customers, it does not matter which group initially pays the charge. The costs will be passed up or down the production chain, so the outcome is the same. This result significantly reduces the differences between the ‘beneficiary pays’ and the ‘regulated activity pays’ approaches. Even if the beneficiaries are different from those undertaking the regulated activities, producers and consumers share the cost recovery charge in the same way.<sup>3</sup>

### **When do both approaches result in full cost recovery?**

The ‘regulated activity pays’ approach to cost recovery will always start from a presumption of full cost recovery, unless there are other government policy, economic or practical reasons that full cost recovery is not appropriate. These reasons are discussed later in this appendix.

In many cases, the ‘beneficiary pays’ approach will also result in full cost recovery from the regulated industry because the beneficiaries are either the businesses within the industry or their customers. The beneficiaries of consumer protection legislation (such as issuing the requirement for a certificate of electrical safety), for example, are homeowners who have more certainty that electrical work is undertaken properly. In these cases, full cost recovery within the regulated industry is appropriate under a ‘beneficiary pays’ approach. This means that the results of using either a ‘beneficiary pays’ or ‘regulated activity pays’ approach are often the same.

### **The case of third party beneficiaries**

The application of ‘beneficiary pays’ can differ substantially from a ‘regulated activity pays’ approach to cost recovery in one important area. Under the former approach, partially recovering costs from the regulated industry is appropriate when the benefits flow to third parties—for example, building standards that

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<sup>3</sup> Different types of charges—for example, a levy on consumers and an application fee on business—have different efficiency effects due to the differences in how the charge is levied and how closely it relates to the activities of the regulator, not due to the differences in who is directly responsible for paying the charge. The differences between levies and fees are discussed under B. 3.

benefit the building owner's neighbours or the general community. When benefits flow to third parties, there is no commercial relationship between the beneficiaries of the regulation and the businesses operating in the regulated industry, so cost recovery based on 'beneficiary pays' would result in business paying lower charges, which are discounted to the extent that benefits flow to people outside the regulated industry.

Under the 'regulated activity pays' approach, partial cost recovery is not appropriate in the case of third party beneficiaries because the starting point is full cost recovery from the regulated industry, regardless of who benefits from the regulation. Thus, who should pay the administration costs of regulation under the 'beneficiary pays' and 'regulated activity pays' approaches diverges for regulation such as the 5 Star energy rating scheme and building standards to protect neighbours and community amenity, which are intended to benefit people outside the housing construction market.

Given inconsistencies between Victoria's cost recovery guidelines and the application of cost recovery in the housing construction sector in Victoria, the Commission has analysed cost recovery arrangements against both the 'beneficiary pays' and the 'regulated activity pays' approaches.

### **B.1.3 Are there economic reasons that cost recovery is inappropriate?**

As noted, there are usually efficiency and equity benefits from the regulated industry meeting the costs of its regulation. But this is not always the case. The Productivity Commission's analysis of cost recovery in regulatory agencies (PC 2001a), which the Commonwealth Government has adopted (DoFA 2002), identified situations when cost recovery would undermine innovation and efficiency—for example, registration and approvals where other businesses can free ride on the approval of the first applicant:

Charging for the assessment of new products can encourage firms to avoid the costs of approvals by waiting for others to seek approval first (thus 'free riding' on the approval of others). This is a problem for premarket approvals (before the product is offered for sale) when the regulator requires the first new example of a product to go through a more onerous and costly process than that for subsequent examples. Charging for such approvals would penalise the first firm that introduces a new product to Australian customers and impair innovation and product development. (Commonwealth Government 2002, p. 16)

Sometimes these problems may not negate the use of cost recovery but they affect the best type of cost recovery charge. This is discussed under B.3.

#### **B.1.4 Is it practical to levy a charge?**

The ease of administration and the ability to target cost recovery charges affects the viability of cost recovery arrangements. It may be impossible or too costly to identify who should pay the charges, enforce the charging regime or link the charges to the regulated activity. Any of these problems can undermine the economic benefits of cost recovery by undermining the links between the charge, the administration costs of the regulation and those who generate the need for the regulation or benefit from the regulation.

If it is possible but very costly to develop a targeted charging system there is a risk that the costs of administering cost recovery will outweigh its benefits, so it is not in the public interest to charge:

For example, it may be inappropriate to levy the whole industry if only a small group of firms creates the need for the regulation, and this group cannot be individually charged. In this event, a levy would have few advantages over general taxation. (Commonwealth Government 2002, p. 16)

The costs of collecting information and designing charges mean that compromise between efficiency and practicality is necessary. It would be difficult to design a fee that accurately charges homeowners for the cost of setting and administering individual building standards, for example. This homeowner group is diverse and their use of the standards would vary depending on the type of house they build and the location of that house. A compromise that averages the costs of administration over homeowners as a group may thus be the only practical way of collecting such a charge. However, if the resulting charge bears little relationship to an efficient charge, cost recovery may not be appropriate.

#### **B.1.5 Would charging undermine other government policy objectives?**

In some cases, levying cost recovery charges would undermine other government policy objectives. If, for example, a voluntary register is used to inform consumers about service providers, and the objective is to have as many businesses as possible register, charging businesses to register is likely to work against the government's policy objective. Similarly, charging consumers to make a complaint or obtain advice from the regulator would discourage them from using this service. This would undermine the regulator's ability to inform consumers about their rights and to obtain valuable information about where problems in the industry are arising. Such a charge would undermine the effectiveness of complaint/information services and, thus, their ability to achieve the government's objectives of making the market and the regulator more informed.



## **B.2 Question 2: Are cost recovery charges calculated on an efficient cost base?**

To achieve their intended benefits, cost recovery charges need to be set at the right level. Excessive charges disadvantage the regulated industry and reduce the pressure on the regulator to administer that regulation efficiently. Undercharging advantages the regulated industry, compared with other industries that meet the full cost of their regulation. But it may result in inadequate funding for the regulator; without additional funding, the capacity of the regulator to deliver and enforce regulation would be undermined.

The importance of calculating cost recovery charges using an appropriate cost base was recognised in *Victorian guide to regulation*:

Both efficiency and equity considerations require the fee to recover the full cost to government (on the basis of an efficient level of regulation that is administered efficiently.) (State Government of Victoria 2005b, p. 3-10)

Unlike government agencies that sell goods in competitive markets, regulators have many of the characteristics of a monopoly and are not subject to market pressure to keep their costs low. In its draft report on *Regulation and regional Victoria*, the Commission noted that the costs from combining inefficient regulation, cost padding and cost recovery can be cumulative:

Regulation that is more onerous than necessary will increase the costs of the regulated industry. This cost increase is compounded if the industry is then charged for the cost of delivering these excessive regulatory requirements. Finally, if the regulator is also operating inefficiently, this will further inflate costs and increase the burden on industry. (VCEC 2005b, p. 252)

Overcharging can be difficult to detect because it may not result in the agency accumulating reserves. The excess revenue could be absorbed by inefficient administration or channelled into activities that would not be justified if they were subject to a rigorous cost–benefit test or that should not be funded by cost recovery charges levied on the regulated industry.

### **B.2.1 Is the level of regulation appropriate?**

Over regulation can inflate cost recovery charges, undermining the efficiency benefits of cost recovery. Processes such as the preparation of regulatory impact statements (RISs) and business impact assessments (BIAs) help to set the right level of regulation. But caution should be exercised when the regulatory agency is responsible for preparing this analysis, because agencies can face incentives to

expand the scope and complexity of the regulation they manage (regulatory creep)—for example:

- As problems arise, regulatory agencies may advocate more regulation to avoid criticism that the problems stem from deficiencies in their administration or enforcement of the existing regulation.
- Prescriptive regulation, while often imposing additional costs on business, can be easier to enforce. Regulatory agencies have an incentive to seek to increase the prescriptiveness of regulation because it would make it easier to demonstrate their effectiveness in encouraging compliance and prosecuting offenders.

Agencies often have some administrative discretion in the related activities in which they are involved, such as information provision and education. While flexibility allows responsive innovative approaches to emerging issues, governance arrangements should also allow for transparency and accountability in these decisions. To the extent that cost recovery reduces scrutiny of the activities in which the agency is involved, it can exacerbate the risk of overregulation. Checking that the level of regulation is appropriate is an important early step in designing and reviewing cost recovery arrangements.

### **B.2.2 Are the charges based on efficient costs?**

Even if the level of regulation is appropriate, that regulation needs to be delivered efficiently, and its cost needs to be allocated correctly between different regulatory activities. If regulatory services are provided inefficiently, this inflates the cost base, resulting in overcharging and undermining the efficiency benefits of cost recovery. What is efficient cost, however, is not a straightforward question. There are two aspects to consider:

- (1) Are the costs inflated by poor administration or other practices? Incorporating inflated costs into cost recovery charges disadvantages those required to pay the charges.
- (2) Are the types of cost incorporated into the price appropriate, given the activities being cost recovered? It is important to use a sound method to allocate costs to particular cost recovered activities.

The Victorian Government guidelines for setting fees and charges discuss the costing frameworks for user charges but not regulatory fees. Several methods—such as fully distributed cost, marginal cost, avoidable cost or incremental costs—could be used to allocate costs between various activities. One common approach is to require activities to meet their long run avoidable costs—that is, the costs that could be avoided in the long run if the regulatory agency did not undertake that activity. Significant activities, such as those that tie up a substantial proportion of the agency’s resources, would meet a share of fixed and

overhead costs. If the cost recovered activity is a minor adjunct to the agency's other activities, such that additional capacity is available at little or no extra cost, then the charge would reflect only the variable costs of undertaking that activity. But setting the timeframe used to assess long run avoidable cost and knowing how to recover any remaining overhead costs are both complicated issues.

There is no single 'right way' of allocating costs between cost recovered activities. This makes transparency crucial: whatever cost recovery approach is used, the method of identifying and allocating costs needs to be transparent. The Victorian guidelines for setting fees and charges recognise this for user charges:

There are several techniques that can be employed to allocate costs to service delivery. Costing methods vary in simplicity, accuracy, and overall value in pricing and decision making. Irrespective of the costing technique utilised, costing decisions should be adequately documented and transparent. Cost allocation criteria can include items such as volume, duration and space-allocated. (DTF 2005, p. 7)

Such transparency is also important for regulatory charges.

### **B.3 Question 3: Are charges set appropriately?**

The cost base determines the overall level of costs to be recovered. The charging structure determines how individual charges are set and who pays those charges. This includes whether the right type of charge (fee or levy) is used and whether the charge has the right mix of fixed and activity based components.

The structure of the charge will affect the potential efficiency and equity benefits of cost recovery:

- If the wrong businesses or groups are charged, then the costs of regulation will not be incorporated into the cost structures of the appropriate groups, affecting the efficiency benefits. Also, people may be required to pay for regulation when they are not responsible for the need for that regulation and do not benefit from the regulation, affecting the equity benefits.
- Poorly structured charges can adversely affect the way in which the market operates. A fixed licence fee that is too high, for example, can stifle the entry of new businesses into the industry.

#### **B.3.1 Are the charges imposed on the right group?**

Under a 'beneficiary pays' approach to cost recovery, the beneficiaries should pay for the costs of regulation. As noted, if the beneficiaries are the customers of regulated businesses, the charge could be imposed on the regulated businesses.

This view is reflected in the Commonwealth's cost recovery guidelines:

Charging the regulated firms is usually the most practical approach to setting cost recovery charges—particularly where the regulatory services needed differ substantially between firms. This is because, for example, the cost of assessments can vary according to the time and effort needed to undertake each assessment, and at different points over a product's life cycle. Translating such differences into consumer charges would result in a highly differentiated approach to setting fees, and conceivably require different fees for different products, or for similar products marketed by different firms. Charging regulated firms for the regulatory activities would reflect costs more directly. (Commonwealth Government 2002, pp. 29–30)

If some beneficiaries do not have a commercial link to the regulated businesses, other mechanisms would be needed to charge them, or the agency would need to rely on partial taxpayer funding.

Under a 'regulated activity pays' approach, those businesses or groups whose activities generate the need for regulation should meet the costs of that regulation. Either approach, would involve differentiating the links between regulatory activities and different sectors of the industry. As the Commonwealth's cost recovery guidelines note:

It may be inappropriate to levy the whole industry if only a small group of firms creates the need for the regulation, and this group cannot be individually charged. In this event, a levy would have few advantages over general taxation. (Commonwealth Government 2002, p. 16)

In addition, it may be justified to charge some sectors a higher proportion of the costs because they receive more benefits or require more intensive regulation. These decisions are important because they can affect competition among activities within an industry and among industries.

### **B.3.2 Is the charging structure appropriate, with the necessary legal authority?**

The choice of charging structure should be driven by the approach that best links the costs of administering the regulation to those being charged, accounting for the costs of collection and enforcement:

- A fee charges individuals or businesses directly for the costs of undertaking the regulatory activity.
- A levy is a form of tax. It is imposed broadly across a group of individuals or businesses.

Because fees are more direct than levies, they should be used when they are efficient, cost effective and consistent with other policy objectives. Levies do not

link individuals closely to the cost of undertaking the regulatory activities, so they are usually less efficient than fees, particularly if charges should be differentiated across sectors in the industry.

Much of the funding of the Building Commission is generated from industry levies. In its submission, the Department of Sustainability and Environment argued that the potential advantages of levies are that they:

- impose a broad user pays regime
- take account for externalities, public good and free rider issues
- are administratively more efficient and simple than alternatives. (sub. 84, p. 74)

The levy clearly provides a broad charging system. The issue for choosing between a levy and a fee is whether such a broad approach is justified. First, a broad approach will be appropriate only if those activities generating the need for regulation or the beneficiaries of the regulation are also a broad group. If the group that should be paying cost recovery charges is very narrow, a broad levy would have few, if any, efficiency benefits over funding from general tax revenue. Second, the broad approach removes the nexus between those paying the cost recovery charge and the regulator, further reducing the potential for those paying the charge to pressure the regulator to improve its efficiency.

The department argued that levies can account for externalities, public goods and free rider issues. It is difficult to see why the department perceived externalities as relevant if a ‘regulated activity pays’ approach to cost recovery is being used. Externality issues should be dealt with in the regulation. Cost recovery is about recovering the administration costs of that regulation; it should not be confused with other policies such as externality pricing.

Under a ‘beneficiary pays approach’, externalities affect the distribution of charges because the benefits of regulation flow to third parties. Those that fall outside the housing construction industry justify partial cost recovery. Externalities could justify an industry levy if they fall across most stakeholders in the housing construction industry, such that all people subject to the levy are seen as beneficiaries of the regulation.

Public goods are products or services where one person consuming the service does not reduce anyone else’s ability to consume it, and where it is not possible to charge people for using the service because you cannot exclude them from using it. Public good issues are most likely to arise when the government has chosen to provide information to consumers to reduce the problems caused by inadequate information (discussed in chapter 3). If the best strategy for improving access to information is to make it broadly available, particularly through media or websites, then the information is likely to have public good characteristics. In these cases, fees are usually impractical and a broad based levy

may be the best way of recovering the costs of providing such information services. In some cases, however, a targeted levy would allow costs to be recovered while avoiding the free rider problem.

As noted by the DSE, levies in some cases may be less costly to impose and enforce compared with a fee. However, these lower collection costs need to be weighed against the benefits of a fee that links the level of revenue more closely to the level of regulatory activity, that is more likely to ensure cost recovery charges are paid by the appropriate group, that is more transparent, and that potentially makes the agency more accountable for the level and use of the revenue raised.

Whatever charging mechanism is chosen, it should have the appropriate legal authority. Accountability is also an important issue. At the Commonwealth level, the Constitution (s.55) requires that a law imposing a tax can deal only with the imposition of taxation, which means that taxes can be implemented only through separate tax Acts (PC 2001a, p. I.2). This increases the scrutiny on cost recovery charges that are levied through tax instruments and prohibits the use of charges that over-recover costs being incorporated into other legislation. These restrictions do not apply in Victoria. The mechanisms for accountability discussed under B. 4 are thus even more important.

### **B.3.3 Would the charge stifle competition or innovation?**

In some cases, cost recovery charges could prohibit certain types of business from entering the market or discourage new products from being introduced. A fixed charge for registering to operate in an industry, for example, may have little effect on a specialist business, which can spread the registration costs over a range of services. It may, however, discourage a diversified business from providing that service in conjunction with other services because the business might not think that the additional work would offset the registration charge.

Care is needed with regulation dealing with new industries in emerging sectors. If the regulatory costs are heavy at the start-up phase, such industries may not develop. These issues should be considered when designing cost recovery charges to ensure they do not inappropriately stifle competition or innovation.

## **B.4 Question 4: Are there other mechanisms to ensure ongoing efficiency?**

As noted, in industries such as housing construction that have a large number of diverse businesses that are not well organised and depend on the regulator for their right to operate in the industry, the regulator is unlikely to face strong industry pressure to maintain and improve its efficiency. Removing these

regulators from the budget process, where their demand for funds would be scrutinised more closely, could thus reduce their incentives to decrease costs and improve their effectiveness. The Western Australian 2004 public sector performance report reviewed cost recovery arrangements in six agencies. It recommended that additional information be provided to the Western Australian Department of Treasury and Finance to ‘enhance its review of agency fee setting practices’ (Auditor General for Western Australia 2004, p. 4)

A range of mechanisms are likely to be needed to maintain efficiency. For this reason, while the process for initially setting the right charge is important, mechanisms that provide ongoing pressure to maintain efficiency are also necessary.

#### **B.4.1 Do the regulatory instruments and the processes used to set charges encourage efficiency and fairness?**

Victoria has a transparent review process to assess the costs and benefits of cost recovery charges that are set in subordinate legislation (RISs). A similar process, although less transparent, applies to primary legislation (BIAs). Under the RIS process, any new charge (or increase to an existing charge) that imposes an appreciable economic or social burden on a sector of the public must be subject to an RIS. An RIS is required to:

- define the nature and extent of the problem being addressed by the regulation
- state the objectives of the regulation and how it will operate
- identify whom it will affect (and the likely impact on them) and the regulation’s enforcement regime.

The RIS should then:

- identify and analyse the costs and benefits of the proposed regulation, including the economic, social and environmental impacts and the likely administration and compliance costs
- identify and assess the costs and benefits of any other practicable means of achieving the same regulatory objectives
- contain sufficient information to allow a decision on whether the proposed regulatory measure is justified (State Government of Victoria 2005b).

Not all cost recovery arrangements are set in regulation, so they are not all subject to the RIS process. Those set in Acts have not been subject to review in the past. The new process of preparing BIAs will apply to future new and amended cost recovery arrangements, but these assessments are Cabinet-in-Confidence documents, so the approach to cost recovery will rely on parliamentary debate for scrutiny.

For other cost recovery arrangements, the level of transparency and rigor in costing and analysis is at the discretion of the regulatory agency. The Commission highlighted the consequences of this arrangement, particularly in regulation by local government, in its draft inquiry report on *Regulation in regional Victoria*. The Commission recommended that fees administered by PrimeSafe and Dairy Food Safety Victoria be prescribed in regulation so they are subject to an RIS and that the Department of Human Services, in conjunction with the Municipal Association of Victoria, work with councils to develop and publicly report guidelines for setting registration fees under food safety regulation (VCEC 2005b, pp. 167-169).

While the level of rigor and transparency in the establishment of charges is important, key agencies may also rely on other mechanisms to help develop appropriate cost recovery, such as industry representation on the board of the regulator or industry consultation bodies.

Unlike the Commonwealth, which requires all significant cost recovery arrangements not subject to an RIS to undergo a cost recovery impact statement, Victoria does not have a universal mandatory mechanism that sets the framework for assessing cost recovery. The internal processes of agencies are, therefore, important to the effectiveness of the arrangements.

#### **B.4.2 Are there appropriate mechanisms for consultation, monitoring and review?**

The usefulness of consultation to improve the acceptance and design of cost recovery arrangements is internationally recognised (OECD 1998; The Treasury (New Zealand) 2002; Treasury Board of Canada 2000). The views of industry are important in developing cost recovery but there is a need to avoid the risk of regulatory capture. Those involved in consultation should not have undue influence over regulatory decisions. Their advice should be considered, but they should not have de facto decision making powers. In addition, continuing to improve cost recovery arrangements involves collecting information about their performance and periodically analysing that information. This effort involves ongoing monitoring and review processes.

Those cost recovery arrangements subject to an RIS already have mandatory consultation requirements, although the Commission has been critical that the 28 days required for consultation is too short for significant or complex issues (VCEC 2005b, p. 235). Regulations also sunset every 10 years and must be subject to an RIS before being re-made. The RIS process thus builds in an automatic review, with a requirement for a new RIS if the cost recovery arrangements change significantly within the 10 year period. It does not include monitoring requirements.



For cost recovery arrangements that are not subject to an RIS, the consultation, monitoring and review framework are at the agency's discretion.

### **B.4.3 Do governance arrangements place pressure on regulators to maintain their efficiency?**

Because cost recovery charges can reduce the incentives for agencies to operate efficiently, it is important that other accountability mechanisms are in place to maintain this efficiency. All regulatory agencies should be accountable to either a minister or to a board that is accountable to the minister.

Accountability to the minister and Parliament helps ensure public bodies serve the public interest. But it is not a good mechanism for monitoring detailed policy or operational issues. Parliamentary accountability is strongest when the issue is large enough to affect voters' future decisions, and the elected representatives recognise and respond to that risk. A board can more effectively monitor and control policy implementation, but the guidance given to the board needs to be clear and transparent, and the outcomes need to be monitored to ensure the government's objectives are delivered.

Alone, neither parliamentary monitoring nor setting up a responsible board would maintain sufficient pressure on the regulator to ensure it operates efficiently and sets appropriate cost recovery arrangements. Consultation would help, as would transparent monitoring and periodic reviews, but other strategies such as performance agreements, independent reviews and annual reporting can also assist. Agencies funded by cost recovery need to develop a package of strategies to ensure they maintain and improve their efficiency.



## Appendix C: Cost of housing construction regulation

A core characteristic of good regulation is that the benefits exceed the costs. While a focus of developing best practice regulation is to identify and assess the net benefits of proposals before new regulation is introduced, assessing the costs and benefits of existing regulation is also desirable when reviewing the regulatory framework. This assessment is not straightforward, because the information needed is generally not readily available. Further, identifying and measuring regulatory costs and benefits raises challenging conceptual issues.

The Victorian Competition and Efficiency Commission has been transparent about the data provided and assumptions made, to allow the estimates presented in this appendix to be assessed.

### C.1 Objectives of this exercise

Robust, consistent and comprehensive estimates of the cost of housing construction regulation in Victoria, or in Australia generally, are not available. There have been attempts to cost elements of the regulatory framework, either as part of regulatory impact statements (RISs), or through industry surveys or other studies. There have been few attempts, however, to estimate the overall cost of the housing construction regulatory framework. The objective of this exercise is to estimate the costs of (selected) Victorian and local government housing construction regulation. In particular, this appendix seeks to test other estimates of the regulatory costs that are in the public domain, by:

- providing an indicative estimate of the aggregate costs of housing construction regulation
- identifying the relative significance of specific regulatory costs.

The information presented in this appendix provides greater insights into the nature and extent of the costs faced by business in complying with regulation, and any flow-on effects for housing affordability. It also helps to identify Regulations where the indicative cost estimates are relatively high or cover a wide range, and thus merit further consideration.

Regulation is warranted where it generates more benefits than costs, and is the best way to address a policy problem. However, even less information appears to be available on the benefits of regulation than on its costs. This appendix, a cross-check against other estimates in the public domain, focuses solely on estimating the costs of complying with the Regulations. **It does not attempt to assess whether the Regulations are yielding net benefits.**

## C.2 Estimating the cost of housing construction regulation

The housing construction regulatory framework is complex. Requirements are imposed at national, state and local levels, and via a multitude of regulatory instruments (table C.9). The cost of complying with these Regulations is likely to vary according to factors such as business size, project size, type and location. Regulations also impose different costs on different sectors of the community (box C.1). The Commission sought to obtain estimates of the costs incurred by industry in complying with Victorian housing construction regulation.

### Box C.1 Defining regulatory costs

Regulations impose different costs on different sectors of the community. The compliance costs faced by businesses (and partly or fully passed onto consumers) include:

- administrative costs—for example, the time and resources required to understand new regulation and to complete the paperwork associated with ongoing regulatory compliance
- capital and production costs—for example, changing design and construction methods to meet regulatory requirements
- indirect or efficiency costs—for example, the effect of the regulation on the price of inputs.

Private households are likely to also bear costs in the form of delays that result from the imposition of regulation on the housing construction process.

In addition, state and local governments incur costs in administering and enforcing regulation, which may be recovered (in full or in part) by fees or charges.

### C.2.1 The Commission's approach

The Commission adopted a two stage approach in obtaining estimates of the industry compliance costs of housing construction regulation. First, recognising the complexities of estimating the costs of complying with housing construction regulation, the Commission met with a sample of industry participants to discuss their estimates of compliance costs and to explore the factors that may lead these costs to vary.

To minimise the time required of survey respondents, the Commission developed a set of questions focusing on those Regulations considered to impose high costs, and/or where the information could not readily and reliably be obtained from other sources. The Commission developed a 'core' set of 18 questions that appeared to be most appropriately directed to builders, and a further set of nine questions better directed to other industry practitioners. It

sought the survey respondents' responses to the second set of questions where relevant and where time permitted.

The Commission conducted a 'pilot' run of the questionnaire to test the appropriateness of the questions and the ease with which they could be answered. This pilot provided useful feedback and, while the questions were refined, the content of the core questions did not change.

Following the release of the draft inquiry report (VCEC 2005a), the Commission invited further responses from industry participants on the costs of complying with the selected Regulations. It made copies of the questionnaire available on its website for interested industry participants. The questionnaire sought estimates of the capital costs, administrative costs<sup>1</sup> and efficiency costs of complying with the Regulations. The efficiency losses that result from market distortions that the Regulations might be causing are difficult to estimate and are not reflected in the estimates provided. Where possible, this exercise sought estimates of the *incremental* compliance costs imposed by regulation—that is, the additional cost imposed above the costs that would be incurred if there were no housing construction regulation (box C.2). Given the conceptual difficulties of determining the counterfactual, however, the extent to which the respondents' estimates reflect incremental costs varies. In addition, there may be unmeasured indirect costs due to barriers to competition and innovation.

Some inquiry participants commented on the Commission's approach and questioned the value of the estimates it produced. The Department of Sustainability and Environment stated:

The approach employed to determine the incremental costs of regulation has merit ... However, the SE portfolio considers that the value of the effort by the VCEC to estimate costs is impaired for three main reasons:

- The small sample size of 12 practitioners
- The inability to determine if the costs quoted were, in fact, incremental regulatory costs

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<sup>1</sup> The Commission has applied the same hourly rate (\$40) to all respondents' estimates of the administrative burden for consistency in the treatment of administrative costs. The estimate is derived from Australian Bureau of Statistics (ABS) data on average weekly earnings (ABS 2005a), adjusting base wage values by assuming 50 per cent on-costs and a 38-hour working week. The Commission used an overall measure of average weekly earnings rather than a housing construction-specific measure, on the grounds that many administrative tasks, particularly for larger builders, may be undertaken by dedicated administrative staff rather than the builder. This approach is also consistent with that used by the Commission in other exercises. Nonetheless, the use of an overall rather than construction-specific measure does not have significant cost implications. (The equivalent construction hourly rate would be one dollar higher than the overall hourly rate.)

- The insufficient capacity to compare costs with benefits as no apparent attempt is made to estimate the benefits of the regulations. (sub. DR172, p. 3)

The Commission acknowledges the analysis in the draft inquiry report is limited in terms of the small sample (which has since increased to 32) and the extent to which the estimates reflected incremental costs. While it agrees that a careful assessment of the costs and benefits is crucial in assessing any regulatory proposal (State Government of Victoria 2005b, p. 3-5), it did not intend to assess the net benefits of the Regulations in this appendix. Instead, the Commission was seeking to test the limited available information on the costs of complying with housing construction Regulations. While the benefits of the Regulations are no less important, the available information on the benefits appears to be even more limited than that on the costs.

### **Box C.2 Estimating incremental costs**

Ideally, the costs of regulatory compliance should include only the incremental costs of compliance, or the additional costs incurred above the costs that would be incurred if there were no housing construction regulation. Identifying and disentangling regulatory compliance costs from usual business costs can be difficult and uncertain, and regulatory compliance costs may be over or underestimated as a result (Rimmer & Wilson 1996, p. 6).

Consider the incremental costs imposed by builders warranty insurance. Regulation requires all builders undertaking domestic building work valued at over \$12 000 to have warranty insurance. In the absence of regulation, some builders may still choose to hold this insurance, perhaps as an indicator of quality or as a marketing support. Some consumers may choose to take out a similar product directly. Alternatively, builders and/or consumers may elect to take insurance, but demand a different insurance product—perhaps ‘first resort’, rather than ‘last resort’ cover. In addition, the insurance market, the pool of insurers and the prices of the products they offer, would be different.

Difficulties in obtaining mandatory building warranty insurance affect the supply of builders. Builders unable to readily obtain the required insurance may, for example, leave the market, become a subcontractor or even become an owner–builder. The cost of the regulation should ideally include the cost of these indirect supply-side changes.

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## Box C.2 **Estimating incremental costs** (continued)

Clearly, the incremental cost of complying with the requirement to hold builders warranty insurance is not the total cost of premiums currently paid. But, at the same time, it is difficult to estimate the counterfactual—that is, what would happen if there were no regulation. One option could be to look at a similar, but unregulated, market. Builders warranty insurance is not required in Victoria for buildings over three storeys (with two or more separate dwellings), for example. However, a number of factors (in addition to insurance) are likely to influence the cost of constructing these buildings relative to other forms of housing. Alternatively, the market in another jurisdiction could be examined.

Another option could be to examine the effects on a relatively stable market before and after a significant regulatory change. While this approach may offer some promise, the complexity and evolving nature of the regulatory framework suggest it would be difficult to observe the effects of an individual regulatory change.

Recognising these challenges, the Commission asked the businesses to estimate the cost of labour, goods and services, the administration time involved, and any other costs in complying with the Regulations. It also asked the businesses to estimate the extent to which they would comply if they were not required to do so under the Regulations. The Commission recognises this is not a perfect measure of incremental costs—which would require more extensive information on the distribution of costs in the absence of regulation—but it produces indicative estimates while simplifying the information requested from survey respondents.

### **Profile of survey respondent sample**

In total, 32 industry practitioners provided estimates of the costs of complying with Victoria's housing construction Regulations (table C.1). They included 23 domestic builders, two commercial builders, two building surveyors, four architects and a tiler.<sup>2</sup> The sample included businesses working in metropolitan and/or regional areas of Victoria.

Prior to the release of its draft inquiry report (VCEC 2005a), the Commission approached industry associations—the Housing Industry Association (HIA) (Victoria), the Master Builders Association of Victoria and the Royal Australian Institute of Architects (Victorian Chapter)—requesting contact details for a representative sample of industry participants with whom the Commission could meet. It spoke with representatives from 12 businesses operating in the industry, largely nominated by these industry associations, before the release of its draft inquiry report. A further 20 Victorian businesses in the industry responded to the Commission's request for further information following release of the draft inquiry report. The Commission understands that the HIA (Victoria) and the

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<sup>2</sup> A building practitioner operating in regional New South Wales also provided information of the costs of complying with Regulations in that jurisdiction.

Master Builders Association of Victoria advised members of this request for further information.

**Table C.1 Survey respondent profile**

<i>Practitioner<sup>a</sup></i>	<i>No. jobs per year</i>	<i>Region</i>	<i>Other</i>
Builder A	< 10	Melbourne	New houses, additions & alterations
Builder B	30–40	Melbourne	New houses
Builder C	30–35	Melbourne	Additions & alterations
Builder D	70–100	Melbourne	New houses, multi-unit developments
Builder E	> 1000	Melbourne & regional Victoria	New houses
Builder F	–	–	Commercial <sup>b</sup>
Builder G	30–35	Regional Victoria	New houses
Builder H	60	Melbourne	Additions & alterations
Builder I	140	Melbourne	New houses
Builder J	70	Melbourne & regional Victoria	New houses
Builder K	6	Melbourne	Additions & alterations
Builder L	40	Melbourne & regional Victoria	New houses
Builder M	80	Melbourne	New houses
Builder N	20	Melbourne	New houses, additions & alterations
Builder O	75	Melbourne	New houses
Builder P	11	Melbourne	New houses, additions & alterations
Builder Q	13	Melbourne	New houses, additions & alterations
Builder R	8	Regional Victoria	New houses, additions & alterations
Builder S	7	Melbourne	New houses, additions & alterations
Builder T	30	Melbourne	New houses
Builder U	50	Melbourne	New houses
Builder V	150	Melbourne & regional Victoria	New houses

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Table C.1 **Survey respondent profile** (continued)

<i>Practitioner<sup>a</sup></i>	<i>No. jobs per year</i>	<i>Region</i>	<i>Other</i>
Builder W	20	Melbourne	New houses
Builder X	15	Regional Victoria	New houses
Builder Y	na	Regional Victoria	Commercial <sup>c</sup>
Building surveyor A	1200 <sup>d</sup>	Melbourne & regional Victoria	New houses, additions & alterations
Building surveyor B	700 <sup>d</sup>	Melbourne & regional Victoria	New houses
Architect A	< 10	Melbourne	Additions & alterations
Architect B	< 10	Melbourne & regional Victoria	New houses, units, additions & alterations
Architect C	10–20	Melbourne & regional Victoria	New houses, units, additions & alterations
Architect D	55	Melbourne	New houses, units, additions & alterations
Other A	350	Melbourne & regional Victoria	Tile, houses, additions & alterations

<sup>a</sup> A builder operating in regional New South Wales also completed the questionnaire. <sup>b</sup> Not currently undertaking domestic building work but maintains domestic builder registration. <sup>c</sup> Not comparable with domestic builders' estimates. <sup>d</sup> Number of building permits issued. **na** Not available

## **C.2.2 Indicative estimate of the cost of housing construction regulation**

In the draft inquiry report, based on survey respondents' estimates, the Commission conservatively estimated that the selected Victorian and local government Regulations represented at least 4 per cent of the cost of new house construction. The Commission considered that the 4 per cent estimate represents a lower end estimate of the total cost of regulation, particularly given that survey respondents could not provide cost estimates for all the Regulations identified and that information was not sought for all Regulations affecting housing construction in Victoria.

Some inquiry participants supported the Commission's view that 4 per cent was a conservative estimate of the total cost to business of complying with housing construction regulation in Victoria. The HIA stated:

HIA contests the cost of the regulatory burden is much higher, up to two times the Commission's estimate, and considerably more when issues not considered by [the] Commission such as land supply constraints, are taken in to consideration. (sub. DR163, p. 4)

Bruce Langford Jones, of Langford Jones Homes stated:

... the draft report suggests the cost of state and local government regulation could be up to 4 per cent of the cost of a house—which I believe is too conservative. (sub. DR126, p. 5)

Work undertaken for the Building Commission—which estimated that Victorian housing construction regulations could impose costs of 5.1 per cent of a typical \$300 000 house (Davis Langdon Australia Pty Ltd 2005, p. 21)—also suggested that an estimate of 4 per cent is not unreasonable and may understate the costs for some houses.

Since the draft inquiry report, the sample of survey respondents has increased to 32 practitioners, 20 of whom estimated the regulatory costs for new houses. The estimates varied widely, from 2 per cent to 20 per cent of the cost of an 'average' house within the practitioners' standard product range (table C.2). This variation occurred partly because the extent to which respondents could provide estimates for all of the selected Regulations varied, but also because respondents had different views about the incremental cost attributable to regulation. Further, the cost estimates varied according to the type of house—for example, the cost of scaffolding is higher for double-storey houses than single-storey houses—and its siting and location—for example, the cost of some regulation is higher in regional areas than metropolitan Victoria.

While the range of estimates here is wider than in the draft inquiry report, the Commission considers its earlier estimate of at least 4 per cent is still at the lower end of the estimates provided. The average of survey respondents' lower bound estimates, for example, suggests the cost of complying with Victorian housing construction Regulation is approximately 6 per cent of the cost of new housing construction,<sup>3</sup> and the average of respondents' upper bound estimates is higher again (9 per cent).

Assuming that the experience of the practitioners participating in this exercise is representative of the broader industry, it would be reasonable to infer that the selected Regulations impose a cost equal to *at least* 4 per cent of the value of housing construction in Victoria. Chapter 2 noted that the value of housing construction in Victoria exceeded \$10 billion in 2004, which suggests that housing construction regulation cost *at least* \$400 million in 2004. Noting the discussion above, however, this cost could be considerably higher.

The estimated cost of at least \$400 million does not include the costs of levies—the building permit levy (0.064 per cent), the Building Advice Conciliation Victoria levy (0.064 per cent) and the HIH levy (0.032 per cent)—totalling 0.16 per cent of the cost of all housing construction work. Based on 2004 construction activity, the levies cost an additional \$16 million in 2004.<sup>4</sup> Including this estimate of the cost of the levies suggests the cost to businesses of complying with the selected Regulations was at least \$416 million in 2004.

While \$416 million is a conservative estimate of the total cost to business of complying with housing construction regulation, the extent to which this represents the incremental costs of regulation is unclear. The Commission considers that this estimate seems unlikely to overstate the incremental costs substantially, based on the evidence provided. The estimate is based on the lower bounds of survey respondents' estimates of the incremental regulatory costs, and is consistent with other attempts to estimate some or all of the regulatory costs.

The estimates reported in this appendix suggest the costs to industry of complying with Victorian housing construction Regulations are significant. While the appendix does not attempt to determine whether the Regulations are yielding net benefits, it helps identify those Regulations where closer consideration of costs and benefits may be warranted.

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<sup>3</sup>The mean and median of respondents' lower bound estimates are both 6 per cent of the cost of constructing a new house.

<sup>4</sup>This estimate may slightly overstate the amount paid as the levies are only payable for building work costing more than \$10 000.

## Indicative cost estimates: new houses

Twenty industry practitioners (19 builders and one architect) engaged in the construction of new houses provided estimates of the costs of regulatory compliance. Their responses are listed in table C.2, along with estimates provided by the HIA in its submission to a recent Productivity Commission inquiry (HIA 2003b). The figures in table C.2 reflect the survey respondents' estimates of the direct costs, additional expenses and administration time involved in complying with the specific Regulations for an 'average' house.

Table C.2 indicates that the participants' views of the costs of some of the selected Regulations varies widely, from 2 per cent of the value of the house to nearly 20 per cent. The percentage cost estimates reflect differences in respondents' cost estimates and the cost of an 'average' house for each respondent (which ranged from \$100 000 to \$750 000). Further, additional factors are likely to influence the observed differences in the percentage cost estimate:

- The Regulations for which respondents could provide cost estimates differed—for example, builders J and O did not provide details of their builders warranty insurance premiums for confidentiality reasons, while the HIA and builder E provided information on additional areas of regulation.
- The types of house built, and thus the regulatory requirements triggered, differed—for example, the cost of scaffolding for double-storey houses is typically higher than for single-storey houses.
- The way in which survey respondents estimated costs differed—for example, builder B estimated the regulatory cost of building permits to be higher than that estimated by other survey respondents. Builder B estimated the cost of obtaining a building permit today relative to that of 20 years ago (when less detailed information was required to obtain a permit), noting that today's cost includes engineering costs, the costs of developing more detailed plans, and the costs of administration and delays that were not present 20 years ago.
- The extent to which the cost estimates reflect the cost to the builder versus the final costs to consumers also differed. At least one survey respondent estimated the costs of the Regulations to consumers. This estimate may reflect some mark-up to allow for profit, so may be higher than estimates of the costs faced by builders.
- The size of the survey respondents' businesses varied considerably—for example, the number of new houses built by the survey respondents range from three per year to approximately 1500 per year.

**Table C.2 Indicative cost estimates: new houses<sup>a</sup>**

	<i>HLA<sup>b</sup></i>	<i>Builder A</i>	<i>Builder B</i>	<i>Builder D</i>	<i>Builder E</i>	<i>Builder G</i>
Builders warranty insurance (\$)		2800	2500–4000	885 <sup>c</sup>	1300	734
Building permits (\$)			10 000–15 000 <sup>d</sup>		650–1000 <sup>e</sup>	
5 Star energy efficiency (\$)	3300	10 000	10 000–18 000	250	10 250	6175–10 175 <sup>f</sup>
Water saving devices (\$)	2500		4500 <sup>g</sup>		150	
Termite protection (\$)		500	1000–4000	1000	1200–3000 <sup>h</sup>	1800 <sup>i</sup>
Perimeter scaffolding (\$)	10 000–12 000	Single: 1000 Double: 6000 <sup>j</sup>	5000–15 000 <sup>k</sup>	4250* <sup>l</sup>	Single: 1500 Double: 9000–10 000 <sup>m</sup>	2000–3000 <sup>n</sup>
Electrical tagging (\$)	260	200				
Council property information (\$)	0–300		500	65	75	50
Temporary site fencing (\$)	900 (full) 450 (front)	500	500–800	200	900* (full) 60* (front) <sup>o</sup>	Not required
Rubbish containers and tipping fees (\$)	350–450		700–800	300	500	700
Sediment control (\$)	300–500		300–400	250	80* <sup>p</sup>	100 <sup>q</sup>
Temporary vehicle crossing (\$)	<sup>r</sup>				40* <sup>s</sup>	
Other (\$)	600 <sup>t</sup>				835–925 <sup>u</sup>	
<b>Subtotal (\$)</b>	<b>17 760–20 720</b>	<b>15 000–20 000</b>	<b>35 000–62 500</b>	<b>7200</b>	<b>15 805–27 295</b>	<b>11 559–16 559</b>
Admin. (hours)		10	34–39	4.5	42.3–45.3	7
Admin. costs (\$) <sup>v</sup>		400	1360–1560	180	1692–1812	280
<b>TOTAL (\$)</b>	<b>17 760–20 720</b>	<b>15 400–20 400</b>	<b>36 360–64 060</b>	<b>7380</b>	<b>18 332–30 032</b>	<b>11 839–16 839</b>
Average project (\$)	150 000	400 000	325 000	150 000–200 000	200 000	170 000
<b>Share of average project (%)</b>	<b>11.8–13.8</b>	<b>3.9–5.1</b>	<b>11.2–19.7</b>	<b>3.7–4.9</b>	<b>9.2–15.0</b>	<b>7.0–9.9</b>

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**Table C.2 Indicative cost estimates: new houses (continued)**

	<i>Builder I</i>	<i>Builder J</i>	<i>Builder L</i>	<i>Builder M</i>	<i>Builder N</i>	<i>Builder O</i>
Builders warranty insurance (\$)	675	<b>w</b>	2060	1565	3000	<b>w</b>
Building permits (\$)						
5 Star energy efficiency (\$)	4150	na <sup>x</sup>	6150	10 000–30 000	na <sup>y</sup>	13 000
Water saving devices (\$)				2500	5000	500
Termite protection (\$)	500	400	550	800	1000	1200
Perimeter scaffolding (\$)	300 (single) 10 000 (double)		1500 (single) 8500 (double)	2875 (single) 16 375 (double)		1000* (single) 2900 (double)
Electrical tagging (\$)		12 #	25 #		75 #	
Council property information (\$)	30–500	33	30–60	120	1200	60
Temporary site fencing (\$)	480	na	525 (full) 225 (front)	550	40* (full) 588* (front)	60* (full) 168* (front)
Rubbish containers and tipping fees (\$)	150	na	750	250*	2000	200
Sediment control (\$)			210	30*		15*
Temporary vehicle crossing (\$)	220			150		200
Other (\$)						
<b>Sub total (\$)</b>	<b>6505–16 675</b>	<b>645</b>	<b>3290–10 620</b>	<b>18 840–52 340</b>	<b>14 903</b>	<b>16 403–20 303</b>
Admin. (hours)	33.4–34.3	42.2	19.6	42.6–42.7	27	33.1–34.6
Admin. costs (\$) <sup>v</sup>	1336–1372	1687	782	1704–1709	1080	1324–1384
<b>TOTAL (\$)</b>	<b>7841–18 047</b>	<b>2332</b>	<b>4072–11 402</b>	<b>20 544–54 049</b>	<b>15 983</b>	<b>17 727–21 687</b>
Average project (\$)	180 000	100 000	200 000	375 000	750 000	400 000
<b>Share of average project (%)</b>	<b>4.4–10.0</b>	<b>2.3</b>	<b>2.0–5.7</b>	<b>5.5–14.4</b>	<b>2.1</b>	<b>4.4–5.4</b>

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**Table C.2 Indicative cost estimates: new houses (continued)**

	<i>Builder P</i>	<i>Builder R</i>	<i>Builder S</i>	<i>Builder T</i>	<i>Builder U</i>	<i>Builder V</i>
Builders warranty insurance (\$)	3247	940	3000	1200	1120	861
Building permits (\$)						
5 Star energy efficiency (\$)	15 250	900	14 770 <sup>z</sup>	5200	6510	5350–10 350
Water saving devices (\$)	10 000	150	4500	3000	3000	500
Termite protection (\$)	2000	2500	1500	1200	450	490
Perimeter scaffolding (\$)	12 000	220* (single) 5100 (double)	1750* (single) 8500 (double)	1875* (single) 8000 (double)	550 (single)	950 (single) 5500 (double)
Electrical tagging (\$)	227 <sup>#</sup>	150 <sup>#</sup>	286 <sup>#</sup>			33 <sup>#</sup>
Council property information (\$)	<b>aa</b>			100	100	180
Temporary site fencing (\$)	2000 (front)		1600 (full)	750* (full) 700 (front)	6* <sup>ab</sup>	250* (full) 140* (front)
Rubbish containers and tipping fees (\$)			1500	75*	570	250
Sediment control (\$)					200	125*
Temporary vehicle crossing (\$)						70
Other (\$)						
<b>Sub total (\$)</b>	<b>32 725–44 725</b>	<b>4860–10 180</b>	<b>28 906–39 156</b>	<b>13 350–19 525</b>	<b>12 506–12 906</b>	<b>9199–18 749</b>
Admin. (hours)	89–94	11–12	26–87	9–10	27–28	19
Admin. costs (\$) <sup>v</sup>	3553–3753	448–496	1054–3494	346–395	1080–1120	760
<b>TOTAL (\$)</b>	<b>36 278–48 478</b>	<b>5308–10 676</b>	<b>29 960–42 650</b>	<b>13 696–19 920</b>	<b>13 586–14 026</b>	<b>9960–19 510</b>
Average project (\$)	500 000	190 000	600 000	160 000	180 000	165 000
<b>Share of average project (%)</b>	<b>7.3–9.7</b>	<b>2.8–5.6</b>	<b>5.0–7.1</b>	<b>8.6–12.5</b>	<b>7.5–7.8</b>	<b>6.0–11.8</b>

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**Table C.2 Indicative cost estimates: new houses (continued)**

	<i>Builder W</i>	<i>Builder X</i>	<i>Architect D</i>
Builders warranty insurance (\$)	1500	2400	<b>ac</b>
Building permits (\$)			
5 Star energy efficiency (\$)	4300	7400–14 400	8200–15 200
Water saving devices (\$)	4000	3500	2000–3000
Termite protection (\$)	500	2500	1500
Perimeter scaffolding (\$)	1000 (single); 6000 (double)	1125* (single); 6000 (double)	na <sup>ad</sup>
Electrical tagging (\$)		100 <sup>#</sup>	na
Council property information (\$)	na <sup>ae</sup>		450
Temporary site fencing (\$)	1000 (full)		
Rubbish containers and tipping fees (\$)	100		
Sediment control (\$)			
Temporary vehicle crossing (\$)			
Other (\$)			
<b>Sub total</b>	<b>12 400–17 400</b>	<b>17 025–28 900</b>	<b>12 150–20 150</b>
Admin. (hours)	9	58–61	19–23
Admin. costs (\$) <sup>v</sup>	360	2327–2427	760–920
<b>TOTAL (\$)</b>	<b>12 760–17 760</b>	<b>19 352–31 327</b>	<b>12 910–21 070</b>
Average project (\$)	130 000	200 000	450 000–600 000
<b>Share of average project (%)</b>	<b>9.8–13.7</b>	<b>9.7–15.7</b>	<b>2.2–4.7</b>

Totals may not add due to rounding. \* This reflects the cost to the 'average' house; the actual cost is higher but is not incurred for all houses; # Annual cost divided by the number of projects per year. <sup>a</sup> Not all respondents provided estimates for new houses. <sup>b</sup> HIA (2003b) submission to the Productivity Commission inquiry into first home ownership, pp. 93–4. <sup>c</sup> Average builders warranty insurance premium of \$861 per house and an additional \$24 per house to cover professional indemnity insurance (\$2000 allocated across 85 houses). <sup>d</sup> Survey respondent estimated costs relative to the costs involved in obtaining a planning permit 20 years earlier. The estimate includes engineering costs (\$2500–3000), more detailed plans (\$2000–3000), cost to send and follow up notices to neighbours, and time to obtain required documentation. <sup>e</sup> Range reflects cost differences in metropolitan (\$650–700) and regional (\$900–1000) Victoria. <sup>f</sup> Estimated it currently costs \$6000 to achieve standard, including the cost of a solar hot water service plus \$175 to obtain an energy rating. Estimated this cost could increase to \$10 000 per house after 1 July 2005. The actual cost will vary depending on house siting. Estimated that approximately 20 per cent of houses would achieve the 5 Star standard if this were not regulated. <sup>g</sup> Water tank. <sup>h</sup> Range reflects cost differences in metropolitan (\$1200) and regional (\$3000) Victoria. <sup>i</sup> Builder advised that 100 per cent of houses would install termite protection if it were voluntary. <sup>j</sup> Single-storey houses require guard rails at cost of \$1000; double-storey houses require scaffolding at total cost of \$6000 (including guard rail at \$1000, scaffolding at \$3000 and mobile towers at \$2000). Estimated that previously spent \$2000 on scaffolding before introduction of Regulations. <sup>k</sup> Estimated cost ranges from \$5000 per single-storey house up to \$15 000 for a double-storey house. <sup>l</sup> Based on 60 per cent of properties requiring scaffolding at a total cost of \$7080 (guard rail at \$1750 and scaffold at \$5330). <sup>m</sup> Estimated use of a guard rail on 50 per cent of single-storey houses and scaffolding on 100 per cent of double-storey houses (\$9000 in metropolitan areas and \$10 000 in regional areas). <sup>n</sup> Applies to double-storey houses only (proportion not available).

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## Table C.2 Indicative cost estimates: new houses (continued)

<sup>o</sup> Estimate of cost for 'average' house based on 20 per cent of properties requiring front fence at total cost of \$300, and 60 per cent requiring full site fencing at total cost of \$1500, and requiring three hours administration. <sup>p</sup> Estimate for 'average' house based on sediment control measures required for 20 per cent of properties at cost of \$400 and requiring three hours administration. <sup>q</sup> Silt fencing costs \$200 (\$100 to install and \$100 to maintain) and is required for 50 per cent of houses. <sup>r</sup> Included in aggregate estimate under 'other'. <sup>s</sup> Estimate for 'average' house based on temporary vehicle crossings required for 10 per cent of properties at a cost of \$400 and requiring three hours administration. <sup>t</sup> Includes plumbing certificates of compliance (\$60), temperature control valves (\$150), electrical safety switch (\$80), certificates of electrical safety (\$60) and lockable meter boxes (\$250). <sup>u</sup> Includes temperature control valves (\$500), electrical safety switch (\$85–100), lockable meter boxes (\$100) and mains powered smoke alarms (\$150 single-storey, \$225 double-storey). <sup>v</sup> Administration time is costed at \$40 per hour. <sup>w</sup> Builder unable to disclose builders warranty insurance premium. <sup>x</sup> Respondent constructs granny flats and indicated 5 Star requirements did not apply. <sup>y</sup> Respondent indicated that architects/draughtspersons include 5 Star adjustments in drawings and plans. <sup>z</sup> Estimate based on costs for first project; respondent expected cost to increase in future projects. <sup>aa</sup> Respondent indicated 'many hours' of administrative time were involved. <sup>ab</sup> Total cost is \$600 but only required for 1 per cent of projects. <sup>ac</sup> Architects are not required to provide builders warranty insurance. <sup>ad</sup> Unable to estimate because builder's responsibility. <sup>ae</sup> Architect/draughtsman obtains this information. <sup>na</sup> Not available.

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### Indicative cost estimates: additions and alterations

Nine builders engaged in constructing additions and alterations estimated the costs of regulatory compliance. Table C.3 presents their estimates of both the costs and administration time involved in complying with the specific Regulations for an 'average' house. It also expresses the estimated costs of regulation as a share of the 'average' addition or alteration project.

As for new houses, table C.3 indicates that the average lower bound of practitioners' estimates of the costs of complying with Victorian housing construction Regulations was 6 per cent.<sup>5</sup> Estimates ranged from 2.1 per cent to 15.3 per cent.

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<sup>5</sup> The mean of respondents' lower bound estimates was 6 per cent; the median was 5 per cent.

**Table C.3 Indicative cost estimates: additions and alterations<sup>a</sup>**

	<i>Builder A</i>	<i>Builder C</i>	<i>Builder H</i>	<i>Builder K</i>	<i>Builder N</i>
Builders warranty insurance (\$)	2000	800	758	2700	2500
Building permits (\$)					
5 Star energy efficiency (\$)	5000		4000	5300	<b>b</b>
Water saving devices (\$)			1000	300	na
Termite protection (\$)	500	1000	600	4000	400
Perimeter scaffolding (\$)	Single: 1000 Double: 6000* <sup>c</sup>	800–3500* <sup>d</sup>	2000* (single) 9000–11 000 (double)	700* (single) 7000 (double)	2400* (single) 5000 (double)
Electrical tagging (\$)	200 <sup>#e</sup>	500 <sup>#f</sup>	42 <sup>#</sup>	25 <sup>#</sup>	75 <sup>#</sup>
Council property information (\$)		50	800		800
Temporary site fencing (\$)			180* (front)	70* (front)	12* (full) 160* (front)
Rubbish containers and tipping fees (\$)			1200	150*	570*
Sediment control (\$)					
Temporary vehicle crossing (\$)			40*	25*	
Other (\$)					
<b>Sub total (\$)</b>	<b>8700–13 700</b>	<b>3150–5850</b>	<b>10 620–19 620</b>	<b>13 270–19 570</b>	<b>6917–9517</b>
Admin. (hours)	9	46–47	25–27	59–86	12–15
Admin. costs (\$) <sup>g</sup>	360	1840–1880	984–1084	2359–3439	570–602
<b>TOTAL (\$)</b>	<b>9060–14 060</b>	<b>4990–7730</b>	<b>11 604–20 704</b>	<b>15 629–23 009</b>	<b>7487–10 119</b>
Average project (\$)	200 000	140 000–150 000	166 000	150 000	350 000
<b>Share of average project (%)</b>	<b>4.5–6.7</b>	<b>3.6–5.5</b>	<b>7.0–12.5</b>	<b>10.4–15.3</b>	<b>2.1–2.9</b>

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**Table C.3 Indicative cost estimates: additions and alterations (continued)**

	<i>Builder P</i>	<i>Builder Q</i>	<i>Builder R</i>	<i>Builder S</i>
Builders warranty insurance (\$)	2427	2500	600	2600
Building permits (\$)				
5 Star energy efficiency (\$)	250 <sup>h</sup>	<sup>i</sup>	300	6000 <sup>j</sup>
Water saving devices (\$)	10 000	3000	100	3500
Termite protection (\$)	2000	400	1500	400–500
Perimeter scaffolding (\$)	12 250 (double)	1000* (single) 8000 (double)	150* (single) 1600 (double)	900* (single) 7500 (double)
Electrical tagging (\$)	227 <sup>#</sup>	154 <sup>#</sup>	150 <sup>#</sup>	286 <sup>#</sup>
Council property information (\$)		50		50
Temporary site fencing (\$)	2000 (front)	900 (full)		900 (front)
Rubbish containers and tipping fees (\$)		1000		1000
Sediment control (\$)				
Temporary vehicle crossing (\$)		50*		63*
Other (\$)		2600 <sup>k</sup>		15 698–22 398
<b>Sub total (\$)</b>	<b>17 155–29 155</b>	<b>11 654–18 654</b>	<b>2800–4250</b>	<b>15 698–22 398</b>
Admin. (hours)	70–75	32–58	8–9	25–52
Admin. costs (\$) <sup>g</sup>	2800–3000	1280–2320	320–360	1014–2074
<b>TOTAL (\$)</b>	<b>19 955–32 155</b>	<b>12 934–20 974</b>	<b>3120–4610</b>	<b>16 713–24 473</b>
Average project (\$)	250 000	250 000	50 000	400 000
<b>Share of average project (%)</b>	<b>7.8–12.7</b>	<b>5.2–8.4</b>	<b>6.3–9.2</b>	<b>4.2–6.1</b>

Totals may not add due to rounding. \* This reflects the cost to the 'average' house; the actual cost is higher but is not incurred for all houses. # Annual cost divided by the number of projects per year. <sup>a</sup> Not all builders provided estimates for alterations and additions. <sup>b</sup> Respondent indicated that architects/draughtspersons include 5 Star requirements in drawings and plans. <sup>c</sup> Average across all jobs: \$3500 = (0.5\*1000) + (0.5\*6000). 50 per cent of jobs require a guard rail at \$1000; a further 50 per cent require a guard rail at \$1000, scaffolding at \$3000 and mobile towers at \$2000. Builder noted that would probably spend \$2000 on scaffolding in absence of Regulations. <sup>d</sup> Estimate for the average project based on 80 per cent of single-storey jobs requiring scaffolding at a cost of \$1000 and 100 per cent of double-storey jobs requiring scaffolding at a cost of \$3000–3500. <sup>e</sup> Based on 50 tools, tagged four times a year at a cost of \$6 per tool divided by six projects a year. <sup>f</sup> Based on cost of \$700 per year passed on by 50 subcontractors, working 50 per cent of their time with the business, on 35 jobs per year. <sup>g</sup> Assuming administration time is costed at \$40 per hour. <sup>h</sup> Cost of energy rating only. Respondent indicated it would cost 'many thousands' to bring existing homes up to 5 star. <sup>i</sup> Indicated that every project is different. <sup>j</sup> Estimate based on first project. <sup>k</sup> Includes protection works (\$2000) and engineering design of footings (\$600). <sup>na</sup> Not applicable.

### **Indicative cost estimates: practitioner registration/licensing**

Registration and licensing requirements are another regulatory cost imposed on business. Registration and licensing can act as a barrier to entry and may affect the competitive structure of the market (discussed in chapter 6). In addition to the registration/licence fee, businesses incur administrative costs in meeting the requirements. Some practitioners (domestic builders) must obtain insurance as a condition of registration. The annual administrative costs of obtaining insurance cover (as opposed to the administrative costs of taking out a policy for an individual building project) is also reported in table C.4. Where practitioners are required to obtain insurance as a condition of registration, the total administration costs can be significant, but the estimates vary significantly. One builder (builder F) indicated, for example, that a person within business would spend two months a year obtaining eligibility for builders warranty insurance. At the other extreme, another builder indicated that the time involved in obtaining insurance was negligible.

Table C.4 reports the estimated costs of practitioner registration. The estimates vary widely, largely due to significant differences in the estimated administration involved in obtaining insurance cover. While the costs to businesses are not insignificant, when the estimates are allocated across the number of domestic building projects undertaken each year, practitioner registration does not impose substantial costs relative to its price or other regulatory costs imposed (table C.4). However, because a number of registered practitioners may be involved in any one project (for example, a building surveyor, architect, builder and subcontractors), the ‘effective’ cost per house is likely to be higher than any of the individual estimates provided in table C.4.

**Table C.4 Indicative cost estimates: practitioner registration**

<i>Survey respondent<sup>a</sup></i>	<i>Annual admin. for insurance (hrs)</i>	<i>Admin. time (hrs)</i>	<i>Admin. cost<sup>b</sup> (\$)</i>	<i>Renewal fee (\$)</i>	<i>Total (\$)</i>	<i>Per project<sup>c</sup> (\$)</i>
Builder A		1	40	180	<b>220</b>	37
Builder B		2–3	80–120	180	<b>260–300</b>	7–8
Builder C	24	<b>8<sup>d</sup></b>	1280	180	<b>1460</b>	45
Builder D		2	80	180	<b>260</b>	3
Builder E	40	8	1920	180	<b>2100</b>	1
Builder F	320		12 800	180	<b>12 980</b>	<b>e</b>
Builder G		16–24	640–960	180	<b>820–1140</b>	25–35
Builder H		8	320	180	<b>500</b>	8
Builder I		10	400	180	<b>580</b>	4
Builder J	40	16	2240	180	<b>2420</b>	34
Builder K		8	320	180	<b>500</b>	83
Builder L		np		180	<b>180</b>	<b>5<sup>f</sup></b>
Builder M		15	600	180	<b>780</b>	10
Builder N		2	80	180	<b>260</b>	13
Builder O		0.5	20	180	<b>200</b>	3
Builder P		np		180	<b>180</b>	<b>16<sup>f</sup></b>
Builder Q		4	160	180	<b>340</b>	26
Builder R	4	2	240	180	<b>420</b>	53
Builder S		3	120	180	<b>300</b>	43
Builder T		2	80	180	<b>260</b>	9
Builder U	10–20	0.5	420–820	180	<b>600–1000</b>	12–20
Builder V		5	200	180	<b>380</b>	3
Builder W		50	2000	180	<b>2180</b>	109
Builder X		80	3200	180	<b>3380</b>	225
Architect A	1		40	150	<b>190</b>	27
Architect B	1		40	150	<b>190</b>	12
Architect C	1		40	150	<b>190</b>	12
Architect D		30	1200	150	<b>1350</b>	25
Building surveyor A	24		960	90	<b>1050</b>	1
Building surveyor B	24		960	90	<b>1050</b>	2

<sup>a</sup> Registered domestic building practitioners only, hence excludes builder Y, <sup>b</sup> Administration time costed at \$40 per hour. <sup>c</sup> Rounded to the nearest \$1. <sup>d</sup> Time to register as both domestic and commercial builder. <sup>e</sup> Maintains domestic builder registration but does not undertake any domestic building projects. <sup>f</sup> Based on registration fee apportioned across average number of projects because estimate of administration time was not provided. **np** Not provided

### **C.2.3 Significance of specific regulatory costs**

While the survey respondents' cost estimates vary, both in aggregate and for individual regulatory requirements, some consistent observations emerge. Survey respondents generally identified four areas of regulation that impose relatively high compliance costs on business:<sup>6</sup>

- (1) 5 Star energy efficiency (including water saving devices)
- (2) building warranty insurance
- (3) perimeter scaffolding
- (4) termite protection.

Despite these consistently being identified as imposing relatively high costs, these costs differ according to the size of house (for example, higher scaffolding costs for double-storey houses) and the size and risk profile of the builder (for example, insurance premiums and the ability to spread fixed administrative costs). Further, the percentage cost estimates reflect differences in respondents' cost estimates and the cost of an 'average' house within each respondents' product range.

Survey respondents were also generally consistent in identifying the Regulations that impose relatively low costs on business. One notable exception is building permits, where one business estimated that current building permit requirements impose a significant additional cost. Comparing current building permit requirements with those that applied 20 years ago, the survey respondent argued that plans are now required to be significantly more detailed, and that more professional input is required, such as mandatory engineering reports. This builder's estimate is unlikely to be directly comparable with other estimates that are not based on a similar relative comparison.

#### **5 Star energy efficiency**

Survey respondents observed that the cost of meeting the 5 Star standard could vary considerably according to a house's style and orientation, and other characteristics of the building site. Survey respondents generally estimated the cost of meeting 5 Star energy efficiency requirements to be high. Most of the new house builders estimated between \$4000 and \$30 000 per house. Expressed as a proportion of the cost of an average house for each respondent, the additional cost ranged from 1.4 per cent to 8.0 per cent for most respondents (table C.5). The percentage cost estimates reflect differences in respondents' cost estimates and in the cost of an 'average' house within each respondents' product range.

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<sup>6</sup> Information provided following the release of the draft inquiry report also indicates that the provision of rubbish containers and tipping fees can impose substantial costs.

There were, however, some exceptions. Builder D, for example, considered the \$250 cost to obtain an energy rating to be the only additional cost imposed. Builder R also indicated that they ‘do not have a problem achieving affordable ratings’ and that ‘[a] 5 or 6 star rating adds less than 1 per cent to our client costs’. An architect expressed the view that making a house environmentally sustainable should not impose additional capital costs if the house is designed to meet this standard from the outset. The architect considered that additional costs arise when the house is designed and then retrospectively altered to achieve the specified standard.

The range of estimates provided is broadly consistent with a recent survey conducted for the Building Commission, which found that 36 per cent of respondents considered 5 Star energy requirements would add costs of 3–5 per cent of the cost of a new house. Eighteen per cent of respondents indicated the added cost would be less than 3 per cent, while a further 32 per cent of respondents considered it would be greater than 5 per cent<sup>7</sup> (Chant Link & Associates 2005, p. 47).

It is not clear to what extent the cost estimates reflect the incremental costs faced by the whole industry. While builder D considers that this requirement imposes few incremental costs because planning permit conditions required the business to meet this standard for the past four to five years, many builders would not have been subject to equivalent (planning) requirements.<sup>8</sup> Other builders commented that consumers displayed a relatively high awareness of energy efficiency issues, and that some consumers may demand this standard anyway. Nonetheless, the Regulations will impose additional costs where consumers would otherwise choose a lower standard of energy efficiency.

The estimates provided for alterations and additions should be interpreted with caution. A Victorian variation to the Building Code of Australia states that alterations to existing buildings must achieve a house energy rating not less than the rating of the house before the alterations, or not less than three stars, whichever is the greater. There appears to be a lower awareness of the energy efficiency requirements for alterations to existing buildings. Consequently, some builders did not estimate the cost of meeting energy efficiency standards. Again, some builders identified a relatively high level of consumer awareness of energy efficiency matters, so the arguments raised above could be applied in considering the extent to which the estimates reflect incremental costs.

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<sup>7</sup> A further 14 per cent of respondents indicated that they did not know what the added costs of complying with the 5 Star requirements would be.

<sup>8</sup> Builder D principally constructs unit and townhouse developments in the Monash, Whitehorse and Boroondara municipal areas. The builder advised that the multi-unit nature of the developments triggered the need to obtain a planning permit, which in turn imposed energy efficiency requirements.

**Table C.5 Indicative cost estimates: 5 Star energy efficiency**

<i>Survey respondent</i> <sup>a</sup>	<i>Average project cost (\$)</i>	<i>Admin. time (hrs)</i>	<i>Admin. cost (\$)</i> <sup>b</sup>	<i>Other costs (\$)</i>	<i>Total cost (\$)</i>	<i>Share of average project (%)</i>
<i>New house</i>						
Builder A	400 000			10 000	<b>10 000</b>	2.5
Builder B	325 000	16	640	10 000– 18 000	<b>10 640– 18 640</b>	3.3–5.7
Builder D	150 000– 200 000			250	<b>250</b>	0.1–0.2
Builder E	200 000	22	880	10 250	<b>11 130</b>	5.6
Builder G	170 000	2	80	6175– 10 175 <sup>c</sup>	<b>6255</b>	3.7–6.0
Builder I	180 000	4	160	4150 <sup>d</sup>	<b>4310</b>	2.4
Builder J	100 000					
Builder L	200 000	7.5	300	6150	<b>6450</b>	3.2
Builder M	375 000			10 000– 30 000	<b>10 000– 30 000</b>	2.7–8.0
Builder N	750 000			na <sup>e</sup>		
Builder O	400 000	2	80	13 000	<b>13 080</b>	3.3
Builder P	500 000	18.75	750	15 250	<b>16 000</b>	3.2
Builder R	190 000	1	40	900	<b>940</b>	0.5
Builder S	600 000	4	160	14 770	<b>14 930</b>	2.5
Builder T	160 000	3–4	120–160	5200	<b>5320– 5360</b>	3.3–3.4
Builder U	180 000			5510	<b>5510</b>	3.1
Builder V	165 000	2	80	5350– 10 350	<b>5430– 10 430</b>	3.3–6.3
Builder W	130 000	2	80	4300	<b>4380</b>	3.4
Builder X	200 000	20	800	7400– 14 400	<b>8200– 15 200</b>	4.1–7.6
Architect D	450 000– 600 000	4–5	160–200	8200– 15 200	<b>8360– 15 400</b>	1.4–3.4
<i>Additions/alterations</i>						
Builder A	200 000			5000	<b>5000</b>	2.5
Builder C	140 000– 150 000			na <sup>f</sup>		
Builder H	166 000			4000	<b>4000</b>	2.4
Builder K	150 000			5300	<b>5300</b>	3.5
Builder N	350 000			na <sup>e</sup>		
Builder P	250 000		750	250 <sup>g</sup>	<b>1000</b>	0.4 <sup>g</sup>
Builder Q	250 000			np <sup>h</sup>		
Builder R	50 000			300	<b>300</b>	0.6
Builder S	400 000			6000	<b>6000</b>	1.5

(continued next page)



## Table C.5 Indicative cost estimates: 5 Star energy efficiency (continued)

<sup>a</sup> Not all respondents provided estimates for new houses and/or additions/alterations. <sup>b</sup> Administration time is costed at \$40 per hour. <sup>c</sup> Estimated it currently costs \$6000 to achieve standard, including the cost of a solar hot water service plus \$175 to obtain an energy rating. Estimated this cost could increase to \$10 000 per house after 1 July 2005. Noted that the actual cost will vary depending on house siting. Estimated that approximately 20 per cent of houses would achieve the 5 Star standard if this were not regulated. <sup>d</sup> Includes a solar hot water service with renewable energy credits (\$4000) and obtaining an energy rating (\$150). <sup>e</sup> Architects/draughtspersons include requirements in plans. <sup>f</sup> Did not believe 5 Star energy efficiency requirements applied to additions and alterations. <sup>g</sup> Includes only administration and rating costs. Respondent indicated that it would cost thousands to bring existing homes up to 5 Star standard. <sup>h</sup> Unable to estimate because every project is different. **na** Not available.

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### Builders warranty insurance

Survey respondents' estimates of the costs of builders warranty insurance ranged from \$794 to \$4120 per project (table C.6), which included the cost of the time the businesses spent obtaining and maintaining this insurance. It is not surprising that a range of estimates was provided, because premiums vary with project cost, and the survey respondents' average project cost varied. The estimated cost of builders warranty insurance also varied as a share of each respondent's average project cost, from 0.4 per cent to 1.8 per cent.<sup>9</sup> This additional variation is likely to be explained by differences in the insurers' assessment of the relative risk of the survey respondents, and differences in the builders' estimates of the administrative burden imposed.

An assessment of the extent to which these estimates represent incremental costs is difficult. Some builders suggested they would not take out insurance at its current cost to obtain the level of cover currently offered by builders warranty insurance. What is not known, however, is the extent to which builders would take out insurance at a lower cost, or with a higher level of cover, than currently offered. Builders may also provide (at some cost) some alternative form of guarantee to consumers. Where builders would otherwise incur costs to provide some form of consumer protection, the total costs of insurance would overstate the incremental costs; however, the extent to which this is the case with these estimates is not clear.

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<sup>9</sup> The highest and lowest dollar cost estimates may not result in the highest and lowest percentage estimates, given differences in the participants' average project cost.

Table C.6 **Indicative cost estimates: builders warranty insurance**

<i>Survey respondent</i> <sup>a</sup>	<i>Average project cost (\$)</i>	<i>Admin. time (hrs)</i>	<i>Admin. cost (\$)</i> <sup>b</sup>	<i>Other costs (\$)</i> <sup>c</sup>	<i>Total cost (\$)</i>	<i>Share of average project cost (%)</i>
<i>New houses</i>						
Builder A	400 000	2	80	2800	<b>2880</b>	0.7
Builder B	325 000	2–3	80	2500–4000	<b>2580–4120</b>	0.8–1.3
Builder D	150 000–200 000	0.5	20	885	<b>905</b>	0.5–0.6
Builder E	200 000	4	160	1200–1400	<b>1360–1560</b>	0.7–0.8
Builder G	170 000	1.5	60	734	<b>794</b>	0.5
Builder I	180 000	20	800	675	<b>1475</b>	0.8
Builder J	100 000	0.6	24	<b>d</b>	<b>d</b>	
Builder L	200 000			2060	<b>2060</b>	1.0
Builder M	375 000	0.5–0.6	20	1565	<b>1585–1590</b>	0.4
Builder N	750 000	6	240	3000	<b>3240</b>	0.4
Builder O	400 000	16	640	<b>d</b>	<b>d</b>	
Builder P	500 000	6	240	3247	<b>3487</b>	0.7
Builder R	190 000	5	200	940	<b>1140</b>	0.6
Builder S	600 000	1	40	3000	<b>3040</b>	0.5
Builder T	160 000	0.8	32	1200	<b>1232</b>	0.8
Builder U	180 000	8.5	340	1120	<b>1460</b>	0.8
Builder V	165 000	0.8	32	861	<b>893</b>	0.5
Builder W	130 000	2	80	1500	<b>1580</b>	1.2
Builder X	200 000	13	520	2400	<b>2920</b>	1.5
<i>Additions/alterations</i>						
Builder A	200 000	2	80	2000	<b>2080</b>	1.0
Builder C	140 000–150 000	1.7	68	800	<b>868</b>	0.6
Builder H	166 000	3	120	758	<b>878</b>	0.5
Builder K	150 000		0	2700	<b>2700</b>	1.8
Builder N	350 000	3	120	2500	<b>2620</b>	0.7
Builder P	250 000	5.7	228	2427	<b>2655</b>	1.1
Builder Q	250 000	2	80	2500	<b>2580</b>	1.0
Builder R	50 000	5	200	600	<b>800</b>	1.6
Builder S	400 000	1	40	2600	<b>2640</b>	0.7

<sup>a</sup> Not all builders provided estimates for new houses and/or additions/alterations. <sup>b</sup> Assuming administration time is costed at \$40 per hour. <sup>c</sup> Typically refers to the cost of the average premium but may include other costs (for example, apportioned additional accounting costs or the costs of obtaining a bank guarantee). <sup>d</sup> Respondent was unable to disclose premium for confidentiality reasons.

## Scaffolding

The Occupational Health and Safety (Prevention of Falls) Regulations require that guard rails and/or scaffolding are installed where work is undertaken at a height greater than two metres. When estimating the cost of complying with this Regulation, survey respondents typically distinguished between the cost for single-storey houses, which often require only a guard rail for installing the roof, and double-storey houses, which require additional scaffolding. Some survey respondents also estimated the proportion of houses requiring some form of scaffolding. Where this information was available, table C.7 indicates the average cost of scaffolding for an ‘average’ house across the businesses’ range of houses (indicated with an asterisk). Where information on the proportion of building projects requiring scaffolding was not available, table C.7 indicates the survey respondents’ estimates of the cost of meeting this requirement. These different perspectives should be considered when comparing the estimates provided.

The survey respondents estimated that the cost of installing scaffolding for single-storey new houses ranged from \$570 to \$5120, or 0.3–1.6 per cent of the average project value (although, the ‘average’ cost was as low as \$208, or 0.2 per cent, for respondents not required to provide scaffolding for all single-storey houses). Survey respondents estimated that the cost of installing scaffolding for double-storey new houses ranged between \$2000 and \$16 375, or 0.3–5.1 per cent of the average project value. The wide range of the estimates reflects differences in the estimated cost of scaffolding, and in the average project value for each survey respondent. (One survey respondent estimated too that the cost of scaffolding was higher in regional areas than in metropolitan areas.) Survey respondents also provided a range of estimates of the cost of providing scaffolding for additions and alterations, with the cost of scaffolding for double-storey houses typically substantially higher than that for single-storey houses (table C.3).

Most survey respondents indicated that they would use some means to prevent falls even if not required by regulation, and some survey respondents indicated that they would incur these costs regardless of a regulatory requirement to provide a safe working environment. Where a builder would otherwise not install scaffolding as required under current Regulations, however, the regulation imposes incremental costs. The incremental costs of this requirement across the industry depends on the proportion of builders that would install scaffolding as required under the Regulations, and the proportion of builders that would use some alternative means to prevent falls, and the costs of those alternatives. Given the small sample of estimates, it is not possible to identify accurately the extent to which they represent the incremental costs faced by the whole industry.

Table C.7 **Indicative cost estimates: scaffolding on new houses**

<i>Survey respondent</i> <sup>a</sup>	<i>Average project cost (\$)</i>	<i>Storeys</i>	<i>Admin. time (hrs)</i>	<i>Admin. cost (\$)</i> <sup>b</sup>	<i>Other costs (\$)</i>	<i>Total cost (\$)</i>	<i>Share of average project (%)</i>
Builder A	400 000	Single:	3	120	1000	<b>1120</b>	0.3
		Double:	3	120	6000 <sup>c</sup>	<b>6120</b>	1.5
Builder B	325 000	Single:	2–3	80–120	5000	<b>5080–5120</b>	1.6
		Double:	2–3	80–120	< 15 000	<b>&lt; 15 120</b>	< 4.7
Builder D	150 000–200 000	Double:			4248 <sup>d</sup>	<b>4248</b>	2.1–2.8
Builder E	200 000	Single:	3	120	1500	<b>1620</b>	0.8
		Double:	6	240	9000–10 000	<b>9240–10 240</b>	4.6–5.1
Builder G	170 000	Double:			2000–3000	<b>2000</b>	1.2–1.8
Builder I	180 000	Single:	0.1*	4*	300*	<b>304* e</b>	0.2*
		Double:	1	40	10 000	<b>10 040</b>	5.6
Builder J	100 000	Single:	0.2*	8*	200*	<b>208* f</b>	0.2*
Builder L	200 000	Single:	1	40	1500	<b>1540</b>	0.8
		Double:	1	40	8500	<b>8540</b>	4.3
Builder M	375 000	Single:			2875 <sup>g</sup>	<b>2875</b>	0.8
		Double:			16 375 <sup>g</sup>	<b>16 375</b>	4.4
Builder N	750 000	Single:	2	80	1000	<b>1080</b>	0.1
		Double:	2	80	2000	<b>2080</b>	0.3
Builder O	400 000	Single:	0.5*	20*	1000*	<b>1020* h</b>	0.3*
		Double:	1	40	2900	<b>2940</b>	0.7
Builder P	500 000	Double:	5	200	12 000	<b>12 200</b>	2.4
Builder R	190 000	Single:	0.2*	8*	220*	<b>228* i</b>	0.1*
		Double:	1	40	5100	<b>5140</b>	2.7
Builder S	600 000	Single:	10–15*	400–600*	1750*	<b>2150–2350* j</b>	0.4*
		Double:	41	1640	8500	<b>10 140</b>	1.7
Builder T	160 000	Single:	0.2*	8*	1875*	<b>1883* k</b>	1.2*
		Double:	0.4	16	8000	<b>8016</b>	5.0
Builder U	180 000	Single:	0.5	20	550	<b>570</b>	0.3
Builder V	165 000	Single:			950	<b>950</b>	0.6
		Double:			5500	<b>5500</b>	3.3
Builder W	130 000	Single:			1000	<b>1000</b>	0.8
		Double:			6000	<b>6000</b>	4.6
Builder X	200 000	Single:	1.5*	60*	1125*	<b>1185* l</b>	0.6*
		Double:	4	160	6000	<b>6160</b>	3.1

(continued next page)

## Table C.7 Indicative cost estimates: scaffolding on new houses (continued)

\* Not required for all houses, so represents the average cost to the 'average' house; the actual cost of the requirements is higher. <sup>a</sup> Not all respondents provided estimates for new houses. <sup>b</sup> Administration time is costed at \$40 per hour. <sup>c</sup> Includes guard rail (\$1000), scaffolding (\$3000) and mobile towers (\$2000). Estimated that would have spent \$2000 on alternative system before the introduction of the regulatory requirement. <sup>d</sup> Includes cost of guard rail (\$1750) and scaffold (\$5330) and required for 60 per cent of properties. <sup>e</sup> 10 per cent of single-storey houses require scaffolding at a total cost of \$3000 and involve one hour of administration time. <sup>f</sup> 20 per cent of houses require scaffolding at a total cost of \$1000 and involve one hour of administration time. <sup>g</sup> Includes \$110 000 in additional occupational health and safety management costs apportioned across 80 houses per year. <sup>h</sup> 50 per cent of single-storey houses require scaffolding at a total cost of \$2000 and involve one hour of administration time. <sup>i</sup> 20 per cent of single-storey houses require scaffolding at a total cost of \$800 and involve one hour of administration time. <sup>j</sup> 40–60 per cent of single-storey houses require scaffolding at a total cost of \$3500 and involve one hour of administration time and three days time to change building practices as a result of using scaffolding. <sup>k</sup> 75 per cent of single-storey houses require scaffolding at a total cost of \$2500 and involve 15 minutes of administration time. <sup>l</sup> 75 per cent of single-storey houses require scaffolding at a total cost of \$1500 and involve two hours administration time.

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### Termite protection

Local councils may declare municipalities that are likely to be subject to termite infestation and thus require termite protection to be provided. At 13 January 2005, 48 of the 78 Victorian municipalities were declared (Creffield 2005, p. 1). The extent to which the survey respondents operated in declared municipalities and are required to provide termite protection varied. Table C.8 indicates survey respondents' estimates of the cost of providing termite protection where required. Their estimates ranged from \$400 to \$4500, or 0.1–3.1 per cent of the cost of an average project. The percentage cost estimates reflect differences in respondents' cost estimates and in the cost of an 'average' house for each respondent.

Survey respondents noted that the cost of termite protection differs according to the method—for example, lower cost chemical methods or higher cost physical barriers. One survey respondent (builder E) estimated that the cost of providing termite protection was higher in regional areas because physical barriers, rather than chemical barriers, were used.

Because not all municipalities require termite protection, the incremental cost for all new houses in Victoria would be lower than the estimated costs in table C.8. Some survey respondents also indicated that they would install termite protection if not required to do so, but others indicated that they would not. The incremental costs, therefore, are likely to be lower than the cost estimates in table C.8, although it is not clear to what extent.

Table C.8 **Indicative cost estimates: termite protection**

<i>Survey respondent<sup>a</sup></i>	<i>Average project cost (\$)</i>	<i>Admin. time (hrs)</i>	<i>Admin. cost (\$)<sup>b</sup></i>	<i>Other costs (\$)</i>	<i>Total cost (\$)</i>	<i>Share of average project (%)</i>
<i>New houses</i>						
Builder A	400 000	1	40	500	<b>540</b>	0.1
Builder B	325 000	5–6	200–240	1000–4000 <sup>c</sup>	<b>1200–4240</b>	0.4–1.3
Builder D	150 000–200 000			1000	<b>1000</b>	0.5–0.7
Builder E	200 000	3	120	1200–3000 <sup>d</sup>	<b>1320–3120</b>	0.7–1.6
Builder G	170 000	0.5	20	1800 <sup>e</sup>	<b>1820</b>	1.1
Builder I	180 000	1	40	500	<b>540</b>	0.3
Builder J	100 000	3.75	150	400	<b>550</b>	0.6
Builder L	200 000	1.25	50	550	<b>600</b>	0.3
Builder M	375 000	2	80	800	<b>880</b>	0.2
Builder N	750 000			1000	<b>1000</b>	0.1
Builder O	400 000	1	40	1200	<b>1240</b>	0.3
Builder P	500 000	12.5	500	2000	<b>2500</b>	0.5
Builder R	190 000	1	40	2500	<b>2540</b>	1.3
Builder S	600 000			1500	<b>1500</b>	0.3
Builder T	160 000	0.25	10	1200	<b>1210</b>	0.8
Builder U	180 000	1	40	450	<b>490</b>	0.3
Builder V	165 000	2	80	490	<b>570</b>	0.3
Builder W	130 000			500	<b>500</b>	0.4
Builder X	200 000	5	200	2500	<b>2700</b>	1.4
Architect D	450 000–600 000	1	40	1500	<b>1540</b>	0.3
<i>Additions/alterations</i>						
Builder A	200 000			500	<b>500</b>	0.3
Builder C	140 000–150 000			1000	<b>1000</b>	0.7
Builder H	166 000	1	40	600	<b>640</b>	0.4
Builder K	150 000	12.5	500	4000	<b>4500</b>	3.0
Builder N	350 000			400	<b>400</b>	0.1
Builder P	250 000	12.5	500	2000	<b>2500</b>	1.0
Builder Q	250 000	0.5	20	400	<b>420</b>	0.2
Builder R	50 000	1	40	1500	<b>1540</b>	3.1
Builder S	400 000	0.5	20	400	<b>420</b>	0.1

<sup>a</sup> Not all respondents provided estimates for new houses and/or additions/alterations. <sup>b</sup> Administration time is costed at \$40 per hour. <sup>c</sup> Estimated chemical barrier costs between \$1000 and \$1200, while physical barrier costs approximately \$4000. <sup>d</sup> Estimates based on reticulation method in metropolitan areas (\$1200) and physical barriers in regional areas (\$3000). <sup>e</sup> Indicated that would install in 100 per cent of houses if not required by regulation.

## **C.2.4 Contextual information**

Survey respondents also provided useful contextual information regarding housing construction regulation in Victoria. In particular, they commented on the complexity of the regulatory environment, the high costs of complying with specific requirements, and the difficulties of isolating the costs of building regulation from those imposed by planning regulation.

### **Complexity of the regulatory environment**

A number of survey respondents noted that the complexity of the regulatory environment generally imposed costs on their businesses. These costs included the cost of maintaining an understanding of the current regulatory arrangements, and the delays that result from the added complexity of requirements.

One survey respondent suggested that the regulatory burden is disproportionately high for smaller businesses, encouraging smaller builders to either leave their businesses to work for larger businesses, or to grow their businesses to deal with the complex regulatory requirements. They argued that a decision to grow the business (to reach a size where regulatory compliance is more efficient) may be detrimental because a small builder may be a very good builder but will not necessarily have the skills to operate a larger business.

### **Insurance**

A number of survey respondents commented on the high cost of obtaining mandatory insurance (both builders warranty and professional indemnity) and the significant variations in premiums in recent years. One builder stated that the requirement to hold builders warranty insurance, along with the difficulties involved in obtaining it, was the sole reason for the business no longer undertaking domestic building work. While the business is not currently undertaking domestic building work, it continues to seek eligibility for builders warranty insurance to maintain domestic builder registration. It estimated one staff member would spend two months per year full time dealing with insurance companies to maintain eligibility.

### **Overlap between building and planning regulations**

A number of survey respondents commented that planning regulation had the potential to add significant costs to housing construction, particularly as a result of delays imposed by the planning system. One survey respondent stated that the cost of complying with planning regulation, particularly the cost of delays, overwhelms all other regulatory costs.

Another builder (who typically operated in the Monash, Whitehorse and Boroondara municipal areas) provided the following example highlighting the high costs imposed by town planning requirements. The builder noted that unit developments require a planning permit, which imposes conditions on units relative to single houses:

- Planning requirements restrict the first-storey floor area to no greater than 65 per cent of the ground floor area. This implies that the first floor walls cannot be supported by the ground floor walls, which necessitates the use of structural steel to support the first floor walls. The builder estimated the cost of installing this structural steel to be approximately \$25 000 per dwelling.
- Planning requirements also require the installation of a storm water drain detention system on multi-unit developments. The builder estimated that the cost of installing such a system is approximately \$16 000 per dwelling.
- Obtaining a planning permit also involves engaging a planning consultant at a cost of \$2500 per dwelling.
- The planning requirements impose an additional \$42 500 in costs on a dwelling relative to a comparable (two-storey) dwelling not required to obtain a planning permit compared with the builder's estimated \$10 000 per dwelling to comply with the selected Building Regulations.

A number of survey respondents raised issues highlighting the challenge of isolating the effects of planning regulation from those of building regulation. In particular, where a planning permit is required, it must be obtained before a building permit can be issued; in some instances, the planning permit addresses issues that would otherwise be addressed by Building Regulations (if a planning permit were not required). It is difficult, therefore, to isolate the costs of complying with building regulation from those incurred as a result of planning regulation.

### **C.3 Comparison with other cost estimates**

One means of verifying the estimates obtained is to compare them with other cost estimates in the public domain. This comparison has its limitations because the estimates are based on different approaches, but nonetheless provides some basis for verification. The results of previous attempts to estimate the cost of housing construction regulation, and how they compare with the Commission's estimates, are discussed below.



### **C.3.1 Estimates of the costs of state and/or local government Regulations**

#### **Housing Industry Association**

The HIA October 2003 submission to the Productivity Commission inquiry into first home ownership provided estimates of the cost impact of changes to the housing regulatory frameworks nationally and at the state/territory level. The submission included estimates of changes to the Victorian housing construction regulatory framework that were considered to have had a significant impact on housing affordability. It estimated that selected state regulation and local laws cost \$17 700 for an average new house (based on an average house of \$150 000, thus equivalent to over 11 per cent of its cost) (HIA 2003b, pp. 93–4).

The HIA submission included estimates of the cost of many of the same Regulations covered in this appendix. The approach taken in the HIA submission differs from the Commission’s approach mainly in that it generally did not include explicit estimates of the administrative costs that businesses incurred in complying with the Regulations. It did, however, include administration costs associated with occupational health and safety requirements.

Table C.2 compares the HIA estimates with other estimates for the same Regulations selected for estimation in this appendix. Overall, while within the broad range of estimates, the HIA estimates are towards the upper end of estimates provided to the Commission. This is particularly the case when considering that the HIA data do not include estimates for two of the relatively high cost Regulations—building warranty insurance and termite protection.

The HIA estimates of the cost of meeting 5 Star energy efficiency requirements (including the installation of a rainwater tank) are based on figures included in the Plumbing Industry Commission estimates of the cost to supply and install a rainwater tank and the Building Commission’s *Regulatory information bulletin: energy efficiency standards for new residential buildings* (2002d) (discussed below). They appear to be towards the lower end of the estimates provided to the Commission in absolute terms (but less so when expressed as a proportion of the cost of the house). To the extent that these costs increase with the value of the house, this may reflect the lower average house value used for the HIA’s exercise relative to those in the Commission’s sample.

On the other hand, the HIA estimates for the cost of installing scaffolding appear to be at the upper end of estimates provided to the Commission. In absolute terms, the HIA’s estimates are within the range of estimates provided by other industry participants, but above other estimates provided when expressed as a percentage of the house construction costs (6.7–8.0 per cent). Aside from

the scaffolding costs, the HIA's cost estimates otherwise appear broadly comparable with other estimates provided to the Commission.

### **Master Builders Australia national survey**

Master Builders Australia conducted a national survey of members to support its May 2004 submission to the Productivity Commission inquiry into reform of building regulation. The survey received 299 responses, comprising 211 residential projects and 88 commercial projects. Among other questions, the survey asked survey respondents to provide an estimate of the additional construction costs of local planning and building laws imposed beyond the Building Code of Australia. The survey estimated that additional council requirements added \$1712 (or 1.1 per cent) to the cost of building a \$150 000 house in Victoria (MBA 2004, p. 15).

It is difficult to compare Master Builders Australia's estimates and those provided to the Commission. The Master Builders Australia survey focused on the additional costs imposed by local government planning and building requirements. The Commission's estimates relate to the additional costs of Victorian and local government building regulation; planning regulation was outside the scope of this exercise. Further, the Commission could not obtain a breakdown of the Master Builders Australia survey results to understand the composition of its estimate, or to compare the costs of individual Regulations.

### **Building Commission costing exercise**

The Building Commission recently commissioned Davis Langdon Australia Pty Ltd to help identify the costs associated with regulation of the housing construction sector in Victoria (box C.3). The study focused on Victorian and local government regulation and was similar in scope to the Regulations considered in this appendix. It also attempted to identify the incremental costs of the regulatory requirements. The study adopted a case study approach, based on a typical \$300 000 single-storey house built in metropolitan Victoria, to provide a clear basis for estimating the regulatory costs (Davis Langdon Australia Pty Ltd 2005, p. 7).

The study found that mandatory Victorian housing construction Regulations could impose costs of \$15 171, or 5.1 per cent of the cost of a typical \$300 000 house. This estimate is consistent with the Commission's findings and within the broad range of estimates reported elsewhere in this appendix.

### Box C.3 **Building Commission costing exercise**

The Building Commission commissioned David Langdon Australia Pty Ltd to help identify the costs of housing construction regulation in Victoria. The report of this study was released in June 2005.

The study adopted a case study approach, identifying the costs for the construction of a typical house that are incurred as a result of Victorian housing construction regulatory requirements. It identified the costs incurred as a result of mandatory state and local government regulation, as well as potential regulatory costs that may be incurred on a case-by-case basis.

The assumptions for the case study home included:

- \$300 000 total construction costs (including regulatory costs)
- single-storey, brick veneer home of 200 m<sup>2</sup>, built on a concrete slab with a tiled roof and one fireplace
- located in Werribee, City of Wyndham
- not built as part of an estate development but otherwise a typical home
- vacant block in an area requiring termite protection
- block size sufficiently large (more than 500 m<sup>2</sup>) to not require a planning permit<sup>10</sup>
- perimeter fence required for street face only
- built under a major domestic building contract with a registered domestic builder
- competent reputable builder with a good builders warranty insurance claims history.

The report noted that the level of cost incurred will differ according to factors including, but not limited to: the size of the house and number of storeys; the size of the house block; and decisions relating to siting (such as decisions to build on the boundary or over an easement, or to obtain a variation to the siting requirements under the Building Regulations (Part IV)).

The study found that mandatory Victorian housing Regulations could impose costs of \$15 171, or 5.1 per cent of a typical \$300 000 house. Calculating the 'worst case scenario', the study also found that case-by-case costs could impose a further \$10 410 in costs for a \$300 000 house.

Source: Davis Langdon Australia Pty Ltd 2005.

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<sup>10</sup> Single dwellings require a planning permit where the lot size is less than 300 m<sup>2</sup> or 500 m<sup>2</sup> (depending on the municipality).

### **C.3.2 Estimates of the cost of specific Regulations**

In addition to estimates of the costs of housing construction regulation more generally, the Commission is aware of estimates of the cost of specific Regulations. The key studies and reports relevant to Victoria are summarised below. Some international estimates of the cost of housing construction regulation are summarised in box C.4.

#### **Box C.4 International estimates of the cost of housing regulation**

The Commission is aware of some international studies on the cost of housing regulation. A survey by the US National Association of Home Builders in 1998, for example, estimated that government Regulations, delays and fees added an average of 10 per cent to total building cost and accounted for upwards of 20 per cent of the sales price in some markets (Washington Research Council 2001). The Commission notes, however, that much of the US work on the cost of housing regulation appears to include the effect of planning issues—that is, issues associated with land release and urban growth restrictions, which are broader than the issues defined by the terms of reference for this inquiry.

### **5 Star energy efficiency requirements**

There have been a number of attempts to estimate the cost of complying with 5 Star energy efficiency requirements (including the cost of installing water saving devices).

#### *Building Commission survey*

In February 2005, the Building Commission commissioned a survey of 601 builders regarding their awareness, support for and compliance with various energy and water efficiency related building standards. One question asked in the survey was, ‘On average, for each new house that you build, how much more does it cost, if any, in percentage terms to build to the 5 Star standard compared with the cost before the standard was introduced?’.

The survey found that 83 per cent of builders considered that cost increases had resulted from the 5 Star initiative. Over one third of respondents (36 per cent) indicated that meeting the 5 Star requirements would increase costs by 3–5 per cent. Nearly one fifth of respondents (19 per cent) estimated costs had increased by 6–10 per cent, and a further 13 per cent of respondents felt costs had increased by 10 per cent or more (Chant Link & Associates 2005, p. 47).

The question asked in the Building Commission survey differs slightly from that used by the Victorian Competition and Efficiency Commission. The former survey asked builders to estimate the costs in percentage terms. The Victorian

Competition and Efficiency Commission has assumed that the survey was seeking the additional costs as a percentage of the total costs of construction, which would enable comparison with the estimates obtained for this appendix.

The Building Commission survey finding, that the costs of meeting the 5 Star requirements may vary (quite considerably) according to circumstances, is consistent with the Victorian Competition and Efficiency Commission's observations. The median estimate of the survey is that the 5 Star initiative imposes additional costs of 3–5 per cent—equivalent to costs of between \$4500 and \$7500 for a \$150 000 house, and of between \$12 000 and \$20 000 for a \$400 000 house. The estimates of the cost of 5 Star energy efficiency requirements provided to the Victorian Competition and Efficiency Commission range between 0.1 per cent and 8.0 per cent.

#### *Regulatory information bulletin*

The Building Commission released a regulatory information bulletin, *Energy efficiency standards for new residential buildings* in August 2002 following the Victorian Government announcing the introduction of a minimum 5 Star energy efficiency standard for new housing. Two studies were commissioned to evaluate the costs and benefits of the new standards: an analysis of additional housing construction costs, prepared by Energy Efficient Strategies (2002); and an analysis of the wider effects of the measures on the Victorian economy, prepared by The Allen Consulting Group (2002).

The Energy Efficient Strategies study involved obtaining the energy rating for a large representative sample of housing designs and estimating the costs of the improvement measures required to achieve the target performance standard. Improvement options included fitting seals to external doors, sealing gaps and cracks, increasing insulation, installing thermally approved window frames, and installing double glazing and shading devices to windows. The study estimated the average initial investment cost to meet the 5 Star standard to be \$3280 (BC 2002d, pp. 44, 47).

This approach does not appear to include the administrative costs involved in achieving the 5 Star standard. Some survey respondents providing cost estimates to the Commission considered there were significant administration costs from the need to revise and redraft plans to ensure compliance. While the cost of revising and redrafting plans may represent a transitional cost that reduces over time, the Energy Efficient Strategies study may underestimate the current costs of compliance relative to the estimates in this appendix.

The estimate of additional costs of \$3280 appears to be at the lower end of estimates provided to the Commission, even allowing for administrative costs and the fact that some estimates provided to the Commission include the costs of installing rainwater tanks.

*Regulatory impact statement on the Plumbing (Water and Energy Savings) Regulations*

The discussion of costs and benefits in the RIS prepared for the 2004 amendments to the Plumbing Regulations 1998 (PIC 2004b) drew on The Allen Consulting Group (2004a) report *Enhancing 5 Star home energy standards in Victoria*. The report estimated that the additional cost to supply and install a rainwater tank is approximately \$1895, and the additional cost to supply and install a solar hot water heater is between about \$1830 and \$2260 (beyond the cost of a conventional hot water service) (PIC 2004b, pp. 13–16). The estimates include labour costs to install the devices but do not appear to explicitly include any administrative costs.

The estimate of \$1895 to supply and install a rainwater tank is at the lower end of estimates provided to the Commission, which ranged from \$2000 up to \$6000 for supply and installation only. The Commission has limited information with which to compare the estimated additional cost of a solar hot water service relative to a conventional service. Survey respondents estimated that the cost to supply and install a solar hot water service ranged between \$1700 and \$4500 (before the rebate) but they did not provide information to calculate how much of this cost is additional to a conventional hot water service.

*Master Builders Australia*

The Master Builders Australia submission on the Productivity Commission's draft report on energy efficiency commented on estimates of meeting cost energy efficiency requirements (MBA 2004). Master Builders Australia approached Victorian members (who have been complying with the 5 Star requirements for about 12 months) to estimate the costs of making a range of three bedroom, brick veneer homes comply with the 5 Star requirements. The members estimated the requirements added between \$13 000 and \$18 000 to the cost of a house, depending on the house design and location. Master Builders Australia observed these estimates were significantly higher than the \$3280 in additional costs for the average house, cited in the regulatory information bulletin. As noted, the estimates provided to the Commission also tended to be significantly higher than the \$3280 used in the regulatory information bulletin.

### **C.3.3 Cost estimates provided in submissions to the inquiry**

Submissions made to the inquiry also estimated the cost of complying with specific Regulations, including 5 Star energy efficiency requirements, builders warranty insurance, termite protection and metal roofing.

## 5 Star energy efficiency

Inquiry participants expressed mixed views on the costs of complying with 5 Star energy efficiency requirements. Submissions contained varied estimates of the overall cost of complying with the requirements, reflecting variation in the estimates provided to the Commission as part of this exercise. Bruce Langford-Jones of Langford-Jones Homes, for example, estimated that compliance, where possible, costs approximately \$10 000 for a \$90 000 'lightweight' home (sub. 14, p. 5). And the Timber Promotion Council noted that 'builders are spending anywhere between \$1000 and \$10 000 in additional costs to meet the 5 Star standard' (sub. 52, p. 5).

The Insulation Council of Australia and New Zealand stated:

The higher costs quoted by industry may indicate that the houses presented as evidence of excessive cost are simply at the upper end of the cost range. Alternatively, it may indicate that designers have not yet come to grips with the techniques needed to achieve the required rating in the most cost-effective manner. Henley Properties have been quoted as saying their costs are around \$1500 per house including the upgrade to 5 star heating and hot water appliances. They achieved this by redesigning their range of houses using the energy rating software. As designers gain experience with the energy rating the costs reported by industry may well fall. (sub. DR124, p. 6)

Regarding the incremental costs of solar hot water services, the Department of Environment and Sustainability commented that:

... due to technical developments, the price of gas boosted solar hot water units is declining and now start from around \$3200. Electric boosted systems are available at even lower cost, in the order of \$600 to \$700. Accordingly, the SE portfolio considers that the additional cost of a gas boosted solar hot water system is now considerably lower than that indicated above. (sub. DR172, p. 10)

Conversely, the HIA provided estimates of the average purchase and installation costs for gas boosted solar hot water services (\$6966) relative to those for standard gas hot water services (\$1216), suggesting that the purchase and installation of a gas boosted solar hot water service cost over \$5500 more than for a comparable standard gas hot water service (sub. DR163, p. 35). The HIA also estimated the average purchase and installation cost for a 2000 litre rainwater tank to be \$3792 (sub. DR163, p. 35).

## **Builders warranty insurance**

A number of submissions estimated the cost of builders warranty insurance premiums:

- The Builders Collective of Australia stated that the average premium is \$2500 (sub. 38, p. 5)
- Vero Insurance stated that the average premium in Victoria is 0.49 per cent (sub. 71, p. 14). This implies, for example, that the average premium would be approximately \$980 for a \$200 000 house, and \$1470 for a \$300 000 house.
- MR Constructions stated that builders warranty insurance premiums are typically at least \$3000 for the projects it undertakes (sub. 78, p. 1).

The estimates provided in the submissions are consistent with the range of estimates of builders warranty insurance premiums provided to the Commission as part of the cost estimation exercise.

Building Ethics Australia estimated some of the indirect costs associated with this requirement:

... the costs of warranty insurance with some insurance providers have increased. These cost increases are twofold. Firstly, the basic premium costs have increased while providing less protection for consumers. Secondly, the cost to builders in providing security, restructuring their businesses and complying with the demands of some insurers have all added to the final cost of domestic building. For example, a builder undertaking \$2.5 m in domestic building work annually may be required by some insurers to provide bank guarantees of between \$250 000 and \$500 000. The cost of these guarantees would be up to \$20 000 per year. (sub. 34, p. 3)

## **Termite protection**

The Royal Australian Institute of Architects and Archicentre Limited estimated the average cost of pre-construction treatment of a home site by a pest contractor to be \$1500 (sub. 40, p. 10). This estimate would appear to be consistent with the estimates provided to the Commission, which ranged from \$500 to \$4000 (with higher estimates relating to physical rather than chemical barriers).

## **Metal roofing**

A number of inquiry participants suggested that the requirement that metal roofs be installed by a licensed plumber (not discussed elsewhere in this appendix) leads to higher installation costs for metal roofs relative to tile roofs. Some submissions estimated the cost differential between metal and tile roofs. Bruce Harmer Homes estimated that the cost of installing a metal roof is approximately



\$4000 higher than the cost of a tile roof for an average sized home (sub. 20, p. 1).

Residential Metal Roofing Industry Association of Victoria Ltd stated that ‘most major builders [in Victoria] charge new home buyers an average of \$4500 extra per home for a metal roof compared with concrete tiles’ (sub. 23, p. 6). It also stated, however, that ‘material costs are generally \$1500 per home more for metal roofing’ relative to tiles (sub. 23, p. 7). This would suggest the incremental cost of the regulatory requirement to be approximately \$3000 per house. BlueScope Steel also estimated that it costs ‘approximately \$4500 extra to use steel as the roofing material in Victoria’ (sub. 48, p. 2).

A number of inquiry participants, however, indicated that the estimates of the cost differential in the draft report might have been overstated. An indicative cost comparison of metal and concrete tile roofing prepared by Construction and Planning Economics found that it costs \$2000 more to install a metal roof relative to a tile roof (sub. DR141, pp. 2–4). This cost differential, however, is driven largely by metal roofs requiring more labour (at a slightly higher hourly rate) and, to a lesser extent, higher material prices.

## **C.4 Concluding comments**

In the draft report, based on survey respondents’ estimates, the Commission conservatively estimated that the selected Victorian and local government Regulations represent at least 4 per cent of the cost of new house construction. After incorporating additional information obtained since the draft report, the Commission has found great variation in the estimates of the cost of complying with selected Victorian housing construction Regulations—between 2 per cent and 20 per cent of the cost of an ‘average’ house within the practitioners’ standard product range (table C.2). This variation partly reflects the varying extent to which respondents could provide estimates for all of the selected Regulations, but also the respondents’ different views on the incremental cost attributable to regulation.

While the range of estimates here is wider than that in the draft report, the Commission considers its earlier estimate—that complying with Victorian housing construction regulation costs at least 4 per cent of the cost of new house construction—is still at the lower end of the estimates provided. The average of the survey respondents’ lower bound estimates of the cost of complying with Victorian housing construction regulation is approximately 6 per cent of the cost of new housing construction, and the average of respondents’ upper bound estimates is higher again (9 per cent).

Survey respondents’ estimates varied considerably, reflecting differences in the types of house being constructed, the location of houses, and the profile of the

survey respondents' businesses and experiences. The Commission has not attempted to test these estimates against house type—for example, the number of double-storey houses, or the proportion of houses in regional Victoria—or the sample's representativeness of the industry as a whole.

Nonetheless, the survey respondents' estimates are broadly consistent with other attempts to measure some or all of the costs of housing construction regulation. A similar exercise conducted by the Building Commission (based on a case study approach), for example, estimated that Victorian and local government Regulations impose costs equivalent to 5.1 per cent of a typical \$300 000 house. While consistent with this study, the approach adopted in this appendix has the additional benefit of highlighting the potential for the regulatory costs to vary for individual houses and builders.

There are, however, a number of factors to consider when interpreting the cost estimates presented in this appendix. The appendix provides indicative estimates of the costs of complying with selected housing construction regulation and a cross-check of other organisations' estimates. It provides some insights into where the costs of compliance are likely to be high, and where there would be some merit in testing the estimates further. Similarly, it indicates where the estimated costs of compliance appear broadly consistent and where they do not. A lack of consistency in the indicative estimates may indicate where there is merit in obtaining more information.

As noted, the complexity of the regulatory framework is a key challenge faced in estimating the cost of housing construction regulation. The Regulations featured in this appendix arise from a multitude of different regulatory instruments (table C.9). Further, a number of survey respondents commented that the overlap between building and planning regulations made it difficult to isolate the costs of building regulation alone.

**Table C.9 Source of regulatory requirements**

<i>Regulatory requirement</i>	<i>Source of regulation</i>
Builders warranty insurance	<i>Building Act 1993</i> (s102) and Domestic Building Insurance Ministerial Order, <i>Victorian Government Gazette</i> no. S98, Friday 23 May 2003
Building permits	<i>Building Act 1993</i> , part 3
5 Star energy efficiency	Victorian amendment to the BCA
Water saving devices	Plumbing (Water and Energy Savings) Regulations 2004
Perimeter scaffolding	Occupational Health and Safety (Prevention of Falls) Regulations 2003
Council property information	Building Regulations 1994, part 6, impose the requirement. Municipalities give consent and report for the building permit to be issued.
Termite protection	Local laws—local councils may declare municipalities likely to be subject to termite infestation.
Temporary site fencing	Local laws
Rubbish containers	Local laws
Sediment control measures	Local laws
Temporary vehicle crossings	Local laws
Plumbing certificates of compliance	<i>Building Act 1993</i> , part 12A, division 4
Certificates of electrical safety	<i>Electrical Safety Act 1998</i> , s44(2); Electrical Safety (Installations) Regulations 1999, r410
Lockable meter boxes	Industry Standard for Electrical Installations on Construction Sites
Electrical tagging	Industry Standard for Electrical Installations on Construction Sites
Mains powered smoke alarms	Building Regulations 1994



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