

Housing regulation in Victoria: Building Better Outcomes

A draft report for further consultation and input

July 2005



© State of Victoria 2005

This draft report is copyright. No part may be reproduced by any process except in accordance with the provisions of the *Copyright Act 1968 (Cwlth)*, without prior written permission from the Victorian Competition and Efficiency Commission.

Cover images reproduced with the permission of the Department of Treasury and Finance, Victoria.

ISBN 1920921524

Disclaimer

The views expressed herein are those of the Victorian Competition and Efficiency Commission and do not purport to represent the position of the Victorian Government. The content of this draft report is provided for information purposes only. Neither the Victorian Competition and Efficiency Commission nor the Victorian Government accepts any liability to any person for the information (or the use of such information) which is provided in this draft report or incorporated into it by reference. The information in this draft report is provided on the basis that all persons having access to this draft report undertake responsibility for assessing the relevance and accuracy of its content.

Victorian Competition and Efficiency Commission
GPO Box 4379
MELBOURNE VICTORIA 3001
AUSTRALIA

Telephone: (03) 9651 2211 Facsimile: (03) 9651 2163 www.vcec.vic.gov.au

An appropriate citation for this publication is: Victorian Competition and Efficiency Commission 2005, *Housing regulation in Victoria: building better outcomes*, draft report, July.

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

Opportunity for further comment

You are invited to examine this draft report and provide comment on it within the Commission's public inquiry process. The Commission will be accepting submissions commenting on this report and be undertaking further consultation before delivering a final report to the Government.

Submissions may be sent by mail, fax, audio cassette or email.

By mail: Housing Inquiry
 Victorian Competition and Efficiency Commission
 GPO Box 4379
 MELBOURNE VICTORIA 3001
 AUSTRALIA

By facsimile: (03) 9651 2163 By email: housing@vcec.vic.gov.au

The Commission should receive all submissions by 26 August 2005.

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 has 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.

Preface

The release of this draft report of the inquiry into regulation of housing construction and related issues gives interested participants the opportunity to comment on the Commission's analysis of housing construction regulation and draft recommendations, prior to the presentation of the final report to government.

In preparing this draft report, the Commission has sought to consult widely with a range of businesses and individuals interested in housing construction regulation. The Commission would like to acknowledge the contribution made by those who participated in public hearings, as well as those who provided written submissions. The Commission has also benefited from the input provided by government departments and agencies in understanding the regulatory framework and in providing comments on views put to them.

The Commission invites written submissions on the draft report. These submissions may address any of the issues covered. In a number of areas of the draft report the Commission has indicated that further information is needed to help it firm up its views or to better understand the advantages and disadvantages of its preliminary findings and recommendations. In the next few months, the Commission will also undertake further consultation with interested participants.

At the conclusion of consultation on the draft report, the Commission will produce a final report to be presented to the Victorian Government. The Order in Council establishing the Commission says that the Treasurer should publicly release the final report within six months of receiving it and that the Victorian Government should publicly release a response to the final report within six months of the Treasurer receiving it.

The Commission looks forward to receiving feedback on this draft report.

The Commissioners have declared to the Victorian Government all personal interests that could have a bearing on current and future work.

Graham Evans AO
Chairman

Robert Kerr
Commissioner

Alice Williams
Commissioner

Contents

Opportunity for further comment	iii
Terms of reference	iv
Preface	vi
Contents	vii
Abbreviations	xiii
Key messages	xiv
Overview	xv
Draft recommendations	xxxv
PART A	
1 Introduction	1
1.1 Background to the inquiry	1
1.2 Scope of the inquiry	2
1.3 Conduct of the inquiry	3
1.4 The Commission’s approach	3
2 The housing construction sector	7
2.1 Introduction	7
2.2 Size and composition of the housing construction sector	9
2.2.1 Value of residential work	9
2.2.2 New housing starts	11
2.2.3 Type and location of construction	12
2.2.4 Construction by registered builders and owner–builders	15
2.2.5 Employment	16
2.2.6 Structure and profitability	18
2.3 Productivity	20
2.4 House prices	20
2.5 Health and safety in the home	24
3 Building regulation: its purpose and rationale	27
3.1 What ‘regulation’ is under review?	27
3.2 Purpose and rationale for regulation of the housing construction sector	28
3.3 Market failures in housing construction	29
3.3.1 Consumers’ information disadvantage	30
3.3.2 Spillover benefits and costs	33
3.3.3 Equity	34
3.3.4 Significance of market failures in housing construction	35

3.4	Challenges for government	36
3.4.1	Efficiency effects	36
3.4.2	Effectiveness	38
3.5	Characteristics of a good regulatory framework	39
3.6	Concluding comments	41
4	The regulatory landscape	43
4.1	The Regulation hierarchy	43
4.2	Victorian Government Legislation and Regulation	47
4.2.1	Domestic Building Contracts Act	47
4.2.2	Building Act	48
4.2.3	Coverage of the Building Act	48
4.2.4	Objectives	49
4.2.5	Building (Interim) Regulations	50
4.2.6	Building (Amendment) Act	52
4.2.7	The Building and Construction Industry Security of Payment Act	53
4.3	Other state legislation	53
4.3.1	Architects Act	54
4.3.2	Electricity Safety Act and Gas Safety Act	55
4.3.3	Occupational Health and Safety Act	55
4.3.4	Planning and Environment Act	55
4.3.5	Fair Trading Act	57
4.4	Organisations established under the Building Act	57
4.4.1	The Building Commission	57
4.4.2	The Building Practitioners Board	60
4.4.3	The Building Appeals Board	62
4.4.4	The Building Advisory Council	62
4.4.5	The Building Regulations Advisory Committee	63
4.4.6	Building Advice and Conciliation Victoria	63
4.4.7	The Plumbing Industry Commission	64
4.4.8	The Plumbing Industry Advisory Council	64
4.5	Local government	64
4.5.1	Role of councils in regulating building construction under the Building Act	65
4.5.2	Role of councils in regulating building construction under the Local Government Act	66
4.5.3	Imposition of building controls through council planning schemes	68
4.5.4	Fee setting by councils in relation to building and occupancy permits	70
4.5.5	Ministerial powers under the Building Act in relation to councils	71
4.5.6	Summary	71

4.6	Processes for imposing new obligations	72
4.6.1	Legislation	72
4.6.2	Regulations	73
4.6.3	Building Code of Australia	73
4.6.4	State and territory amendments to the Building Code of Australia	74
4.6.5	Ministerial guidelines	74
4.6.6	Local provisions in planning schemes	75
4.6.7	Local laws	75
 PART B		
5	Regulation of housing design and construction	79
5.1	Introduction	79
5.2	Central role of building surveyors	79
5.3	National regulation adopted in Victoria	82
5.3.1	Benefits of adopting the Building Code of Australia	82
5.3.2	Australian Standards in the Building Code of Australia	85
5.3.3	Varying the Building Code of Australia for Victoria	90
5.4	State-level regulation in Victoria	91
5.4.1	Environmental and energy efficiency	91
5.4.2	Access for people with a disability	103
5.4.3	Occupational health and safety	110
5.5	Local-level regulation in Victoria	112
5.5.1	Planning and building regulations	112
5.5.2	Termite declaration	116
6	Permits and registration	119
6.1	Introduction	119
6.2	Building permits	120
6.2.1	Previous reviews of the building permit process	121
6.2.2	Issues arising from the building permit process	122
6.3	Practitioner registration and licensing	124
6.3.1	Operation of the practitioner registration and licensing system in Victoria	125
6.3.2	Issues related to practitioner registration	127
6.4	Monitoring and enforcement	140
6.4.1	Monitoring and enforcing building permits	141
6.4.2	Monitoring and enforcement of practitioner registration	145
6.5	Impacts on competition	150
7	Insurance	153
7.1	Introduction	153
7.2	Builders warranty insurance	155
7.2.1	Should insurance be mandatory?	157
7.2.2	Is last resort insurance appropriate?	166

7.2.3	Are current exemptions appropriate?	171
7.2.4	Should government provide warranty insurance?	175
7.2.5	Insurance and affordability	178
7.2.6	Effect on the supply of builders	181
7.3	Owner–builders warranty insurance	186
7.3.1	Should insurance be mandatory?	186
7.3.2	The Form 10 regulation and consumer protection	187
7.4	Plumbers insurance	188
7.4.1	Is insurance protecting consumers?	189
7.4.2	Is insurance for air conditioning and mechanical services appropriate?	191
7.5	Professional indemnity insurance	192
7.5.1	Effect on supply, prices and innovation	192
7.5.2	Is indemnity insurance protecting consumers?	194

PART C

8	Improving the Regulatory Framework	199
8.1	Introduction	199
8.2	Improving the objectives of the Building Act	199
8.2.1	Are the objectives understandable?	201
8.2.2	Do the objectives encourage regulation to be the minimum necessary to the scale of the problem?	206
8.2.3	Do the objectives promote accountability?	208
8.2.4	Can the objectives of the Building Act be improved?	209
8.3	Improving processes for adding regulatory obligations	216
8.3.1	Legislation	216
8.3.2	Regulations	217
8.3.3	Building Code of Australia	217
8.3.4	Ministerial guidelines	220
8.3.5	Local planning schemes	221
8.3.6	Local laws	222
8.4	The regulatory impact assessment process	223
9	Regulators' roles and responsibilities	227
9.1	Introduction	227
9.2	Are there any current functions that the regulators should not be undertaking?	228
9.2.1	Current functions	228
9.2.2	Should the Building Commission and Plumbing Industry Commission provide policy advice?	232
9.2.3	Should the Building Commission and the Plumbing Industry Commission coordinate the preparation of draft proposals for regulators?	236
9.2.4	Should the Building Commission act simultaneously as regulator and leader of the building industry?	237

9.2.5	Should the Building Commission and the Plumbing Industry Commission conduct and promote research?	239
9.2.6	Should the Building Commission promote better building standards both nationally and internationally?	243
9.3	Should regulators take on any new functions?	244
9.3.1	Allocating resources between the regulatory bodies	244
9.3.2	Providing advice to consumers	246
9.3.3	Providing advice about the costs of regulation	247
9.4	Can the division of functions across the regulatory entities be improved?	248
9.4.1	Separating the regulatory, leadership and policy roles	249
9.4.2	Licensing and registration	254
9.4.3	Should the Building Commission and Plumbing Industry Commission merge?	258
9.4.4	The way forward	259
9.5	Towards an improved regulatory framework	261
10	Performance reporting	263
10.1	Purpose of this chapter	263
10.2	The role of performance reporting	264
10.2.1	Why it is done	264
10.2.2	How it is done	265
10.3	Performance reporting by the Building Commission and related entities	268
10.3.1	The framework	268
10.3.2	Observations about the framework	271
10.3.3	Observations about performance indicators	272
10.4	The Plumbing Industry Commission	273
10.5	Conclusions about the performance of the Building Commission and related entities	277
10.6	Conclusions about the performance of the Plumbing Industry Commission	280
10.7	Improving performance reporting	280
10.8	Financial reporting	283
11	Fees and charges	285
11.1	Introduction	285
11.2	Designing efficient and fair fees and charges	286
11.3	Fees and charges in the housing construction sector	287
11.4	Should the regulators continue to be funded through cost recovery charges?	291
11.4.1	Analysing the activities subject to cost recovery	291
11.4.2	Should industry meet the costs of regulation?	292
11.4.3	Are cost recovery charges calculated on an efficient cost base?	296
11.4.4	Are charges structured appropriately?	301

11.4.5	Are there other mechanisms to ensure ongoing efficiency?	304
11.5	Summary	307
12	Victoria’s development contributions system	311
12.1	What are development contributions?	311
12.2	Basis for the current development contributions system	312
12.3	Evolution of Victoria’s development contributions system	313
12.4	Concerns about the development contributions system	318
12.5	Concluding comments	331
APPENDICES		
A	Consultation	333
A.1	Introduction	333
A.2	Submissions	333
A.3	Public hearings	336
A.4	Stakeholder consultations	337
B	Cost recovery framework	339
B.1	Question 1: Should cost recovery be introduced?	341
B.2	Question 2: Are cost recovery charges calculated on an efficient cost base?	347
B.3	Question 3: Are charges set appropriately?	349
B.4	Question 4: Are there other mechanisms to ensure ongoing efficiency?	352
C	Cost of housing construction regulation	357
C.1	Objectives of this exercise	357
C.2	Estimating the cost of housing construction regulation	358
C.3	Comparison with other cost estimates	378
References		389

Abbreviations

ABCB	Australian Building Codes Board
ACCC	Australian Competition and Consumer Commission
AMCA	Air Conditioning and Mechanical Contractor's Association of Australia
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
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 regulations are important for consumers, and the current 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, as well as information imbalances, for consumers are not generally well informed and housing is a major financial commitment.
 - But regulation should not come at excessive cost.
- Current regulatory arrangements have served Victorians reasonably well, although hard data on aspects of regulatory outcomes is incomplete.
 - Regulatory costs have been rising and industry participants consider them excessive.
 - Regulatory costs contribute at least 4 per cent to a new house construction cost, with significant variations between different types of houses.
- The key elements of the regulatory architecture should be maintained, with:
 - a Building Act and regulations that use as a base the (national) Building Code of Australia and its standards
 - an independent statutory regulator, the Building Commission/Plumbing Industry Commission, with Consumer Affairs Victoria overseeing consumers' contractual interests and (with VCAT) handling disputes
 - building permits and practitioner registration, with consumers supported by current limited (last resort) builders warranty insurance.
- But the framework can be improved to accord with good regulatory principles, and to reduce compliance costs to the benefit of consumers and the industry.
 - Objectives and statutory functions can be simplified and reporting of outcomes 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.
 - Some institutional linkages can be better arranged.
 - Costs imposed by local government need attention.
- The new development contributions system is soundly based, but its implementation by local councils requires a level of independent audit scrutiny.
- The consequences of these changes will be to improve a familiar environment.
 - Regulatory costs should be reduced, with a goal of at least a \$1500 reduction for a majority of new homes attainable.
 - Moreover, the future growth in the costs of regulation should be contained, as better cost/benefit scrutiny is applied.
- Better information for consumers will ensure they understand the extent of minimum regulatory standards, insurance coverage, and dispute resolution options, empowering them to pursue their preferences beyond minimum standards.

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 industry in the Victorian economy means its efficiency is important to overall resource use and economic welfare. That efficiency is affected by regulation.

The last decade has seen the price of housing increase faster than incomes and housing affordability decrease for first home buyers. Industry organisations claim that regulation in Victoria contributes unnecessarily to higher house prices, by imposing substantial costs on housing construction. There can also be longer-term 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. There has not, however, been a detailed, state-based study. 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 puts forward 36 recommendations (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 simplified, more focused, and more effective, regulatory environment. Objectives would be defined more precisely and the regulators' functions aligned with these objectives. Regulators would be given instructions about how they are expected to operate, and improved performance reporting would enhance transparency and accountability.

The Commission expects that its recommendations would see the cost of regulation reduce over time. It should be a reasonable goal to reduce regulatory costs by at least \$1500 for the majority of new houses. Further, improved information for consumers will support minimum 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 new regulations, with new regulations 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 (minimum requirements for building practices and for various aspects of building performance); state legislation, regulations and variations to the Building Code of Australia; and local government by-laws. Although it has some comments about local government regulations, the Commission has concentrated on core building regulation established by state legislation. While other legislation and regulations affect housing construction, the most important are the *Building Act 1993* (Vic.), *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 decision is made to commission building work that is not exempt. (Exemptions are generally based on scope and safety considerations.)

Domestic building that is not otherwise exempt can only be undertaken legally if a building permit is issued by a building surveyor. The building surveyor must be satisfied that the builder (unless it is an owner-builder) is registered by the Building Practitioners Board and has domestic builders warranty insurance. This insurance provides protection against the consequences of defects in building work for six years, but only in the event that the builder has died, disappeared or become insolvent. The building surveyor collects levies to fund the regulatory process and inspects the progress of the work on (usually four) prescribed occasions, to ensure that the work complies with standards set in the Building Code of Australia and in Victorian building regulations.

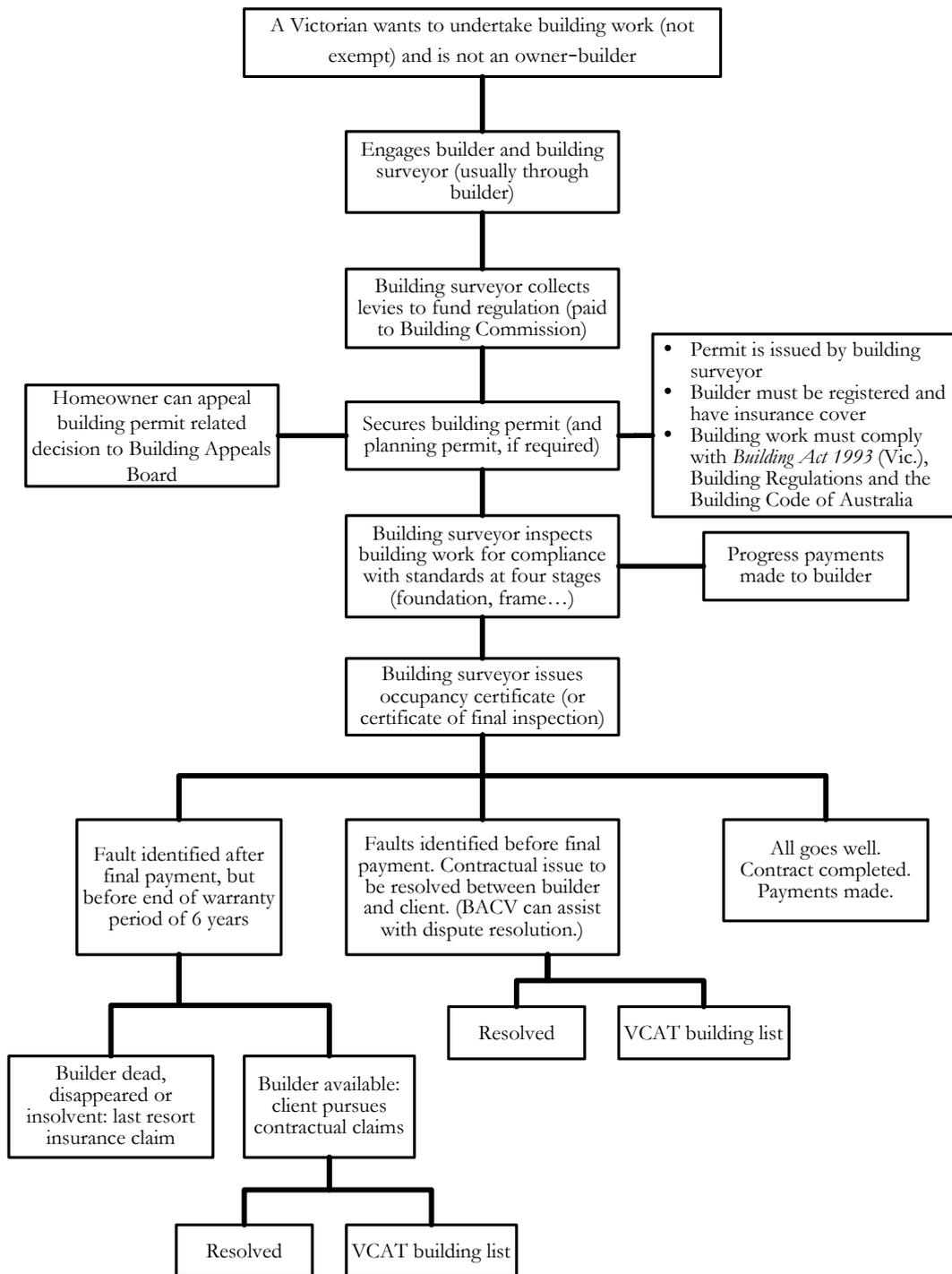
Further, if a building permit states that an occupancy permit is required, a person must not occupy the building until a building surveyor issues an occupancy permit stating that the building is suitable and safe for occupation. The homeowner can appeal any of the building surveyor's decisions to the Building Appeals Board (BAB).

The regulatory arrangements

While figure 1 is a simple way of describing 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, key elements of which are undefined
- the role of the Domestic Building Contracts Act, which regulates the contractual relationship between consumers and builders

Figure 1 Regulation of the building process



- 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—that have 50 statutory functions between them

- more than 1000 standards called up by the Building Code of Australia
- the role of local governments in administering important parts of the regulatory framework and sometimes super-imposing their own requirements
- the seven ways that the Commission has identified, that substantial 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 the building sector:

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

Benefits come from correcting these adverse effects.

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 the builder has better information about building processes, or the information is prohibitively expensive. 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 standard or 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 and lack familiarity with the construction process. Moreover, the potential costs arising from uninformed choice are significant given the large sums at risk. The Housing Industry Association (HIA) commented that:

Home owners 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 complex information imbalances between consumers and suppliers is, however, not a conclusive argument for regulation. It is possible to conceive of a residential building 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 standards in their building contract. They could seek builders by reputation, endorsed either commercially or by industry associations. They could insure against adverse events.

Some market-delivered alternatives already exist. Appropriately qualified experts (for example, architects or building inspectors) are available to supply the information and expertise that consumers may lack. Contractual remedies or insurance may be available to provide redress where the standard of house construction is inadequate. Industry associations may also provide a credible system for rating building practitioners by addressing the inherent difficulty consumers may have in determining a builder's record in delivering a quality product.

The fundamental problem that remains, however, is that consumers are not likely to know what they don't know and may, therefore, be unaware of the information deficiencies they need to address. The Department of Sustainability and Environment noted that this particular 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 the construction of a house are incurred by parties other than those involved in that transaction (for example, the consumer/house owner and the builder), market-driven outcomes are likely to be unsatisfactory from a community perspective. If the owner of a house does not bear environmental costs associated with their use of a particular building material, for example, they are unlikely to deliver an environmental outcome consistent with what is best for the community.

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

Regulation costs

Regulations impose administrative costs, compliance costs (for example, builders may need to change design and construction methods in order to meet regulatory requirements) and efficiency costs (for example, the effect of regulation on competition and innovation). The Building Commission has estimated that state and local government regulations add 5 per cent to the cost of a ‘case study’ house (with a further 3 per cent for more complicated cases). The Commission surveyed a small sample of builders to develop its own indicative estimates of compliance costs. The results varied substantially between builders, from 4 per cent to almost 20 per cent of project cost. While different views existed about the *incremental* cost attributable to regulation, there was general agreement that four areas of regulation (5 Star energy efficiency, scaffolding requirements, termite protection and builders warranty insurance) imposed the highest compliance costs, but there was disagreement 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 regulation is 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 \$10.5 billion, the estimate of 4 per cent suggests that regulation affecting housing construction costs 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 this estimate is unlikely to overstate the incremental costs. The estimate is based on the lower bound of participants’ estimates and is conservative in comparison 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 and this inquiry has focused on whether appropriate processes are in place to encourage this to happen. The central issue is whether the regulatory intervention and the way it is implemented, including its costs, leads to outcomes superior to what would occur in the absence of intervention and other feasible alternatives. This is more likely to occur if the regulatory framework exhibits the following features:

- regulations 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)
- regulations should not be unduly prescriptive
- regulations should be consistent with other laws and regulations
- regulations should be enforceable
- there should be pressures for continual improvement
- regulators should be accountable.¹

Because regulation generates costs as well as benefits, governments should only regulate where it is 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 other feasible options. The most obvious costs of regulation are the administration and compliance costs, while less obvious are the unintended costs, such as any discouragement of market delivered remedies and innovation.

Participants' views

Some inquiry participants were critical of the current regulatory framework. The HIA commented 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)

¹ These factors are consistent with those required by the *Victorian Guide to Regulation*.

Other participants commented about the bodies that administer the arrangements rather than about the framework itself. The Property Council of Australia believes 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 bodies² 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’ (sub. 41, pp. 6, 12).

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 [Building Advisory Council], its roles, activities or responsibilities
- the perception of the [Building Regulations Advisory Committee] is that there are too many self-interested parties involved
- the [Building Appeals Board] provides a cost effective and timely service to the industry
- not enough resources are being given to the [Building Practitioners Board] to properly administer the registration system and to ensure practitioners are carrying out their responsibilities properly (sub. 66, pp. 2-3).

The Australian Institute of Building Surveyors made similar comments:

- the [Building Advisory Council] and [Building Regulation Advisory Committee] should meet more frequently, their representation expanded so as to be available to provide the advice empowered to it under the law
- the [Building Appeals Board] 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. (sub. 41, pp. 1–2)

The Commission’s assessment of the current regulatory framework

While it is possible to conceive of arrangements without regulations (where many consumers would attend to their own interests at a price), the Commission

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

considers that government involvement in regulating housing construction is justified, particularly on health, safety and sustainability grounds. These are the areas where consumers, given their lack of information, are most at risk.

The hierarchical relationship between the Building Code of Australia, Victorian legislation and local laws provides a mechanism to bring to bear the benefits of national consistency while allowing reasonable local variation. Victoria's framework is internally consistent and the various components operate as part of an integrated system. Enforcing minimum building standards helps to ensure that 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 adverse impacts of prescriptive regulation on innovation.

The privatisation of inspections by building surveyors has been a success. The building permit system (with suitable exemptions) appropriately supports the regulatory system. A registration system for builders and plumbers makes it more likely that they will build according to the required standards. Regulatory bodies are needed to ensure that 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, see scope for improvement in three related areas. First, modifications to the key components of the regulatory framework would streamline regulation. Second, the regulators' focus on the outcomes set by the government should be sharpened and their accountability increased. Third, the implementation of new regulations can be improved.

Modifications to the key components of the regulatory framework

Building permits

The point of application for a building permit is an appropriate time to ensure that consumers are well informed because consumer information can generally promote choice and limit the need for more intrusive and costly forms of regulation. The consumer should be made aware of the regulations 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 (discussed below).

There may be some misunderstanding about the role of building inspections, when some consumers incorrectly believe that inspections cover all the work specified in their contract with the builder (rather than minimum building

standards). Consumers who have this misunderstanding may be discouraged from monitoring builders and building surveyors, which is not in their best interests. Regulatory intervention can be ‘lighter’, where consumers understand their role. Steps should be taken to ensure that consumers are adequately informed (*Draft recommendation 6.5 addresses this issue*).

The scope for exemption from the need for a building permit (which triggers the full regulatory process) should not be too narrow because both financial and safety risks could be relevant. Previous exemptions were said to be confusing, but it is not clear whether the latest changes will improve matters.

Housing design and construction: 5 Star energy requirements and accessibility for the disabled

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

The Building Commission’s survey data, showing mean costs almost three times above those used in the original analysis of the 5 Star regulations, casts doubt over the ability of the current proposal to deliver net benefits to Victoria. The data suggests changes in implementation are needed, and a more rigorous assessment than that which accompanied the original 5 Star standard.

The Commission considers Victoria’s energy efficiency regulation embodied in the 5 Star scheme could be improved to better deliver against its objectives. Some improvements that should be considered are: linking it more clearly with the government’s energy efficiency objectives; using more contemporary software packages to estimate energy use; acknowledging embodied and/or life cycle energy costs of construction materials; and giving credit for alternative means of reducing energy use (*draft 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 and should allow a flexible approach to achieving improved outcomes (*draft recommendation 5.4*).

Victoria should continue to support progress on access to premises for disabled people at the national level. However, it is inappropriate at this time to introduce specific regulations 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 about the capacity of targeted, market-related interventions to address the issue.

The Building Code of Australia

The general development of the Building Code adds new obligations. Given the significance of these changes, they should be implemented only after a comprehensive assessment of their costs and benefits has been completed.

Building practitioner registration and licensing

Registration of building practitioners is an integral part of the regulatory framework. Attending to the quality of practitioners (preferably in a light-handed way) lessens the need to monitor every detail of house construction. A building practitioner must be registered to undertake most building work in excess of \$5000. This threshold has not been adjusted since 1994, and is below two of the other three thresholds applying to different parts of the regulatory system. The Commission invites comments about whether there is any reason why it should not recommend in its final report that all four thresholds be aligned, initially at \$12 000 in line with the current insurance threshold, but with provision to increase this threshold over time in response to further information.

The range of trades for which registration is required is a determinant of the costs and benefits of the system. Any future changes to the classes of practitioners required to be registered should be subject to a regulatory impact statement to assess their costs and benefits (*draft recommendation 6.2*).

Some inquiry participants questioned the restriction of metal roofing to licensed plumbers, which 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 removing the current restriction that reserves metal roofing installations for plumbers and from developing a new qualification that provides specific skills in less time (*draft recommendation 6.1*).

Monitoring and enforcement

The building permit and registration system must be enforced to be effective. The Plumbing Industry Commission and the Building Commission have both adopted targeted risk-based strategies and the Commission believes that the rationale for these strategies, the expenditure on them and the assessment of their benefits should all be published regularly. This would encourage feedback and improvement over time (*draft recommendation 6.6*).

Recent changes should mean that consumers better understand the consequences of electing to take on the risks of being an owner-builder. The new owner-builder arrangements, however, which restrict relevant projects to one every three years, need to be monitored to test whether they work as intended and deliver expected benefits (*draft recommendation 6.4*).

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 regulatory impact statement 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 currently gives consumers redress against faults or incomplete work, but only if the builder is insolvent, dies or disappears. If the builder is available, contractual enforcement is necessary. The mandatory requirement, that builders have domestic warranty insurance, imposes direct costs in the form of premiums and indirect costs that may discourage some builders from entering the industry. Insurance requirements do, however, provide consumers with protection 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, even with this information, consumers would be unable to assess the risks and could be exposed to substantial financial risk. Some participants have suggested that the government should re-enter the market, as in Queensland. This could, however, undermine provision by the private sector and result in the loss of benefits of competition.

The Commission accepts the case for this minimum level of insurance to prevent consumers from unknowingly exposing themselves to this risk. The insurance market for builders warranty insurance has matured since the difficulties following the HHH collapse, although some ill feelings remain. Eight providers compete. The risk pool includes New South Wales, which operates under similar arrangements. And premiums are falling.

Improvements to the insurance arrangements could be made, including making sure that consumers are aware from the start of a project of the nature of the insurance cover, and the benefits of having a good contractual base to protect their interests. These improvements need to be supported by information on dispute resolution (*draft recommendation 7.1*).

Improving information

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

Some of the suggestions outlined in this section are about providing more information to consumers about what they can and cannot expect from regulation. It is just as important that practitioners are fully informed. To achieve this, the Commission has proposed that options be explored to provide building standards at zero cost (*draft recommendation 5.1*) and that the Building Commission establish a page on its website that lists the regulatory requirements of each local government (*draft recommendation 5.6*).

Consumers, practitioners and the Government would all benefit from more information about the cost of regulation. Regular published estimates of these costs would reveal, for example, how the costs are changing over time and where they are turning out to be different to that which was expected (*draft recommendation 9.6*).

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 that regulators are held accountable for their actions.

A number of improvements are feasible in these areas.

Outcomes

The outcomes that the Victorian 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, nor does it indicate their relative importance, an important deficiency given the trade-offs 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 high level objectives included in regulation. Ambiguity, however, leads to uncertainty. Providing limited direction to regulators about what they should be targeting limits their capacity to deliver, and to assess their performance and, therefore, reduces accountability. Multiple and ambiguous objectives can breed regulatory confusion or growth.

The Commission believes that the regulators would have more focus if:

- instruments for achieving outcomes were not included as objects of the Act, because this encourages their enshrinement as outcomes in themselves, rather than as a means to an end (*draft recommendation 8.1*)
- the number of desired outcomes were reduced, simplified, clarified and defined (*draft recommendation 8.2*)
- the government provided more guidance about how regulators are to apply the regulatory instruments they are empowered to use (*draft recommendation 8.3*)
- there were more checks and balances on the imposition of new regulations (*draft recommendations 8.4, 8.5 and 8.6*).

Assignment of roles

The effectiveness of regulation will be further 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 customers
- providing an avenue for appeals against regulators' decisions
- providing policy advice about the design of the framework and rules.

Administering the regulations should be the responsibility of the statutory regulators. Approving practitioners, accrediting processes, and enforcing standards are integral parts of regulatory administration, and should be located with 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 regulations and the costs and benefits of housing regulation change over time. The Building Commission considers 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 where it is more difficult to assess regulators' performance. Moreover, playing a lead role in developing new regulations can compromise a regulator's independent administration and enforcement of regulations. 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, responsibility for policy advice—including coordinating the preparation of proposals for regulations, and associated regulatory impact statements—should rest with a government department. The department should consult with the regulators about policy issues and technical aspects of proposed regulatory changes (*draft recommendation 9.1*).

For a wider perspective on the regulatory framework, the department could consult with the Building Advisory Council (which should be merged with the Building Regulations Advisory Committee), which is currently 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 from the Building Commission the policy advice role.

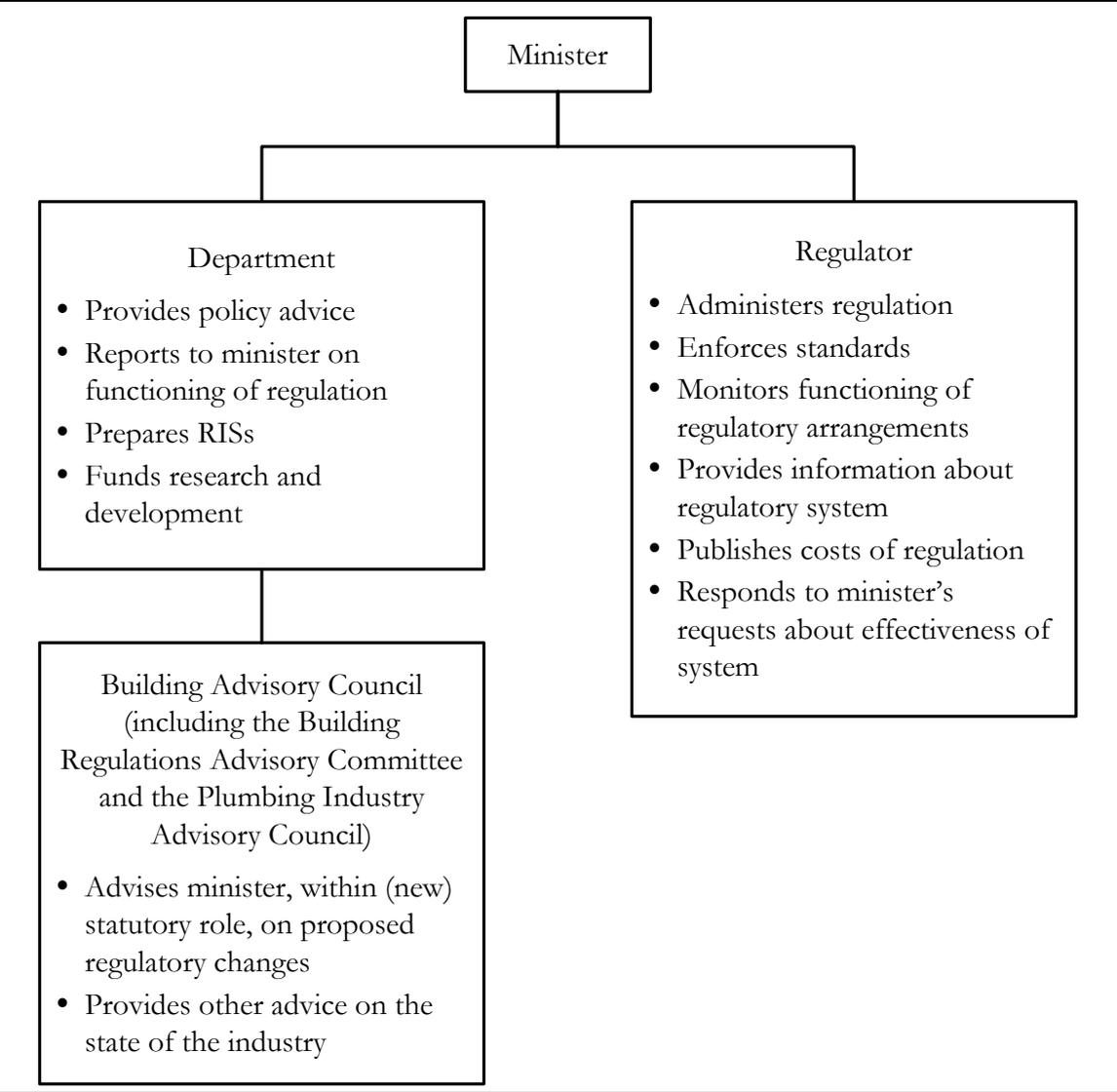
One broader issue relating to role clarity, which may be a consequence of ambiguity in the Building Act, is that the Building Commission sees itself both as a regulator and industry leader. It has an active research program and describes itself as a 'high profile leader of standards and change', whose 'core direction' is 'to take a stronger leadership role in building activities in Victoria', to achieve three outcomes: quality building; an attractive industry; and satisfied consumers.

The Commission considers that an industry leadership role (beyond leadership 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, amalgamating 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 Chair of the Building

Commission and Plumbing Industry Commission should be asked to identify opportunities for cost savings from merging the two commissions' activities without loss of effectiveness (*draft recommendation 9.7*).

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 the services provided by the regulators to their 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. There is a strong argument to reduce the levy, the proceeds of which have been inflated with the long period of growth in the value of housing activity. A smaller levy would fit with less wide-ranging activities by the Building Commission (*draft recommendation 11.3*).

A performance-reporting framework is the other important mechanism for imposing accountability. The Australian National Audit Office notes 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 scope to develop good performance indicators is handicapped by the multiplicity and ambiguity of objectives and functions in the Building Act. As these are simplified, the regulators should make more use of quantitative performance indicators and report publicly and regularly against these indicators, which should be linked more closely to the health, safety and sustainability outcomes that have been set for the regulatory framework. Developing such indicators would provide more detail to the high level outcomes that are specified in the Building Act. If these indicators were included in the 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 (*draft recommendation 10.1*). The Commission also considers that there would be benefits from more transparent financial reporting by the regulatory bodies (*draft recommendation 10.2*).

Improve processes for new regulations

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

First, state and territory amendments to the Building Code can be made without a regulatory impact statement. The Master Builders Association of Victoria, the Building Products Innovation Council, and the National Association of Steel-Framed Housing Inc. all indicated their opposition to state-based variations of the Building Code.

It seems inconsistent that amendments to the Building Regulations are subject to the regulatory impact statement process, while state-based amendments to the Building Code, which are called up by the Building Regulations, are not. Requiring a regulatory impact statement to be undertaken for state-based amendments would provide consistency and help to ensure that these amendments are made only when they provide net benefits (*draft recommendation 8.5*).

Second are standards called up by the Building Code. Victoria must continue to engage with the Australian Building Codes Board to monitor this process, in particular, appropriate cost-benefit evaluation of new standards that should be the norm (*draft recommendation 8.6*).

Third, the Building Act entitles the minister to issue guidelines on various matters, which have considerable force without prior external scrutiny. The Scrutiny of Acts and Regulations Committee proposed that instruments such as guidelines should be subject to the *Subordinate Legislation Act 1994*, which would apply the regulatory impact statement process to them. The government rejected a broad increase in scope for the regulatory impact statement process as it considered the increased costs would not in most cases outweigh any benefits to the public. It noted, however, that there is flexibility for either Parliament to determine the appropriate scrutiny mechanism in individual cases, or for the government to regulate to selectively bring additional classes of regulatory instruments into the regulatory impact statement process.

Fourth, Victorian councils have the power to apply standards in their municipalities that are different to those in the Building Regulations through local provisions in planning schemes. Section 11 of the Building Act provides that in the event of inconsistency between a local planning scheme and a building regulation, the local planning scheme prevails. 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 (*draft recommendation 5.6*).

There are good arguments for requiring that provisions in planning schemes that override the building regulations must be subject to a regulatory impact statement process of the kind required under the Subordinate Legislation Act. This would, however, have implications for local government powers and their relationship with the state government that extend beyond the housing construction sector and 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. Alternatively, the capacity of councils to

override the building regulations could be removed, unless specifically approved by the minister.

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. 5). The Property Council of Australia, however, commented that it:

strongly believes that the processes for introducing new regulations 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 a regulatory impact statement process would improve the quality of these regulations. The Commission is also attracted by the Productivity Commission’s proposal that local governments should be required to seek prior approval from the state government to apply building requirements that are inconsistent with the Building Code. 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 of Victorian Communities should report on a timetable for implementing the Government’s intention to consider an appropriate scrutiny process for local laws (*draft recommendation 5.5*).

Development contributions

The government also asked the Commission to comment on the development contributions system, recently the subject of a prolonged and comprehensive review. Development contributions are part of development charges applied to new housing development.

That review has seen the staged implementation of changes (beginning in May 2003) designed to address shortcomings in the previous system, but which left that system fundamentally intact. The most recent changes were approved in December 2004, although supporting guidance material has yet to be updated.

The current development contributions system is short on 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 (*draft recommendation 12.2*)

- local government should provide a statement of compliance with the development contribution guidelines in their annual reports and ensure internal governance arrangements aid the monitoring of contributions for compliance with these guidelines (*draft recommendation 12.1*)
- the Department of Sustainability and Environment should publish revised guidance material to support the December 2004 reforms (*draft recommendation 12.3*).

The benefits of a simplified regulatory framework

The Commission believes that its recommendations would lead to a simplified, more focused and more effective regulatory environment. Consumers should observe regulatory outcomes being achieved at lower cost, over time.

As mentioned, a goal of cost reductions of at least \$1500 for the majority of new houses seem possible. The reductions would, in practice, vary substantially between houses and circumstances. For example:

- the Building Commission's survey suggests a very large range in the costs that the 5 Star energy requirements impose on different types of houses—so flexible application of this regulation could lead to considerable savings
- participants suggested to the Commission that skill shortages (partly attributable to a regulatory requirement that metal roof installers should be qualified plumbers) can add thousands of dollars to the cost of metal roofing
- some shaving of the building levy would also reduce costs to consumers
- streamlined regulations should trim compliance costs for builders 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, which could result in fewer disputes
- improving the accessibility of information to builders about regulations should increase compliance with the regulations.

Many of the building regulations 'sunset' soon and will need to be re-made by June 2006. Regulatory impact statements will need to be developed for these regulations. It seems a reasonable aspiration that the government should seek to achieve a reduction in the overall cost of regulation of at least \$1500 for the majority of new house construction through this and other processes, without compromising the outcomes sought through the regulations.

Draft recommendations

The recommendations are listed in the order that they appear in the report and 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 explore, through the Australian Building Codes Board, the following options designed 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 A regulatory impact statement analysis of a standard referenced in the Building Code of Australia should 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 The 5 Star scheme should be more clearly related to the government's energy efficiency objectives and should incorporate more flexibility through measures such as using more contemporary modelling, acknowledging the embodied energy in construction materials, and giving credit for the use of smart metering and low energy use hot water systems.
- 5.4 The water saving regulation in the 5 Star scheme should be more clearly related to the government's water efficiency objectives and should allow as flexible an approach as practicable to achieve improved outcomes. Alternative solutions that meet a performance-based test of improved efficiency should be embraced.
- 5.5 The Department for Victorian Communities should report on a timetable for implementing the Government's intention to consider an appropriate scrutiny process for local laws.
- 5.6 With respect to restraining the cost of inappropriate local government variations to building regulation, that the Building Commission, as an interim measure pending changes arising from recent relevant reviews, establish a web link listing selected 'building' requirements of each local council in order to provide a central reference point for building practitioners.

Permits and registration

- 6.1 That the installation of metal roofing is not confined to plumbers, and that a new roofing qualification that imparts the necessary skills for metal roofing in the minimum time be developed. The current plumbing apprenticeship module appears a useful starting point and might serve as a module in a longer roofing qualification.
- 6.2 That future changes to the classes of practitioner registration be subject to a regulatory impact statement to assess their costs and benefits. Any extension of registration should meet competition policy objectives that require new regulations to demonstrate a net public benefit, and are the least-cost way to achieve the Government's objectives.
- 6.3 That the Building Practitioners Board (or successor) should 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.
- 6.4 That by July 2007, the Building Commission monitor and report publicly on the impacts of the new owner-builder regulations embodied in the Building (Amendment) Act 2004, and that the Government use this information to review the Act. This review should consider non-regulatory alternatives to the present arrangements.
- 6.5 That the Building Commission include information about the role of the inspection process and certificate of occupancy (what they are intended to achieve and what they are not intended to achieve) and the roles and responsibilities of building surveyors in its current letter to applicants for building permits.
- 6.6 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 to permit assessment of these strategies and identify any lessons from these strategies.

Insurance

- 7.1 Builders undertaking a job for which builders warranty insurance is required should, at the start of the job, provide their client with a document that contains a brief description of the insurance and what it covers (similar to that provided for plumbers insurance).

Improving the regulatory framework

- 8.1 The instruments that can be used to achieve the revised objectives of the *Building Act 1993* should be set out in the Act separately from the objectives.
- 8.2 That the Victorian Government simplify and clarify the current objectives of the Building Act, replacing the current objectives with:
- (1) achieving minimum standards of buildings, in order 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.

The Act should define health, safety, amenity, environmental efficiency and energy efficiency. Amenity should be narrowly defined, to correspond with the meaning used in the Building Code of Australia and the Plumbing Code of Australia.

- 8.3 The Victorian Government should provide, where necessary, additional guidance on how regulators are to apply the instruments permitted under the *Building Act 1993* to achieve the Act's objectives. This guidance 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 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 well-informed choices.

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

- 8.4 That the exemption from the obligation to prepare a regulatory impact statement, as provided by s.9A of the *Building Act 1993*, should be removed.
- 8.5 That Victorian variations to the Building Code of Australia should be introduced only after being subject to regulatory impact assessment applicable to Regulations under the *Subordinate Legislation Act 1994*.
- 8.6 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 at an early stage in the development of standards that are expected to be referenced in the Building Code of Australia and that are likely to have non-minor effects.

Regulators' roles and responsibilities

9.1 The Building Commission and the Plumbing Industry Commission should not have primary responsibility for providing policy advice to the minister on the regulation of housing construction, although they should be consulted on the implementation of regulation. The commissions' functions should be re-drafted to make it clear that they are not responsible for policy advice, although they may comment in their annual reports on the effectiveness of the Building Act.

9.2 The Victorian Government should:

- provide guidance on the types of research project that can be undertaken by regulators, in the context of matters relating to regulation in the industry
- assess research proposals of the regulators and fund them as appropriate.

The Building Commission and Plumbing Industry Commission should:

- evaluate all research projects that are funded, in terms of how the projects have contributed to the operation of the regulatory system
- report publicly any expenditure on research into matters relating to regulation of the housing sector, either through annual reports or through a special report. This report would show the objective and anticipated cost of each new project and how performance will be evaluated. For projects that have been completed during the year, expenditure and the results of the evaluation should be reported.

9.3 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.'

9.4 The Building Advisory Council should not approve the Building Commission's budget before it is submitted to the minister for approval. The commission's annual report should detail both the funds allocated to each regulatory entity and function, and the rationale for the allocation.

9.5 The Building Commission's and Plumbing Industry Commission's functions should be redrafted to encourage 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.

- 9.6 The Minister for Planning should request that estimates are published every third year of the extent to which building regulations add to the cost of building houses. The method and assumptions used to develop the estimates should be published. If the Building Commission or Plumbing Industry Commission prepares the estimates, those estimates should be verified by an independent source.
- 9.7 The Government should task the chair of the Building Commission and Plumbing Industry Commission to identify opportunities for cost savings from merging the two commissions' activities without loss of effectiveness.
- 9.8 That the Victorian Government should streamline advisory bodies:
- The Building Advisory Council, the Building Regulations Advisory Committee and the Plumbing Industry Advisory Council should merge.
 - A government department should provide administrative support for this new entity, under budget arrangements approved by the minister.
 - A new entity should be established within the Building Commission to undertake the accreditation role currently undertaken by the Building Regulations Advisory Committee.
 - A government department should be responsible for providing policy advice about the regulation of housing construction, but in consultation with the Building Commission and the Building Advisory Council.

Performance reporting

- 10.1 The Building Commission and the Plumbing Industry Commission should review their reporting frameworks to ensure they indicate how well the organisations 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 public reports of their performance against these indicators should be provided on an annual basis, beginning in 2006-07.
- 10.2 The annual reports of the Building Commission and the Plumbing Industry Commission should provide more information about the allocation of funds to the related regulatory bodies, and the rationale for this allocation and for expenditure on research and development. The Building

Commission's annual report should provide more information about its expenditure on special projects.

Fees and charges

- 11.1 The Building Advice and Conciliation Victoria levy should only apply to building permits for residential building activity—corresponding to 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 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 the range of activities undertaken by the Building Commission (consistent with the 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 alternative mechanism to ensure that the costs and benefits of these fees are fully analysed
 - establishing a program to 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. Each housing construction agency should report annually on its cost recovered activities and revenue, and on the implementation of the Victorian Government's cost recovery guidelines. This information should be reported in the budget papers.

Development contributions

- 12.1 Local councils should in their annual report provide a statement of compliance with the Development Contributions Guidelines and ensure internal governance arrangements facilitate the monitoring of contributions for compliance with these guidelines. Disclosure of the collection and disbursement of development contributions within the annual report should be provided by local councils to facilitate transparency and accountability.
- 12.2 There should be an annual audit of a sample of councils to assess their adherence to the conditions of their development contribution plans, the relevant requirements contained 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 as soon as possible.

Requests for information

These requests appear in the order that they occur in the report and need to be understood in the context of the discussion in respective chapters.

Regulation of housing design and construction

1. The Commission requests further information on different impacts of local government regulatory requirements.

Permits and registration

2. The Commission requests information about the advantages and disadvantages of defining exemptions on the basis of the type of building compared with a combined approach using a monetary threshold (provided the job does not adversely affect factors such as public safety) supported by other exemptions (relating to the physical characteristics of the building work).
3. The Commission requests information on particular impediments to it recommending in its final report that the thresholds (for practitioner registration, major domestic building contracts, paying the building permit levies and builders warranty insurance) be aligned, initially at \$12 000 but

with the provision to increase these thresholds over time in response to further information.

4. The Commission seeks information about the frequency with which councils are required to address matters that have been approved by a private surveyor.

Insurance

5. The Commission invites inquiry participants to comment on the benefits and costs of mandatory plumbing insurance for housing construction.
6. The Commission invites inquiry participants to comment on the benefits and costs of mandatory plumbing insurance for air conditioning and mechanical services installed in commercial, industrial and high-rise residential buildings.
7. The Commission invites inquiry participants to comment on the influence that insurance arrangements might have on the propensity of insured practitioners to pursue innovative performance-based solutions to meet building standards.
8. The Commission invites inquiry participants to comment on the cost or practicality of requiring eligibility criteria for providers of indemnity insurance (similar to criteria applicable to warranty insurance providers).

Regulators' roles and responsibilities

9. The Commission seeks information about the costs and benefits of merging the registration and licensing functions of the Building Commission and Plumbing Industry Commission either within the Building Commission or within the Business Licensing Authority.

Cost of housing construction

10. The Commission welcomes further responses from industry practitioners regarding the costs of complying with the selected regulations. Copies of the Commission's survey questionnaire are available on the Commission's website, www.vcec.vic.gov.au, and from the Commission on request.

Part A

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 industry in Victoria in 2004-05 accounted for over \$10 billion in new housing and renovation activity, which represented 4.9 per cent of Victoria's gross state product (ABS 2004b, 2004a). Data on building construction employment indicates the building industry in December 2004 employed the equivalent of 143 000 persons—6 per cent of the total workforce—with housing construction accounting for 49 per cent of the state's total building activity (BC 2001, p. 3; undated A).

The significance of economic activity in this sector goes beyond the direct value of activity and employment, because all economic activity generally stimulates output and employment elsewhere in the economy.

In addition, the cost and quality of housing is 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). In Victoria, the real price of detached dwellings in Melbourne over the past decade has shown an annual average increase of 5.4 per cent. In recent years, the most widely reported indices collectively show that this rise in house prices has been associated with a considerable decline in housing affordability for first home buyers (PC 2004a, pp. 17, 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 home builders warranty insurance.¹

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, asking the Commission to inquire into and report on:

- 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
- 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 regulations in the sector
- ways to improve the processes for developing, administering and enforcing regulations 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 regulations affecting it frequently apply 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.

¹ See, for example, Allen 2002; PC 2004a, 2004c.

Similarly, regulations that mandate insurance cover for specific building practitioners affect 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. On the other hand, institutional changes will need to take account of any responsibilities the regulators have beyond the housing construction sector.

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

- 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.

The Commission received a total of 91 submissions by June 2005. 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 those hearings is available on the Commission's website.

1.4 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. In practice, 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:

- regulations 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)
- regulations should not be unduly prescriptive
- regulations should be consistent with other laws and regulations
- regulations 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 houses prices with the estimated costs of the regulations affecting housing construction helps to place the significance of these regulations 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 regulations that govern the housing design and the choice of construction materials and building techniques. Its main focus is on State Government regulations (including those 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 of concern 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 regulation governing the housing construction sector (the *Building Act 1993*) against best practice principles and examines how those objectives might be improved. It also examines existing processes for assessing new regulations and possible improvements to those processes.
- *Chapter 9* examines the multitude of functions prescribed for the regulatory bodies established under the *Building Act 1993* and the allocation of responsibilities between 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 currently being reported by the main regulatory bodies, summarises evidence on their 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 and 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 these.

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 regulations (in terms of their impact on an 'average' dwelling and in aggregate for the housing sector).

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 estimated costs of the regulations that affect housing construction helps to place the economic significance of these regulations 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 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. (See appendix A for a full description of the building classes in the Building Code of Australia).

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 300m², 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).

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

(continued next page)

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

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 the classification of 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. These datasets use building type definitions different 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*’ (ABS 2005c).

The ABS defines a *dwelling unit* as ‘a self-contained suite of rooms, including cooking and bathing facilities and intended for long-term residential use’ (ABS 2005c). This does not include units (whether self-contained or not) within buildings offering institutional care, such as hospitals, or temporary accommodation such as motels, hostels and holiday apartments.

Residential buildings include both *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*’ (ABS 2005c).

An *other residential building* is ‘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). This includes, for example, blocks of flats, home units, attached townhouses, villa units, terrace houses, semi-detached houses, and apartment buildings.

Sources: ABCB 2005a; 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

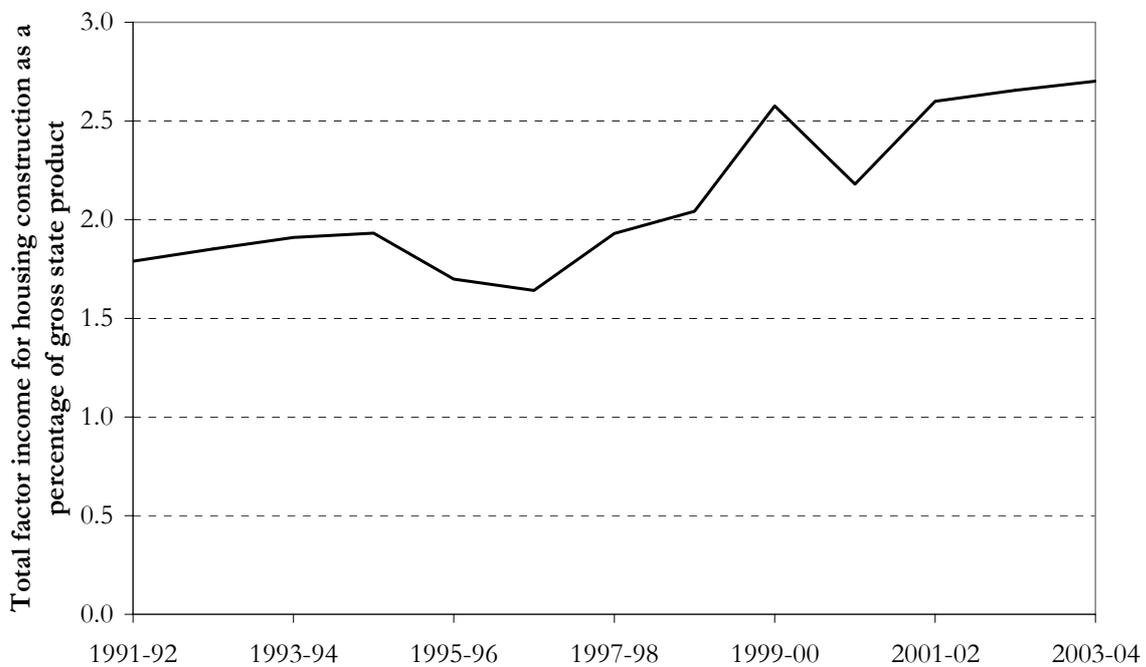
The housing sector, as measured by the total value of residential construction using ABS data, is large and has been growing rapidly:

- The nominal value of housing construction work undertaken in Victoria exceeded \$10.5 billion in 2004. This represented 65 per cent of all building activity in Victoria, or 49 per cent of total construction activity (including building activity and engineering construction activity) (ABS 2004b, 2005c).
- In 2003–04, housing construction total factor income¹ 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 housing construction work in Victoria has increased by around 140 per cent, in real terms, since the beginning of the current growth period in 1996 (figure 2.2). The sector has grown in every year since 1996, except 2001, when activity declined partly because building work was brought forward ahead of the introduction of the goods and services tax (GST) in July 2000.

¹ 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 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.

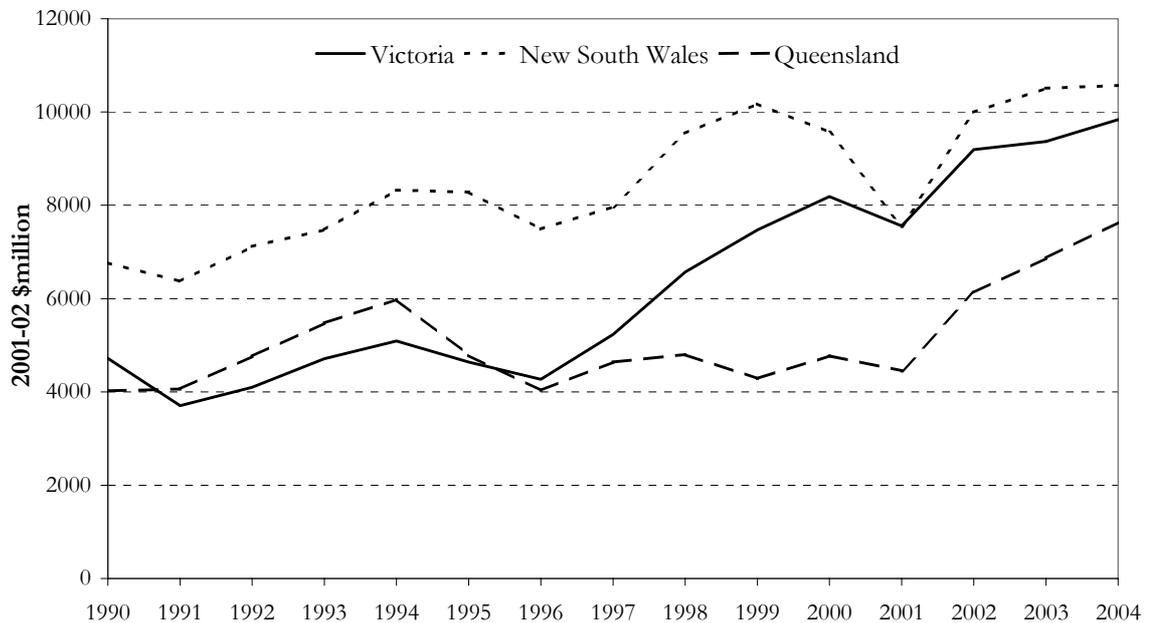
- Over a longer period (between 1993 and 2003), the value of residential building work in Victoria grew by 7.1 per cent per year in real terms, more than double the rate of any other state. The equivalent annual rates of increase in other states were 3.5 per cent in New South Wales, 2.3 per cent in Queensland, 1.4 per cent in South Australia, 2.0 per cent in Western Australia and -2.2 per cent in Tasmania (ABS 2004b).
- In the early 1990s, the value of residential work in Victoria was less than that in both New South Wales and Queensland (figure 2.2). By 2001, the value of construction work in Victoria was above that in any other state (including New South Wales), although New South Wales has subsequently moved ahead.

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



Source: ABS 2004a, 2004b.

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



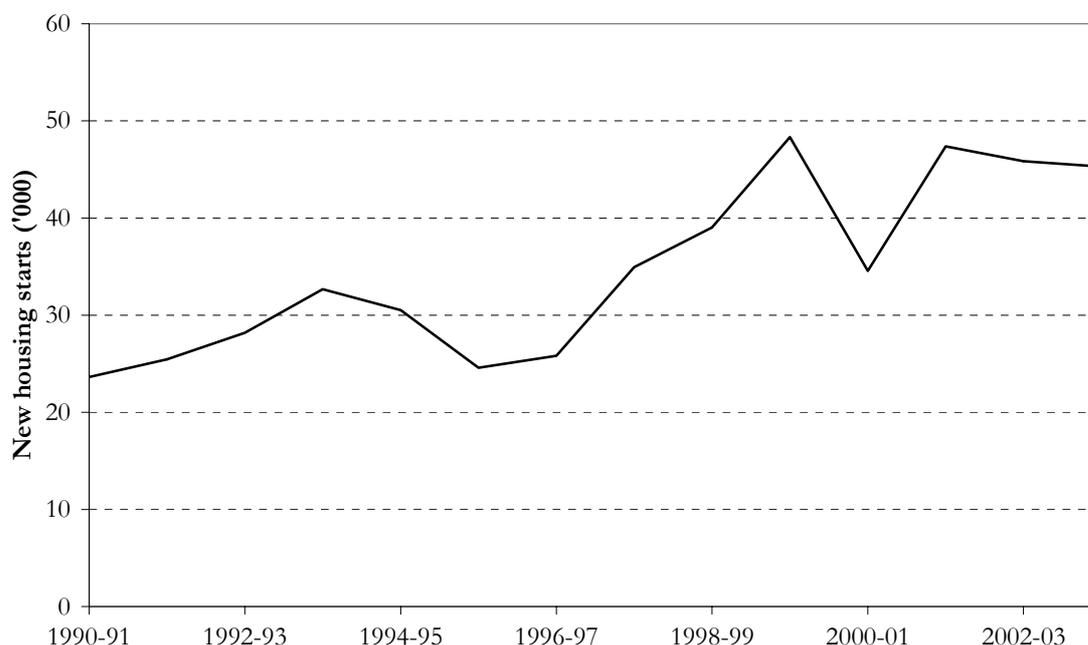
Source: ABS 2004b.

2.2.2 New housing starts

The number of new housing starts is another important housing construction indicator (figure 2.3). Between 1990–91 and 2003–04, the number of new building starts per year increased by 92 per cent, from 23 640 to 45 284 (ABS 2004c). The real value of residential work increased by around 140 per cent over this period, suggesting that the average real value of new houses increased significantly.

Housing starts in Victoria peaked in 1999–2000, and some forecasters expect further weakening. The Victorian Government expects dwelling investment to slow further (Brumby 2005, p. 21), while BIS Shrapnel predict that new housing starts will fall by 8 per cent in 2005–06, after a 13 per cent fall in 2004–05 (Gordon 2005).

Figure 2.3 **New housing starts in Victoria^a**



^a Includes new houses, new 'other residential' and conversions, as defined by the ABS.

Source: ABS 2004c.

2.2.3 Type and location of construction

Most Victorian housing construction occurs in the Melbourne metropolitan area. Between 1998 and 2003, however, the proportion of total housing building work in regional areas increased from 20 per cent to 25 per cent (table 2.1), led by regional centres such as Geelong, Ballarat, Bendigo and Bairnsdale (BC 2004d, p. 4).

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	5213	78.9	1394	21.1
2001	6537	78.6	1776	21.4
2002	7246	76.7	2205	23.3
2003	7383	74.8	2485	25.2

Sources: BC 2004d figures 16 and 17 (and equivalent information in BC 1999, 2000, 2001, 2002b, 2003c).

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. In recent years, however, the proportion of domestic and residential building construction undertaken in inner Melbourne has decreased.

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	3771
1999	1839	40.3	2719	59.7	4558
2000	1664	38.3	2684	61.7	4347
2001	1928	36.7	3323	63.3	5251
2002	1949	33.2	3914	66.8	5863
2003	2117	34.8	3966	65.2	6083
<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	91.6	110	8.4	1300

Sources: BC 2004d, figures 16 and 17 (and equivalent information in BC 1999, 2000, 2001, 2002b, 2003c). See table 2.3 for definitions of inner and outer 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

Table 2.3 Housing construction, by region and municipal area—value and number of permits, 2003

	Domestic ^a		Residential ^a	
	Building permits (no.)	Value of building permits (\$'000)	Building permits (no.)	Value of building permits (\$'000)
<i>Metropolitan Melbourne</i>				
Inner Melbourne				
Melbourne (Melbourne)	302	52 305	254	456 473
Central Bay (Hobsons Bay and Port Philip)	1 992	189 720	200	262 266
Inner West (Maribyrnong and Moonee Valley)	2 442	208 649	117	96 768
Inner North (Banyule, Darebin and Moreland)	5 123	411 705	125	84 631
Yarra (Yarra)	787	68 735	113	70 619
Mid East (Monash and Whitehorse)	4 062	330 500	44	29 989
Inner East (Boroondara, Glen Eira and Stonnington)	5 662	638 016	276	158 059
Bayside (Bayside)	1 821	216 966	38	21 465
Total inner Melbourne	22 191	2 116 596	1 167	1 180 270
Outer Melbourne				
South western (Wyndham)	4 011	495 228	5	895
Western (Brimbank and Melton)	4 827	580 456	18	5 814
North western (Hume)	2 993	346 779	10	886
Northern (Nillumbik and Whittlesea)	2 866	321 651	13	5 915
Eastern (Knox, Manningham, Maroondah and Yarra Ranges)	6 913	508 049	55	39 400
South eastern (Cardinia, Casey, Greater Dandenong and Kingston)	10 610	1 076 477	71	32 971
Peninsula (Frankston and Mornington Peninsula)	6 068	636 918	64	23 832
Total outer Melbourne	38 288	3 965 558	236	109 713
Total Melbourne	60 479	6 082 154	1 403	1 289 983
<i>Rural Victoria</i>				
South west (Colac–Otway, Corangamite, Glenelg, Golden Plains, Greater Geelong, Moyne, Queenscliff, Southern Grampians, Surf Coast and Warnambool)	8 497	713 246	97	25 601
North west (Ararat, Ballarat, Central Goldfields, Hepburn, Hindmarsh, Horsham, Mildura, Moorabool, Northern Grampians, Pyrenees, West Wimmera and Yarriambiack)	5 139	373 286	85	26 371
North central (Buloke, Campaspe, Gannawarra, Greater Bendigo, Loddon, Macedon Ranges, Mitchell, Mount Alexander and Swan Hill)	5 707	464 051	33	7 748
North east (Alpine, Benalla, Falls Creek, Central Shepparton, Indigo, Mansfield, Moira, Mount Buller, Mount Hotham, Murrindindi, Strathbogie, Towong, Wangaratta and Wodonga)	4 750	366 722	76	29 149
Gippsland (Bass Coast, Baw Baw, East Gippsland, Latrobe, Mount Baw Baw, South Gippsland and Wellington)	5 741	458 855	56	19 779
Total rural Victoria	29 834	2 376 160	347	108 648
TOTAL VICTORIA	90 313	8 458 314	1 750	1 398 631

^a Based on the Building Commission's definitions, as explained in box 2.1.

Source: BC 2004d, p. 24.

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 etc.) 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 2003, 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, 2003**

	<i>Registered builder (\$)</i>	<i>Owner-builder registered (\$)</i>	<i>Owner-builder (\$)</i>
New building	200 970	261 156	188 164
Re-erection	34 578	46 870	39 025
Extension/alteration	42 990	47 456	26 818
Change of use	183 899	266 750	41 779
Demolition/removal	5 449	6 286	6 506
Other	15 847	28 815	11 266

Sources: BC 2004d, table 16 (and equivalent information in BC 1999, 2000, 2001, 2002b, 2003c).

Registered builders who were not owner-builders accounted for 70 per cent of the value of domestic building work undertaken in Victoria in 2003. Owner-builders who were registered builders accounted for 7 per cent of building work, while owner-builders who were not registered builders accounted for 23 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 2003, the value of work conducted by owner-builders who were not registered builders increased by 116 per cent, from \$915 million to about \$2 billion. Over the same period, work conducted by owner-builders who were registered

builders increased by 234 per cent (from \$172 million to \$574 million), while the work conducted by registered builders (not owner-builders) increased by 57 per cent (from \$3.8 billion to \$5.9 billion). Between 1998 and 2003, the number of domestic building permits given to registered builders (excluding registered owner-builders) decreased by 2.7 per cent, while the number given to owner-builders who were not registered building practitioners increased by 60 per cent.

Figure 2.4 Value of housing construction work, by builder type

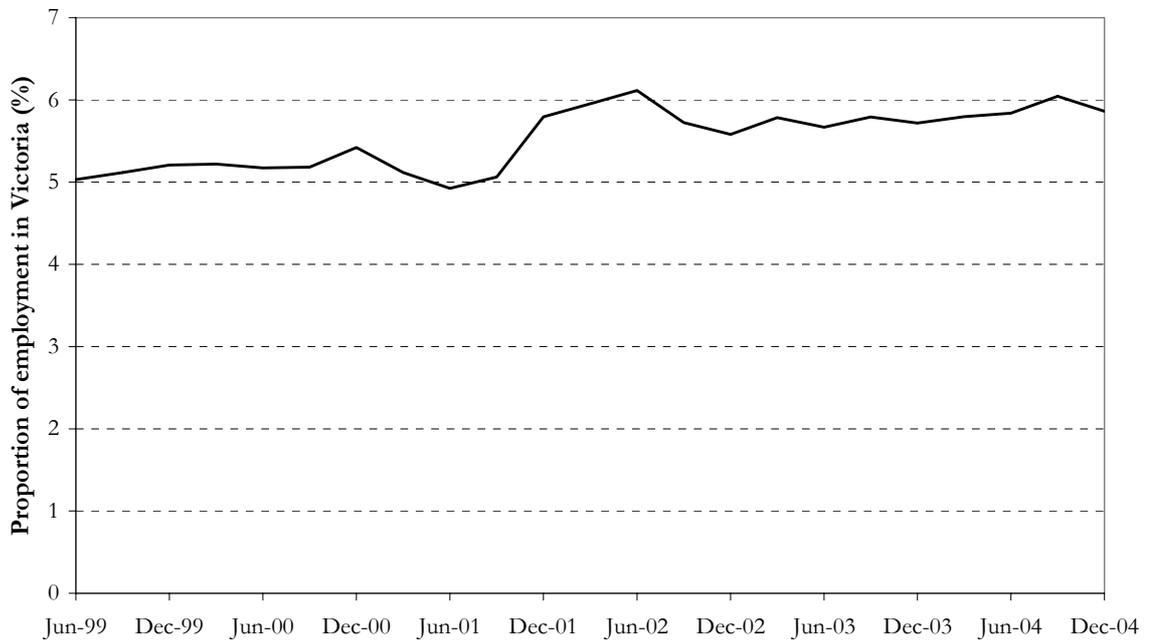


Source: BC 2004d, table 16 (and equivalent information in BC 1999, 2000, 2001, 2002b, 2003c).

2.2.5 Employment

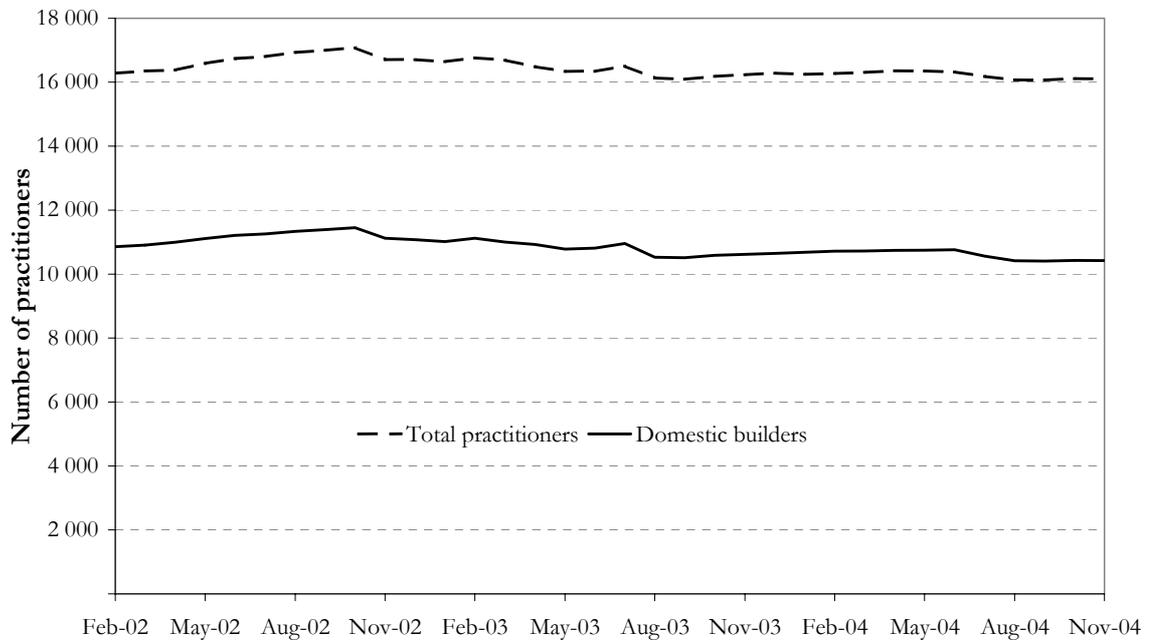
While official data for employment in the housing construction sector are not available, data for building construction as a whole are indicative. This industry employed 143 000 persons in December 2004, making it one of the largest employers in Victoria, with six per cent of the state’s workforce (figure 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.

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



Source: BC undated A.

The number of registered building practitioners remained fairly constant over the past three years. They account for less than 10 per cent of total employment in the building construction industry. In 2004, there were about 16 000 registered building practitioners, of whom just over 10 000 were registered as domestic builders (figure 2.6). According to a Building Commission survey conducted 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).

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, the industry is still dominated by small businesses. 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 and 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 as a whole, nearly two thirds of businesses provide specialist trade services, including plumbers, electricians, carpenters, bricklayers, concreters, tilers and plasterers (HIA 2005, 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 increased in the preceding two years (BC undated A).

With such sketchy data, it is not possible to reach a firm conclusion about 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 may 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)

The extent to which regulation affects competition is discussed in chapters 5, 6 and 7.

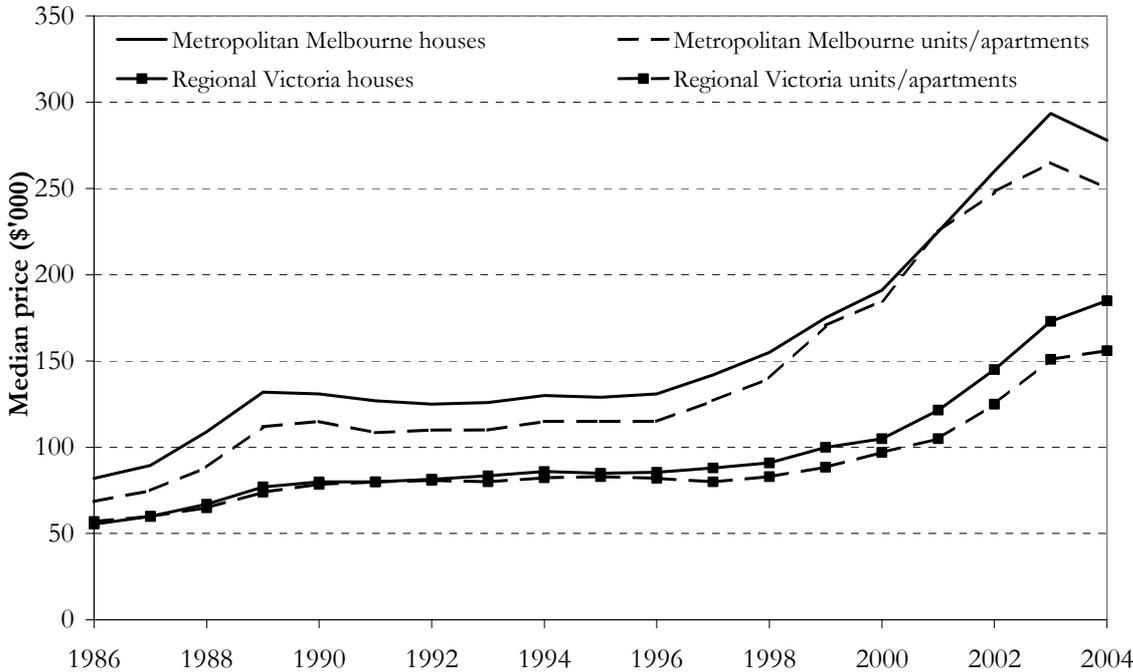
2.3 Productivity

The 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 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 were \$278 000 and \$250 000 respectively. The median price of vacant house blocks in Melbourne was \$135 000, suggesting that land accounts for about half of the median house price. In country Victoria, the median price of houses and units was \$18 000 and \$15 000 respectively in 2004, while the median price of a vacant

Figure 2.7 House and unit prices

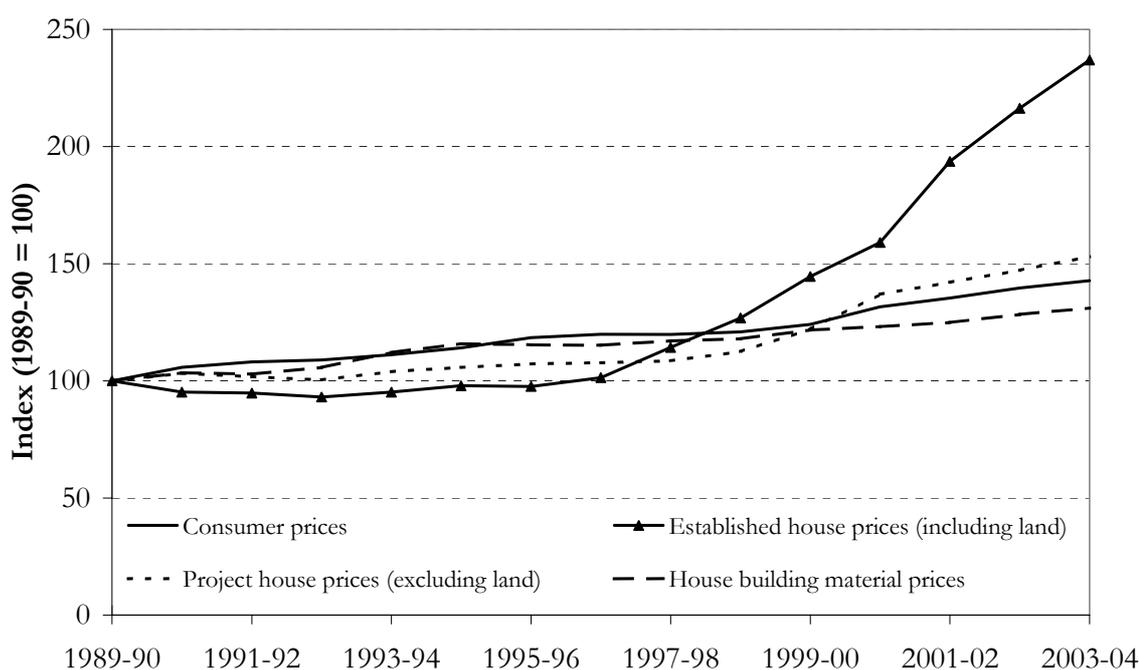


Source: DSE 2004a.

land block was \$6000. These figures mask significant variations—for example, median house prices in Melbourne ranged from \$76 000 in Craigieburn to \$1 382 500 in Toorak; in country Victoria, the range was from \$10 000 in Inglewood and Ouyen to \$684 000 in Lorne (DSE 2004a, pp. 29–40). House prices have risen substantially since the mid-1990s (figure 2.7). Between 1996 and 2004, the median house price in Melbourne increased by \$14 000 (from \$13 000 to \$27 000). Over this period, the median price of a vacant house block increased by \$80 000, from \$55 000 to \$135 000 (DSE 2004a, pp. 15–17). While a comparison of the median prices of houses and vacant house blocks is indicative only, a substantial component of the increase in house prices in the past 10 years appears to have been the result of higher land prices.

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 prices of project houses (excluding land) or house building material prices.

Figure 2.8 Trends in house and building material prices, Melbourne



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

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 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. Notwithstanding this improvement, affordability according to this index is still well below the level in 1997 (HIA–Commonwealth Bank 2004, p. 3).

Given this inquiry’s focus on the regulation of housing construction, the Commission was interested in the extent to which regulation increases house prices. 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). Estimates provided to the Commission, in its discussions with builders and architects and reported in appendix C, are not inconsistent with these estimates, although the costs vary considerably depending on the characteristics of the building and location.

The Commission’s survey respondents estimated that selected Victorian and local government regulations represent at least four per cent of the value of an average house² (table C.2). This represents the lower bound of respondents’ estimates—the estimated cost of complying with the regulations is much higher for some respondents. In addition, there are other regulations affecting housing construction in Victoria for which estimates were not sought.

The estimates of the cost of the selected regulations varied substantially between builders, from 4 per cent to almost 20 per cent. This was partly because the extent to which respondents were able to 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 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.

Assuming that the experience of the practitioners participating in this exercise is representative of the industry more broadly, it would be reasonable to infer that the selected regulations impose a cost equal to at least 4 per cent of the value of

² ‘House’ as used in this section refers to only the value of the building itself. The value of land is excluded.

housing construction in Victoria. With the value of housing construction in Victoria exceeding \$10.5 billion, this suggests that housing construction regulation cost at least \$420 million in 2004.

This estimate does not include 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 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 additional cost of levies was approximately \$16.8 million in 2004.

This suggests that together the selected housing construction regulations and the levies cost approximately \$437 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 this estimate is unlikely to overstate the incremental costs substantially. The estimate is based on the lower bound of 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. The percentage cost estimates reflect differences in respondents' cost estimates and the costs of an 'average' house for each respondent:

- (1) 5 Star energy efficiency (including water saving devices), for which most estimates of additional cost were between \$6000 and \$18 000, or between 2.5 per cent and 6.0 per cent of the costs of an 'average' house, although one builder suggested that the \$250 cost 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 0.5 per cent and 1.3 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 \$15 120, or between 1.2 per cent and 5.1 per cent of the costs of an 'average' house (table C.7)
- (4) termite protection, with estimates ranging between \$540 and \$4240, or between 0.1 per cent and 1.6 per cent of an 'average' house (table C.8).

That regulation adds these 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. 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.

2.5 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. It may not, however, be possible to attribute a decrease in the number of injuries to the introduction of housing regulations, as there can be other influencing factors (for example, improved housing design, removal of obstacles and absence of surface contaminants can contribute to reduced slips and falls).

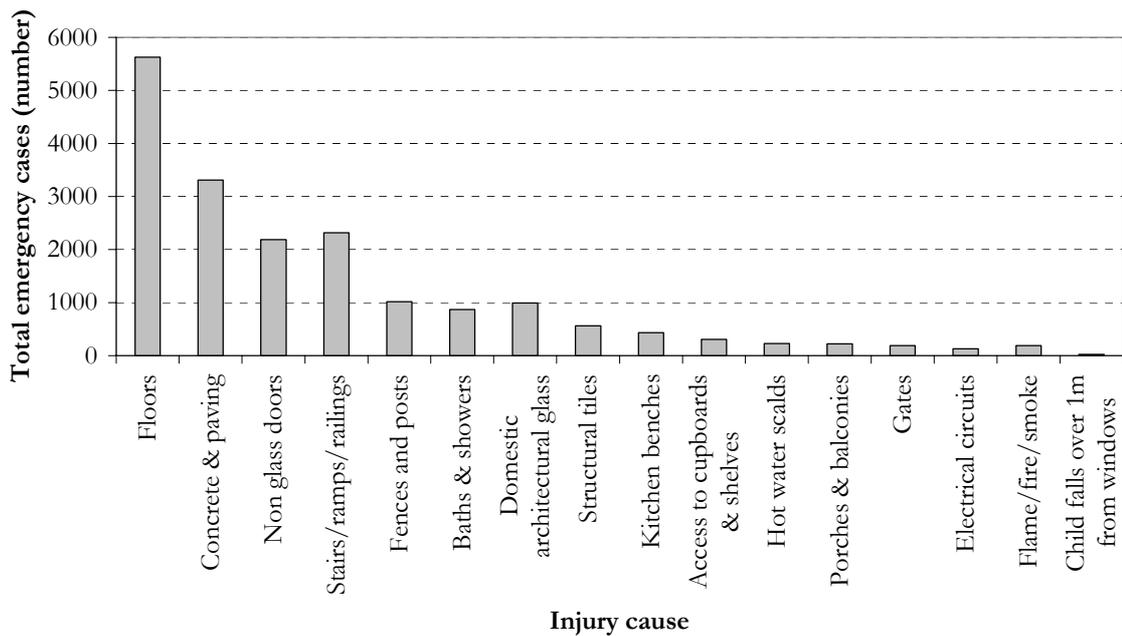
The Australian Building Codes Board operates a database that registers relevant information sources relating to health and safety risks in commercial and residential buildings (Atech Group 2003). Information is collected from Australia (on a national and state-wide basis), Canada, Japan, New Zealand,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

A relevant data source for Victoria reported in the Australian Building Codes Board database is from 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 and Routley 1997), found that:

- 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, 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—causes by frequency (1989 to 1996)**



Source: Derived from Ashby and Routley (1997).

The Commission has not yet discovered any data for Victoria that disaggregates injuries by type of housing and over time periods to allow comparison. It would be useful to have comparative data for the period since 1996 to establish trends in injuries related to structural features, and to see whether this correlates with regulatory changes in the intervening period.

Draft 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.

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 improve housing affordability, but alone will not reverse the decline in affordability experienced in recent years.

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?

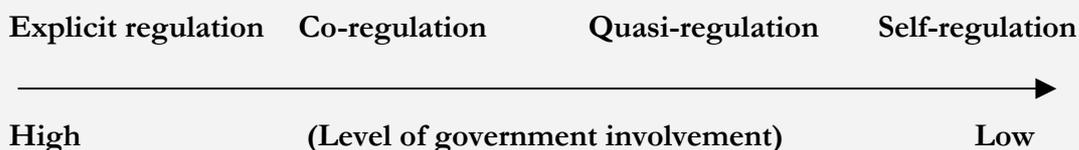
The Victorian Competition and Efficiency Commission is required to undertake a systematic and comprehensive review of Victorian regulations affecting the housing construction industry, to identify where those regulations might be improved and how any improvements might be made. The Organisation for Economic 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.¹ 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 (that is, an Act of parliament), 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.

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

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, 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 enable those arrangements to be enforced. 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 is 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, it is necessary, therefore, 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?

It is generally considered that the three main types of market failure in the housing construction sector are:

- (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 market situations, consumers generally have poorer information than have suppliers about the key attributes of a product or service, such as quality and costs of provision. In the housing construction sector, this means builders are generally better informed 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 a number of key aspects of housing construction. These include structural soundness, the effectiveness of the protection provided 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 ‘home owners 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, there is usually significant tailoring 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, for example, provides plain English contracts and guides to assist consumers. The MBA provides a contact service for consumers.
- 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. There is limited value in a warranty 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. Amongst other things, the Trade Practices Act requires 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.² And many consumers may place little value on the reputations or voluntary warranties of suppliers of housing construction services.

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 that are generated by the production or consumption of goods and services, which accrue to third parties, and are not reflected in prices.

Some costs associated with the construction of a house may fall on others in the community (third parties), not just the parties involved in that transaction (the consumer or the builder). Noise, dust and water run-off are obvious examples of a cost that may fall on third parties. Poorly sited or designed houses may have an impact on the amenity and safety of neighbours. 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.

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

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 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 reasons. In housing construction, regulation aims to ensure health and safety objectives for the community (for example, by proscribing the use of asbestos in housing). 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 underpinned 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 2005, p. 2-2).

Whether regulating to achieve equity outcomes is desirable depends on the issue. Financial support, rather than regulation, may be the best way to assist people on low incomes to obtain housing. The Productivity Commission 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 sorts 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 was around \$10.5 billion in 2003-04. 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 housing construction 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 2005, pp. 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 through 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, represent a cost that society bears. In the housing construction industry, there is a concern that many builders are encouraging their clients to register as owner–builders to avoid certain regulations (chapters 4 and 6).

As noted, imperfect housing construction markets may result in the average quality of housing being less than socially desirable. 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 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 and 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 mechanisms such as statements of objectives and functions, performance agreements and monitoring, and periodic reviews (such as sunset 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 to 11 of this report have found, 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 transactions 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 certain 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 any disputes faster and more cheaply. The effectiveness of the major mechanisms used in Victoria is examined in chapters 5, 6 and 7.

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 extreme 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 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:

- regulations 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)³
- regulations should not be unduly prescriptive
- regulations should be consistent with other laws and regulations
- regulations should be enforceable
- there should be pressures for continual improvement
- regulators should be accountable.

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

³ One of the agreed principles of national competition policy, endorsed by the Victorian Government in the 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 only be achieved by restricting competition (State Government of Victoria 2005, p. 5-17).

Box 3.2 Principles of best practice regulation

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

- Regulations should be developed through consultation that tests specific proposals, including the estimates of costs and benefits, and identifies the potential for unintended consequences.
- Regulations 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.
- The 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 only be achieved by restricting competition.

(3) Regulations should not be unduly prescriptive:

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

(4) Regulations and their administration should be consistent with other regulations:

- 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 3.3 Principles of best practice regulation (continued)

(5) Regulations should be enforceable:

- Regulations should provide the minimum incentives necessary for reasonable compliance.
- They should be fairly and consistently enforced.
- They should be developed to achieve a reasonable level of voluntary compliance and community support.
- They 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 regulations are achieving their 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 the Parliament, those regulated and the wider community to make that assessment.

Sources: Based on VCEC (2005).

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. Just what form that regulation

might take will be influenced by the nature of the market failure or problem to be addressed.

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.

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.

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

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 regulations affect the sector and 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.

Formed by an intergovernmental agreement in 1994, the ABCB's 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 either 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 the deemed to satisfy 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: state and territory legislation, building regulations that adopt the BCA; and local government by-laws.

Figure 4.1 Regulation of the building process

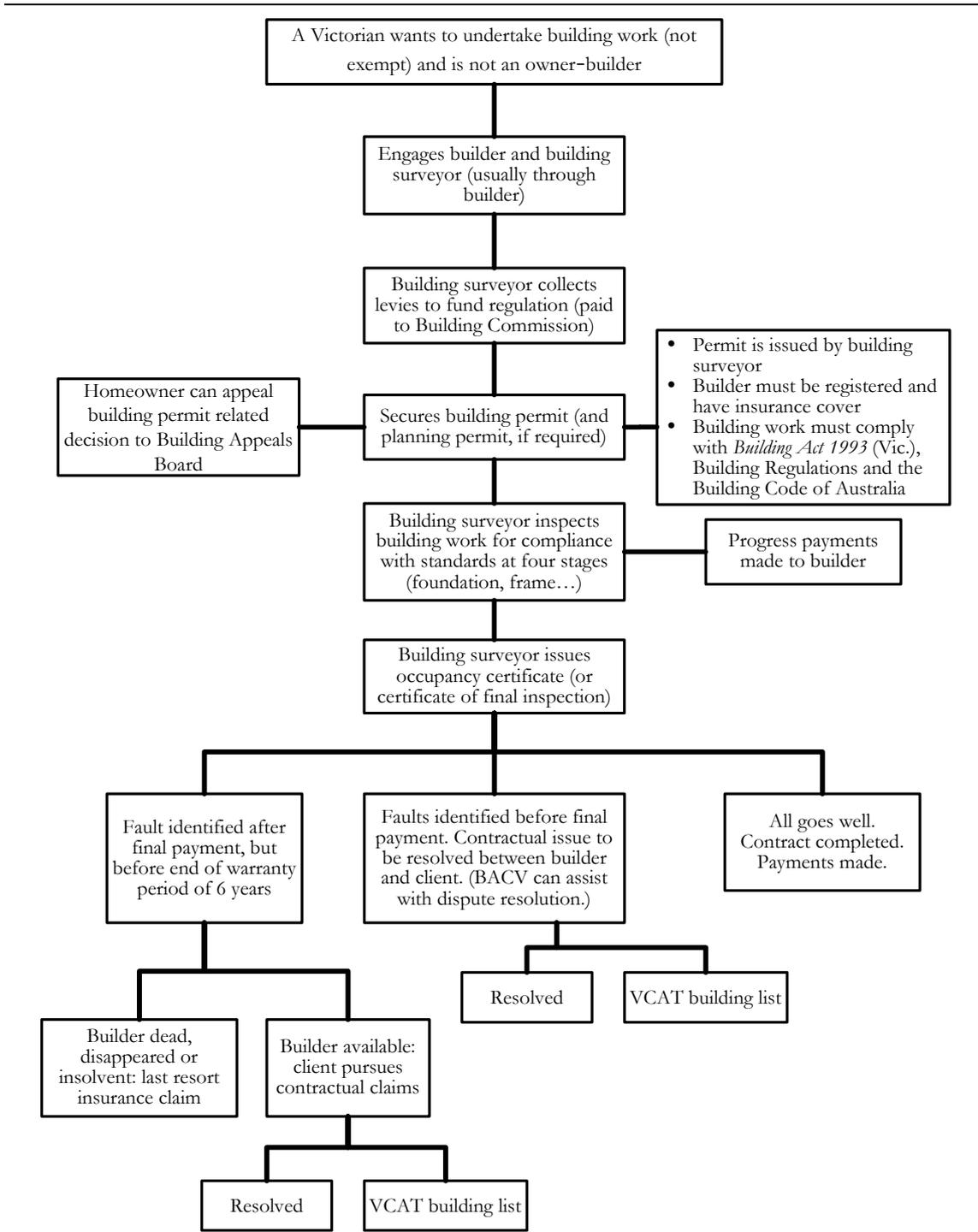


Figure 4.1 provides a perspective on Victoria’s regulatory process by illustrating the steps that are triggered once someone decides to commission building work that is not otherwise exempted.

Building work that is not exempted by the 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 (box 4.1).¹

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.), or is an architect registered under the *Architects Act 1991* (Vic.)(s.24A). Building practitioners include building surveyors and inspectors, quantity surveyors, engineers, draftspersons and various classes of builders (s.4).
- The builder holds domestic builders insurance.
- The owner builder has a certificate of consent from the Building Practitioners Board
- 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.

To improve the timeliness and efficiency of the permit process, the *Building Act 1993* (Vic.) 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.² The building surveyor collects levies to fund the regulatory process (chapter 6) and must inspect the building work on completion of four nominated mandatory stages (s.34).^{3,4} The surveyor may cause inspections at other times (s.35). Building surveyors have significant

¹ Tradespeople carrying out specialised domestic building tasks as a single trade in a range of areas specified in 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 work that exceeds \$5000, they are required to be registered and to enter into a major domestic building contract (CAV 2004, p. 7).

² Planning approvals, unlike building permits, can be processed only by council employees.

³ Section numbers refer to sections in the Building Act.

⁴ The four steps are (1) prior to placing a footing, (2) at completion of a framework, (3) prior to 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).

powers to ensure the effectiveness of the inspections (s.36) and may give directions to ensure the building work complies with the building permit (s.37).

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 that the building is suitable for occupation (s.39). 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 (s.81(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 *Government Gazette* (s.135). 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 2004, p. 80). Commercial builders are required to carry structural defects insurance, while domestic builders are required to carry domestic builders insurance. This 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 disappeared, or is insolvent (CAV 2004, p. 3).

Section 31 of the *Domestic Building Contracts Act 1995* requires details of insurance to be given to the owner. (Insurance is discussed in chapter 7.) If faults are found before a job is completed, or after completion and the builder can be pursued, this is a contractual issue between the builder and client. Building Advice and Conciliation Victoria (BACV) provides a free service to help to resolve such disputes.

The *Wrongs Act 1958* 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 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

When a person decides to build or renovate a house, he or she will normally sign a contract with a builder, which specifies both parties' commitments and provides the point of reference should a dispute arise. The content of building contracts is regulated by the *Domestic Building Contracts Act 1995*, whose objectives 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. (s.4)

The Act specifies the warranties implied in contracts—for example, that work is 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' (s.8(a) and (d)). Nevertheless, there is no requirement for inspections under the Act to ensure warranties are met and the inspections of building surveyors under the Building Act do not take account of the plans or the contract for the building. Misunderstandings about the scope of inspections 'give rise to large numbers of disputes' (CAV, sub. 91, p. vi).

The Act requires that a builder must not enter a building contract unless registered under the Building Act, and that the work must comply with requirements under the Building Act and Regulations. (The Building Act and Regulations are described in sections 4.2.2 and 4.2.3.) Section 124A of the Act incorporates specified monitoring, inspection and enforcement provisions of the *Fair Trading Act 1999* (Vic.) to promote compliance within its provisions.

The Act has broad application, including:

- the erection or construction of a home, including associated work
- the renovation, alteration, extension, improvement or repair of a home
- work to be carried out in conjunction with renovation. (s.5)

The Act establishes a conciliation mechanism which is performed by BACV. The Act also provides for the adjudication of disputes by the Victorian Civil and Administrative Tribunal (CAV, sub. 91, pp. 4–5)

It does not, however, require building inspections, and building surveyors do not certify or account for contractual issues affecting the building work. Nevertheless, the Act links the final payment to the provision of documentation relating to the occupancy permit or final inspection. The Act also requires that builders provide inspection notices (from a building surveyor) to the contracted customer (s.26).

In July 2004, the Victorian Government announced a review of the Act. 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. This review has been completed and recommendations have been made to the minister.

4.2.2 Building Act

A 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 (s.4). The Act consolidates building controls and standards, and substantially enacted the National Model Building Act, 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 (s.188) and guidelines relating to the design and siting of single dwellings (s.188A).

4.2.3 Coverage of the Building Act

'Building' is defined broadly in the Act, so its reach is extensive. The Act applies to the construction of both the largest office building and a temporary marquee (s.3). 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 (s.221A). The second amendment was the insertion of part 5A Registration of Cooling Tower Systems in 2000. Part 5A is outside the terms of reference for this inquiry. The third major amendment is the *Building (Amendment) Act 2004*, which has special provisions for owner–builders. It is discussed in section 4.2.4.

4.2.4 Objectives

The Act has 10 objectives:

- (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 buildings⁵
- (5) To provide an efficient and effective system for issuing building and occupancy permits and administering and enforcing related building and safety matters and resolving building disputes
- (6) To regulate building practitioners and plumbers
- (7) To regulate plumbing work
- (8) To reform aspects of the law relating to legal liability in relation to building and plumbing matters

⁵ In 2004, s.221ZZZV of the Building Act was amended to permit the Governor in Council to make regulations prescribing standards expressed in terms of water efficiency, as well as environmental and energy efficiency, for plumbing work.

(9) To aid the achievement of an efficient and competitive building and plumbing industry

(10) To regulate cooling tower systems. (s.4)

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) 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.

4.2.5 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 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)

The Building Regulations adopt the Building Code of Australia. 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.

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 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.⁶

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

⁶ Nineteen amendments have been made to the Building Regulations by statutory rules since the principal Regulations came into operation.

4.2.6 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 2004, p. 57). Owner–builders can avoid the initial builders registration fee (\$540–680), the annual registration fee (\$180) and the requirement to have domestic building insurance unless the home is sold within 6 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 37 per cent and 23 per cent respectively (BC 2005d, pp. 5–6).

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. 1)

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.

4.2.7 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, there have been 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*.⁷ Also relevant are the *Estate Agents Act 1980*,

⁷ 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.

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, as well as for many builders to understand their obligations.

4.3.1 Architects Act

The main purposes of the Architects Act 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. (s.1)

The Act restricts the use of the term ‘architect’ to persons who are registered by the Architects Registration Board of Victoria (ARBV) and who meet requirements relating to qualifications, experience and conduct. A partnership may call itself an architectural partnership and a company may call itself an architectural company only with the approval of the ARBV.

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 (r.7).

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 hold prescribed insurance.

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 who are registered 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 Victorian Government has announced that the OCEI and the Office of Gas Safety (as well as the pipelines safety functions of the Department of Primary Industries) will be combined to form one office: Energy Safe Victoria.

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. Most provisions of the Act came 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.

The principal objects of the Act 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 (s.2). 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' (s.4).

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. Of particular significance 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' (s.1). 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’ (s.4).

A system of planning schemes is the principal way of setting out objectives for the use, development and protection of land. Each municipality in Victoria 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 (s.4A).

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 (s.8).

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 ... that it believes may be materially affected by the amendment’ (s.19). 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 (s.35). 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.

The Act provides for permits to be granted (or refused) in accordance with the provisions of planning schemes (s.47 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 (s.62).

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 (ie 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 The Fair Trading Act

The Fair Trading Act provides some protection to all consumers in Victoria. 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. The Act also contains additional consumer protection provisions’ (CAV, sub. 91, p. 5).

4.4 Organisations established under the Building Act

The Building Act establishes six bodies to perform specified functions. A seventh body, the BACV, 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. The regulators are self-funding, with a total annual expenditure of about \$27 million (detailed in chapter 11). They employ about 160 staff in total.

The Building Act specifies more than 50 functions for these bodies. (The functions are listed and discussed in chapter 9.) 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 The Building Commission

The second reading speech for the Building Act described the Building Commission as ‘the overseeing body for the building control system’, having regard to the broad functions conferred by s.196. The commission is a statutory authority established under 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 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. (s.196)

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). The Building Commission sees 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 in 2000 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 that are established under Parts 10, 11 and 12 of the Act and providing staff, accommodation, financial services, administration and information technology support for them. (Auditor-General Victoria 2000, p. 91)

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)
- completing investigations into complaints (mentioned by the Auditor-General)
- allocating resources between 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 The 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 (s.183). Its membership includes:

- a chairperson
- one legal practitioner
- one consumer representative
- one member for each category (currently 8) of building practitioner.

Neither the Building Commissioner nor a member of the BAB can be members of the BPB.

The BPB offers three types of registration:

- (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 2004, p. 25)

The BPB sets registration fees, in accordance with guidelines set by the minister.

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 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 for one-off contracts. 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 2004, 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 domestic owner-builders to carry out domestic building work (Building Practitioners Board, sub. 26, p. 6). The BPB must be satisfied that applicants for registration have appropriate qualifications and are of good character (s.170). It assesses applications for each practitioner category against minimum standards set by the minister on advice from the board (Auditor-General Victoria 2000, p. 36). Registrations last until cancelled, but an annual fee is payable and, where applicable, insurance must be maintained (s.172). The BPB must also maintain a register of the names and classes of registered building practitioners (s.173). It can suspend registrations for a number of reasons, including where the person is not covered by required insurance or where a builder refuses to comply with a reasonable direction of the insurer to complete or rectify defective work (s.174).

The BPB has the power to hold inquiries 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 by a person that it has appointed (s.178). Following an inquiry, it can take disciplinary actions, including reprimands, awarding costs against a practitioner, and suspending or cancelling registration

(s.178). The board held 49 inquiries in 2004-05, resulting in 11 cancellations of registration and six suspensions (sub. 26, p. 4).

4.4.3 The Building Appeals Board

The BAB determines disputes and appeals arising from the Building Act and Regulations, including decisions made by the BPB (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 interests of the users of building practitioners, and ‘as many others as the minister considers necessary’ with experience in the building industry or matters related to the industry (s.166(3)). The Building Commissioner and members of the BPB and the Building Advisory Council cannot be members of BAB.

The Auditor-General described the work of BAB 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 The 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 (s.208). 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 (s.207). The original intention was that the council would 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 DSE, the key recent achievements of the BAC 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 The 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 (s.211). 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 are awaiting action by the proposer. (sub. 57, p. 7)

The 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 (s.210). 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 2004, p. 73).

4.4.7 The 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 (s.221A). The Plumbing Industry Commission (PIC), established under part 12A, has a variety of functions:

- 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 restrict the use of the titles ‘plumber’, ‘gasfitter’ and ‘drainer’ to someone who is registered or licensed
- 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 VCAT)
- 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 The 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 (PIAC), which provides advice to the Minister and the Building Commission in relation to part 12A of the Building Act. The PIAC also advises the PIC on the performance of the regulatory system and potential improvements. In 2003-04, for example, it:

- assisted the PIC 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 role of councils 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 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 grant 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 where sufficient private building surveyors are available.

Part 4 of the Building Regulations⁸ confers significant responsibilities on councils, which permit them to vary the Regulations on design and siting issues on 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.

Section 8(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 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. This is discussed below.

⁸ 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.

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 s.212 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 s.111(1) of the Local Government Act, councils may make local laws on the matters covered by these parts. The local law making power conferred on councils by s.111(1) does not permit councils to make laws on building design and construction, however, because such matters fall outside the functions conferred on councils under s.212 of the Building Act.

To ensure there is no doubt that councils do not have power to make local laws on building design and construction, s.13(1) of the Building Act 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 sets out the regulation making powers under the Building Act.

Section 13(2) goes on to provide that s.13(1) does not prevent councils from making local laws under powers conferred by the Building Regulations, but because the Regulations do not confer any powers to do so, the local building law making powers of councils depend entirely on s.212 of the Building Act and consequently are narrowly confined.

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 s.13(1) because they do not provide for matters set out in part 1 of schedule 1 of the Building Act.

The power of councils to make local laws is also restricted by s.111(2), (3) and (4), which provides 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. However, local laws are not subject to a rigorous public impact assessment and there is no mechanism to promote uniformity across Victoria in local building laws.⁹

The City of Boroondara commented:

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 HIA, in its submission to the Productivity Commission inquiry into first home ownership, suggested that ‘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 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

⁹ The procedure for making a local law is set out in s.119 of the Local Government Act. The procedure includes publication in the *Government Gazette* of a notice stating that any person affected by the proposed local law may make a submission to the council.

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. Councils may introduce additional building controls through council planning schemes.

4.5.3 Imposition of building controls through council planning schemes

Councils have limited powers to impose building controls that are unique to a municipality through the provisions of local planning schemes. The Planning and Environment Act provides for planning schemes to promote the objectives of planning in Victoria within the area covered by a scheme (s.6). These objectives include securing ‘a pleasant, efficient and safe working, living and recreational environment for all Victorians’ (s.4(1)(a)). Planning schemes, accordingly, have an impact on building construction.

A planning scheme for a municipality must include state standard provisions and local provisions made by the council (s.7(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’ (s.7(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 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 VCAT, 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 did not appear to cause major problems (DSE, pers. comm. 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 (s.62(4)), except for a condition relating 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 (s.11 Building Act). However, as with local laws, local provisions in planning schemes are not subject to a rigorous public impact assessment and there is no mechanism to promote uniformity across Victoria in planning provisions that affect building construction.

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 also noted a tendency for local governments to use their planning approval processes to extend or alter building requirements, and made some 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)¹⁰. (PC 2004c, p. xxxvii)

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’.

The Building Act also 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 s.188(2) that the guidelines may specify the fees (or maximum or minimum fees) and may specify different fees for different classes of case. The guidelines must be published in the *Government Gazette* (s.188(3)).

The guidelines are not binding on councils when they set their fees. Section 188(4) 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 councils are not obliged to follow the ministerial guidelines and, consequently, have discretion in setting fees.

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.

¹⁰ 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.

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 (s.188) and to the design and siting of single dwellings (s.188A). The effect of guidelines on fees has been discussed above.

Clause 4A of schedule 2 of the Building Act obliges a council to have regard to the minister's guidelines when it considers any permit application and the council must 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 s.222(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 s.11 of the Building Act, a provision of a planning scheme on the siting of buildings takes precedence over an inconsistent building regulation. 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 2005, pp. 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 draft proposals for Building Regulations (s.196(e)) for consideration by the minister. The minister obtains advice on proposed Regulations from the Building Regulation Advisory Committee (s.211) and consults with stakeholders in accordance with the procedures required by the Subordinate Legislation Act.

Under the Subordinate Legislation Act, proposed Regulations are ordinarily assessed in a RIS for their economic, social and environmental costs and benefits for affected groups. The 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 (s.9A Building Act).

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, a 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 conducting an analysis of the broad framework of goals, objectives and structure of the BCA, including technical content. The program includes both policy and technical development

phases. This will include consideration of 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 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

Fifth, the minister administering the Building Act can issue guidelines under ss.188 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 the assistance of the Chief Fire Officer of the Metropolitan Fire Brigade or the 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 *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 and 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 s.188A where relevant.

The guidelines sometimes vary the Building Regulations. The guidelines made under s.188A on 24 November 2001, for example, permit a council to consent to an application for 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.

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. No guidelines by the Building Commission have been made under this provision.

4.6.6 Local provisions in planning schemes

Sixth, as pointed out above, Victorian councils have the power to apply standards different from those in the Building Regulations, through local provisions in planning schemes. Before such standards are imposed, however, councils have to go through a process set out in the 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 (s.12). Although notice of proposed amendments must be given in some cases to persons who may be materially affected by proposed amendments to a planning scheme, planning authorities are not required generally to consult with the residents in the municipality who might have an interest in, or be affected by, the amendments. Planning authorities must submit planning scheme amendments to the minister for approval (s.31), which may be granted in whole or part, or refused (s.35).

4.6.7 Local laws

Seventh, councils can introduce local laws by following a procedure set out in s.119 of the Local Government Act. A council is required to publish a notice in the *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.

Draft finding 4.1:

There are at least seven ways in which additional regulatory obligations can be imposed on participants in housing construction. There do not appear to be sound reasons for having so many approaches. In some cases, extra obligations can be imposed without any analysis of their costs and benefits.

Part B

5 Regulation of housing design and construction

This chapter considers regulations that govern 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 regulations governing housing design, construction materials and building techniques are 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 inconsistent regulation between councils and poor notification procedures add to the regulatory burden for builders (and ultimately to the cost to consumers).

Finally, as Victoria's regulatory framework confers on building surveyors a central role in ensuring the application of regulations 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 the application of the regulatory system in Victoria. Building surveyors are responsible for issuing building permits and ensuring the minimum standards set out in the building regulations 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 regulations. 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.

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. However, the comments noted above suggest the consumer should be better informed about their right to choose a surveyor. This information would help to make clear that the surveyor is not working for, and on behalf of, the builder. (This issue is considered in more detail in section 6.4).

Draft finding 5.1

The evidence presented to the Commission indicates that the privatised building surveyor/permit process is working well. There is a case 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 governing 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 and utilises standards produced by Standards Australia to define building methods. (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.¹ 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)

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.

¹ Chapter 4 describes the nature of the BCA and its application in Victoria.

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 it encouraged greater innovation in planning and building, and 70 per cent thought it encouraged the use of new technology (PC 2004c, p. 54).² 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.³ 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 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)

² The survey did not distinguish between the impact of regulations on housing and commercial building.

³ Where performance was defined to include productivity, innovation, quality and efficiency.

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 closely 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 a number of 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 developing 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 regulations is a sound approach to building regulation in Victoria. 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.

Draft finding 5.2

Victoria's adoption of the Building Code of Australia as a central element of its building regulations 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 regulations, the approach has shortcomings. Inquiry participants raised two general concerns. First, the process for developing standards for inclusion 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 may not always incorporate a sufficiently rigorous analysis of their impact. These 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 Building Code of Australia to over 1400 (sub. 74, p. 3). The fundamental and pervasive role of standards in building regulations raises two issues:

- (1) Whether the process for developing national standards and adopting them into the code is adequate
- (2) Whether Victoria has an adequate process to ensure standards adopted in the code 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)

Similarly, inquiry participants observed that whereas major reform initiatives such as disability access and energy efficiency are subjected to an appropriate assessment process, lesser changes involving the inclusion of new standards are inadequately scrutinised. Moreover, as Stuart McLennan and Associates noted, the ABCB lacks the resources to properly evaluate new standards emerging from

Standards Australia that enter the code and 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 associated with 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 2004b) 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. The Productivity Commission, in a recent review of reform of building regulation, 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 is a matter extending beyond the scope of this inquiry. However, based on the information before it, the Commission considers 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 code will deliver net benefits for Victoria. But while they 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 designed to improve the process by which Australian standards are developed (noted above) 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 that, in view of the potential net costs that even minor reforms to standards might impose on the community:

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 BRAC for their input, and provide comments where warranted to Standards Australia or ABCB. However, the quote from Stuart McLennan & Associates suggests this is either not universally done or not accompanied by sufficient rigour.

Accordingly, the Commission invites comment on measures the Victorian Government might pursue to ensure appropriate analysis is applied to those standards that might have been inadequately assessed by Standards Australia and that Victoria’s building regulation might be expected to adopt. These measures

might include the Building Commission monitoring the impact assessment of all new code standards to be adopted in Victoria's building regulations and, where deficiencies are found, to conduct the necessary assessments to determine their worth for Victoria.

Draft finding 5.3

While Victoria's adoption of the Building Code of Australia as a central element of its building regulations is generally a sound practice, the approach is not without shortcomings. 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 makes a draft recommendation for an RIS-type analysis of proposed standards to 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. For example, 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).

Although it is likely that these costs would be 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 these 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)

It concluded that standards forming part of Victoria's building regulation should be available at production cost. To this end, it 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 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 at length 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)

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 that are designed 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 the standards online at its website free of charge. The hardcopy service is charged at a cost recovery level. This access regime is based on Commonwealth Government policy for legislation and associated standards.

Draft recommendation 5.1

That the Victorian Government explore, through the Australian Building Codes Board, the following options designed 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 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)

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 one of the strengths of the code. (Although, taken to extremes, 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.

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.

Draft recommendation 5.2

A regulatory impact statement analysis of a standard referenced in the Building Code of Australia should 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 regulations of significance for the cost of housing construction were brought to the Commission's attention but 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.) allowing 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 5 Star) adversely affect demand for some building materials.

Energy efficiency

As noted in chapter 4, one of the objectives of Victoria's Building Act is 'To facilitate and promote ... the construction of environmentally and energy efficient buildings'. Consistent with this objective and with Victorian

Government policy, 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 and 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.⁴ 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 a solar hot water system (BC 2005e, p. 3).

Unless these requirements are met and certified by an appropriate assessor (see box 5.3), a building permit for a new house will not be issued.⁵ The energy rating for the standards is based on FirstRate—a software package developed by the Sustainable Energy Authority Victoria (SEAV).

BOX 5.3 Who provides the energy rating?

Only a house energy rater accredited under a scheme administered by 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, 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 and, 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.

⁴ 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).

⁵ 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).

Victoria's 5 Star standards differ from the energy standards embodied in the BCA, and take the form of an addition to the code (ABCB 2004a, p. 611). Box 5.4 contains a description of the BCA standards and their development.

Box 5.4 Housing energy efficiency measures in the BCA

Revised energy efficiency measures for housing were introduced in the 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—firstly, 4 stars with some plumbing features and from 1 July 2005, five stars with the plumbing features.

The 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 the BCA 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 2004f, p. 1).

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 regulations 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 five 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 a regulatory impact statement. Amendments to the state appendixes of the code are, however, not captured in this process. Instead, they must meet the regulatory requirements in that particular state. As 5 Star standards are not embodied in primary legislation or regulations, a formal regulation impact statement was not prepared.⁶ Instead, the Building Commission prepared a Regulatory Information Bulletin (BC 2002d).

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

The Regulatory Information Bulletin (RIB) described why standards were needed, what the proposal required, and the costs and benefits of the proposal (drawn from consultants' reports). The bulletin 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 RIB 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 RIB outlined three types of market failures as the rationale for regulatory intervention:

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

The RIB 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 energy savings resulting from the proposal, and the estimated cost, finding that a 5 Star rating would deliver a greater reduction in greenhouse gas emissions than 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, by The Allen Consulting Group, used a general equilibrium model to evaluate the impact of increasing the energy efficiency from 4 to 5 Star rating for all new houses and major renovations. Using data from SEAV the study showed net benefits (moving from the standards prevailing in the late 1990s to a 5 Star standard) of \$1.8 million in Melbourne (\$9.1 million reduction in energy costs—in net present value terms—less \$7.3 million increase in capital costs). The study concluded that the benefits of moving to a 4-star 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 embodied or 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, a comment from The Royal Australian Institute of Architects (RAIA) and Archicentre Victoria sums 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). It noted:

... 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 2005, p. XLIV)

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 and the Commission has taken this as given.

Instead, the Commission has focused on whether the regulation to give effect to this policy is adequate and what might be done to improve it. As noted, when the 5 Star regulation was introduced, the process preceding it appears to have been significantly less rigorous than a RIS process. It is likely, therefore, that much can be done to improve the regulation. Comments from inquiry participants, and the report on energy efficiency, highlight areas where this might occur and fall into two main areas: first, shortcomings in the process of assessing whether (and what) regulation is warranted; and second, where the current 5 Star regulation is deficient and needs change.

Information reviewed by the Commission highlighted five 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 discount rate, for example, to evaluate the impact of the standards on the Victorian economy. The ABCB used a discount rate of five per cent to evaluate the current BCA energy efficiency standard for housing. In many cases, however, home buyers will 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 currently around seven per cent. The discount rates used to assess new regulation thus appear to be below the interest rates householders pay to fund mandated energy efficiency requirements. This means that ‘the cost effectiveness of energy efficiency improvements is overstated from the perspective of householders’ (PC 2005, p. 152).

Disregard for consumers’ preferences: The Productivity Commission found some home buyers prefer a less energy efficient home to obtain certain highly valued characteristics (PC 2005, p. 153). This inquiry heard that in Victoria’s coastal areas, for example, consumers often wish to have windows facing south to capture views, but this makes it more difficult to achieve the 5 Star standard.

Constraint on consumer access to capital: The Productivity Commission noted the common assumption that home buyers face no constraint on their access to capital. In reality, however, 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 may involve investment in cheaper and less efficient building methods and materials.

Failure to consider alternative means of achieving energy efficiency in housing: The RIB 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 prepayment 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 usage, which they can and do adjust accordingly. The Australian Business Council for Sustainable Energy also suggested the use of more sophisticated meters (sub. 32, p. 6).

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, 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).

Information presented to the Commission highlighted the following (in some cases interrelated) aspects where the regulation is flawed and in need of change:

- (1) the validity of the underpinning software
- (2) failure to take account of embodied energy and lifecycle costs
- (3) adverse effect of energy efficiency standards on the health of building occupants
- (4) monitoring compliance with the standards
- (5) the excessive costs of achieving 5 Star energy rating.

The validity and flexibility of the underpinning software: This aspect of the energy efficiency regulation attracted the most comment. The validity of using software to provide an energy use rating was not considered in Victoria's RIB. It was, however, considered by the Productivity Commission, which doubted that software could accurately predict energy consumption. It observed that while the energy efficiency of appliances and motor vehicles is measured in terms of their energy consumption, this is not the case for the Building Code standards (PC 2005, p. 144). Instead, energy efficiency is:

- simulated, rather than measured directly
- defined in terms of heating and cooling loads.⁷

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's case, as noted, this is via the use of the FirstRate software package.

The Productivity Commission considered reliance on simulations was 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 2005, p. 146)

⁷ Cooling load means the calculated amount of energy removed from the cooled spaces of the building annually by artificial means to maintain the desired temperatures in those spaces. Heating load means the calculated amount of energy delivered to the heated spaces of the building annually by artificial means to maintain the desired temperatures in those spaces. (ABCB 2004, p. 88).

The Productivity Commission 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 2005, 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 2005, p. 149, Draft finding 7.3)

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. 1). It noted that the Department of the Environment and Heritage has 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).⁸ 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. It stated:

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, and stated that these have been overcome with the updated AccuRate software (sub. 28, p. 8).

Another aspect of the validity of using software is the flexibility it allows for attaining the 5 Star standard, raised by Langford-Jones Homes. It maintained that the use of LP gas hot water systems should, under the software algorithm, contribute 1 star towards achieving a 5 Star rating. In their 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 homes fitted with either the solar

⁸ This seems a trivial amount compared with the overall costs and benefits.

(electric boosted) or electric hot water systems as is currently the case (sub. 14, p. 5). The Australian Business Council for Sustainable Energy (sub. 32) also recommends that where a high performance solar hot water service is installed, this should receive recognition in regulations.

Failure to take into account 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. It noted that the 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. But 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). The current form of energy efficiency regulation, therefore, seems at odds with its objectives.

The Building Products Innovation Council also argued that the pursuit of energy efficiency is only sensible from the perspective of the full life cycle analysis of a particular building and particular building applications, noting:

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)

The current rating software penalises the use of some products, such as suspended timber floors and mud bricks.⁹ The Timber Promotion Council claimed this bias against the use 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)

⁹ The corollary is that other industries are advantaged. The Australian Glass and Glazing Association, for example, noted that on the basis of 5 Star legislation, the glass and window industry has embarked on significant capacity expansion that will improve production efficiencies and create significant employment (sub. 77, p. 4).

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 Royal Australian Institute of Architects (RAIA) 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).

Problems in ensuring compliance with the standards: The Australian Business Council for Sustainable Energy (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 RAIA and Archicentre Victoria 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).

Costs of achieving 5 Star are excessive: Prior to the start of this inquiry, key industry bodies such as the HIA and 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 RIB 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 builders conducted in February 2005 for the Building Commission suggest the RIB 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 and Associates 2005, pp. 9 and 50)

Appendix C contains a more detailed discussion of the likely costs of 5 Star. The survey data showing mean costs almost three times above those used in the

RIB,¹⁰ however, casts doubt over the ability of the currently configured 5 Star regulations to deliver net benefits to Victoria. The data suggests that changes are needed, and that a more rigorous assessment than that which accompanied the original 5 Star standard should attend those changes.

On the basis of the above discussion, the Commission considers Victoria's energy efficiency regulation—embodied in the 5 Star scheme—could be improved to better deliver against its objectives. Some improvements that should be considered are: linking it more clearly with the government's energy efficiency objectives; the use of more contemporary software packages; acknowledging embodied and/or life cycle energy costs of construction materials; and giving credit for alternative means of reducing energy use.

Draft recommendation 5.3

The 5 Star scheme should be more clearly related to the government's energy efficiency objectives and should incorporate more flexibility through measures such as using more contemporary modelling, acknowledging the embodied energy in construction materials, and giving credit for the use of smart metering and low energy use hot water systems.

Mandatory water saving measures

As part of the 5 Star energy efficiency 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 between 7.5 and 9 litres per minute)
- reduce water pressure to 500 kPa 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 come into effect on 1 July 2005.

The reforms were introduced via the Plumbing (Water and Energy Savings) Regulations 2004 and were therefore 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 2002 report *Benefit-cost analysis of prospective water*

¹⁰ For the purpose of the survey, the costs of achieving the 5 Star standard may incorporate the installation of a rainwater tank (Chant Link and Associates 2005, p. 34).

efficiency, rainwater tank and solar hot water heating regulations for analysis of costs and benefits.

In the Commission's view, the RIS exhibited a number of 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 2002 report. The RIS also contained a very limited consideration of alternatives.

The Allen Consulting Group was also engaged to conduct a cost-benefit analysis of the plumbing regulations. The approach was similar to the one the group 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 2004, 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 regulations, the HIA and 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. The Commission conducted its own survey to determine such costs, although the range of data at present is inconclusive. Appendix C contains more discussion of the potential costs.

The Australian Business Council for Sustainable Energy raised a more fundamental issue, questioning the sense of combining water and energy efficiency regulation:

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. (sub. 32, p. 4)

Inquiry participants provided little information quantifying the costs and benefits of the water saving measures forming part of the 5 Star regulations. The Commission is, therefore, not able to judge whether these regulations are currently delivering net benefits to Victoria, but some changes appear warranted. In particular, the Commission sees benefit in linking water saving measures more clearly with the government's water efficiency objectives and in allowing for greater flexibility in how improved water efficiency might be achieved.

Draft recommendation 5.4

The water saving regulation in the 5 Star scheme should be more clearly related to the government's water efficiency objectives and should allow as flexible an approach as practicable to achieve improved outcomes. Alternative solutions that meet a performance-based test of improved efficiency should be embraced.

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 these features or to require dwellings to be built so they could be easily adaptable to achieve this. (Box 5.5 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 5.5 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 there are 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).

At present there appears to be little effective regulation affecting accessible, visitable or adaptable private housing in Victoria. The Commonwealth *Disability Discrimination Act 1992* prohibits discrimination against people with a disability in a range of areas, 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 similar terms 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 regulations would not ensure housing is built to be accessible and adaptable (sub. 36, p. 1 and sub. 68, p. 1).

Some of these 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 are 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. The ABCB expects to make recommendations to Ministers in 2005, although it is unlikely that any premises standards will 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 ground floor of dwellings and residential buildings should be accessible or able to be easily made accessible to people with limited mobility'. The standard, however, does not include specific requirements in terms of prescribing minimum door widths, gradient of ramps, dimensions for bathrooms or toilets.

The Building Commission has also taken steps to promote more functional and more accessible housing design through its *Welcome* publication. However, as the EOCV has 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. 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, 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)

The EOCV also noted that a Productivity Commission report on reform of building regulation found it is most unlikely that certain building qualities, such as access for people with disabilities, would be delivered widely in the absence of government intervention (PC 2004c, p. XXIII).

Inquiry participants noted that the scale of the problem would grow in line with our ageing population, increasing the number and proportion of people with chronic illnesses and various levels of disability requiring accessible and visitable dwellings. DSHA and the Victorian Council of Social Services (VCOSS), for example, provided data showing that whereas the incidence of disability is about 20 per cent for the whole population, it exceeds 50 per cent for people aged 60 years and over (sub. 59, pp. 4–5 and sub. 29, p. 2). However, not all these disabilities would necessarily be relevant to the issue of accessible housing.

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). They also noted the potential savings in adaptation costs by providing for such

changes in the design of a building. VCOSS (sub. 29, pp. 4–5) and the City of Melbourne (sub. 45, p. 6) drew attention to an Australian study (Hill 1999) that supports this claim. This study found, for example, that the initial cost to make a townhouse compliant with AS4299 class C¹¹ 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 between 19 and 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).

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)

However, the Commission notes that if Victoria were to introduce such change unilaterally, it risks introducing requirements not subsequently replicated in the other jurisdictions. This has a high risk of forgoing the benefits of a national approach, including economies of scale in materials and the development of knowledge and skills. Such economies are likely to be substantial given the scale of costs and benefits involved.

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 (VCOSS, sub. 29, p. 5; DSHA, sub. 59, pp. 18–9).¹² The City of Melbourne, for example, 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)

¹¹ An Australian Standard specifying certain minimum levels of accessibility.

¹² 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).

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 state-wide 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)

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, therefore, be warranted, although it does not rule out the fact that this situation might also reflect the level of 'effective demand' for those features.¹³

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 up-front costs on all new buildings, even though only some would be used or visited by those with disabilities. It would also only affect the marginal addition to the housing stock (leaving most dwellings unaffected), and so do nothing to make the existing stock more accessible or visitable. A more 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 are not trivial. At a national level, for example, a draft RIS estimated that the present value of costs of implementing the BCA premises standard (noted above) would be \$26.4 billion, while the present value of the quantifiable benefits were \$13 billion (PC 2004c, p. 127). 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 comparable to the cost of some other regulatory requirements, such as meeting energy efficiency goals. (Although, unlike energy regulation that delivers improved efficiency in all new dwellings, the distribution of benefits from improved access would only apply to a proportion of all new dwellings with improved access).

¹³ 'Effective demand' is a term indicating demand backed by the purchasing power to satisfy that demand.

The rise of local government regulation in this area is, therefore, 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)

There are initiatives in place that 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 has 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 for the BCA and the associated protocol for administering building access (box 5.6), provide a basis for the Victorian Government to consider how to respond to this important issue. (It also suggests that a comprehensive RIS-type analysis of the issue will precede any final decision).

Based on the information before it, the Commission considers it is inappropriate to introduce specific regulations in the Victorian Building Regulations at present. Moreover, the Commission considers 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 and is, thus, unlikely to be in the best interests of Victoria.

Box 5.6 Implementing the BCA access to premises standard at state level

A protocol for administering building access has also been developed to ensure a consistent approach to implementing the access requirements for specific buildings. Under the administrative protocol, each state and territory building control administration would set up or designate a methodology for determining whether a proposed alternative solution meets the performance requirements of the revised BCA, and whether a provision in the revised BCA applied to a certain design would result in unjustifiable hardship for a particular 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. This information could assist in promoting the value of accessibility or adaptability features and, to that end, 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 forward this response. The Commission invites comment on these ideas for inclusion in the final report.

Draft finding 5.4

Victoria should continue to support progress on access to premises at the national level. However, it is inappropriate at this time to introduce specific regulations 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 about 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.¹⁴ 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, however, they have expressed concern that it will add substantially to the cost of a new house and thus adversely affect housing affordability. The HIA, for example, estimated that perimeter scaffolding requirements could add about \$10 000–12 000 to the cost of a \$150 000 two-storey house. Those costs represent an impost of 6.7–8.0 per cent on the value of an average house.

The Commission is aware of the substantial cost this regulation can impose on individual construction projects and on the whole housing construction sector. The Commission's 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 preliminary analysis suggest that for a two-storey house, the cost today would range between \$2000–15 120, or 1.5–5.1 per cent of the average project value. The wide range of these estimates reflects differences in the estimates of the cost of scaffolding, and differences in the average project value for each participant.

All inquiry participants surveyed by the Commission indicated that they would use some means to prevent falls even if not required by regulation. Some inquiry participants indicated that they would incur these costs regardless of regulation, to provide a safe working environment. These comments suggest that the added expense attributable to the falls from heights regulation is thus materially less than the total reported cost. Appendix C contains more detailed discussion of these costs.

While the prevention of falls regulation has added to the cost of housing (substantially in some cases), it is not an area that the Commission can usefully comment on because that regulation is part of a much broader body of regulation (that is, occupational health and safety). Sensible comment is only possible in the context of a full consideration of that body of regulation and this task is 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

¹⁴ The Occupational Health and Safety (Prevention of falls) Regulations 2003.

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 prevention of falls 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 the HIA drew attention to (because of its potential to impose unwarranted costs on the housing construction sector) was the requirement to check and tag power tools. Prior to the inquiry, the HIA estimated this added an average of about \$260 to the cost of a house. The Commission's analysis generally confirms this level.

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 of this was excessive when the time taken for workers to deliver tools for tagging was also taken into account. It considered it was ludicrous that new power tools too need to be checked and tagged. Moreover, it expressed scepticism about the effectiveness of the regulation, noting that it is conceivable that the day after tagging a tool, its lead could be damaged, yet it 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 and therefore has not been the subject of a regulatory impact statement.¹⁵ According to the Victorian Workcover Authority, (VWA 2002), the Victorian code of practice for 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. While this does not seem a significant imposition, the Commission doubts whether the industry standard is achieving its objective efficiently or effectively. Analysing the requirement to check and tag power tools along the lines of a regulatory impact statement analysis would identify the costs and benefits of achieving the goal of electrical safety on building sites (and those of alternative approaches).

¹⁵ The requirement was introduced under the Industry Standard for Electrical Installations on Construction Sites.

It would be worth requiring that the standard relating to the checking and tagging of power tools be subject to a regulatory impact statement assessment analysis, with particular attention 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 regulations governing housing construction. It may do so through its power to make those regulations and to decide whether to apply state regulations in their areas (such as designating areas as prone to termite infestation, bushfires, flood or as alpine). Most of the comments from inquiry participants regarding local government concerned councils' power to make regulation.

5.5.1 Planning and building regulations

Chapter 4 noted that local councils have limited powers to impose building controls that are unique to a municipality. As the AIBS 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 on this, noting:

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 powers 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).

Many inquiry participants were critical of local government involvement in regulation of housing construction, citing the excessive costs they considered this imposed on the sector. These costs were attributed to both the proliferation of such regulation and its inconsistency (with the BCA and between council areas). The MBAV and BAB, while noting that local regulations attempt to address

genuine concerns of councils and ratepayers, nonetheless observed:

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)

Box 5.7 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, 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 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 regulations being introduced without a full assessment of the possible costs and benefits of that regulation.

‘[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 amendments. Therefore, there is potential for new and unnecessary costs to be added to 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)

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 5.7 contains a selection of the many examples of added costs that inquiry participants provided to the Commission in support of their criticism of local 'building' regulation.

The numerous specific and general examples provided to the Commission of local regulation that add to the cost of a house attest the scale of the problem. However, the Commission received little in the way of 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). Some additional information of the likely level of these costs in aggregate is provided in appendix C.

Request for information

The Commission requests further information on different impacts of local government regulatory requirements.

This issue of local government imposing building regulation is not unique to Victoria. A recent Productivity Commission report on reform in building regulations (PC 2004c) identified the increasing use by local governments of their planning processes to extend or alter building requirements as a nation-wide issue. It noted 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 level of impact analysis of their regulations. As a result, new regulations may be introduced that contain extra requirements on business, with increased costs, for uncertain benefit (PC 2004c, p. XXXVII). It made some 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 [Australian Building Code Board] discussions
- facilitating inter-jurisdictional 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, if followed, they 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. That committee 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. The Department for Victorian Communities has advised the Commission that implementation of other reforms has meant progress has not been made on further consideration of this recommendation.

Draft recommendation 5.5

The Department for Victorian Communities should report on a timetable for implementing the Government's intention to consider an appropriate scrutiny process for local laws.

Inquiry participants had their own views on how to resolve this issue of what they considered 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 regulations across Victoria, using the objectives of the Building Act to do so (sub. 74, p. 2). The AIBS and MBAV also considered this a solution to the current plethora of local regulations and the differences they often exhibit between 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)

Evidence presented to the Commission highlighted the growing local regulation affecting housing construction. It also indicated the substantial costs this adds to housing construction (with a corresponding adverse effect on affordability). That evidence was consistent with the findings of the Productivity Commission review of reform of building regulation.

Based on the information before it, 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 the Minister for Local Government, in consultation with councils, considers establishing an appropriate scrutiny process for local laws. However, mindful of the view put to it by inquiry participants, the Commission suggests the role of a model law approach be part of the consideration of scrutiny process. For example, departures from the 'model law', whilst not ruled out, would be subjected to RIS-type scrutiny.

The Commission is aware that the machinery of change at 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, as part of its information provision role, should establish a web link to list selected requirements of each local council in order 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.

Draft recommendation 5.6

With respect to restraining the cost of inappropriate local government variations to building regulation, that the Building Commission, as an interim measure pending changes arising from recent relevant reviews, establish a web link listing selected 'building' requirements of each local council in order to provide a central reference point for building practitioners.

5.5.2 Termite declaration

During the course of the inquiry, the question of how councils might implement regulation via their power to designate areas as termite zones was raised. This issue was deemed significant because of its potential to 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 ... (AIBS, trans. p. 99)

The RAI A 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 elements¹⁶ of class 1 and 10 buildings 'considered susceptible to termite attack'. Compliance with the BCA requires a termite barrier, or a combination of barriers, to be installed for concrete slabs and suspended floors.

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 will then apply for that area, but only to a building being constructed (regulation 6.3(2)(a)). Existing buildings are not subject to the termite 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 decision by a council to designate an area as a termite zone has a substantial cost for new building. The Building Regulation Advisory Committee has estimated the average cost of termite protection for new homes at \$1500–3000 (sub. 57, p. 8).¹⁷ Conversely, there are potential costs if termite protection is not installed in a new house: the RAI A and Archicentre Limited indicated that the average repair cost, should a house become infested, is \$4500 (sub. 40, p. 10).

At issue here is whether the application of this building regulation (by designating an area a termite zone) is being decided after a sufficient consideration of the costs and benefits involved. There is some evidence that

¹⁶ 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'.

¹⁷ 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.

decisions to declare termite zones, and thus impose costs on consumers, is not being done in a sufficiently rigorous manner. For example, in 2004 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 the decisions of these councils, 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)

It appears that concerns over potential litigation were a significant factor in these municipalities deciding 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 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' assessment of the costs and benefits of declaring their areas as likely to be subject to termite infestation. 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).

6 Permits and registration

This chapter describes the operation of two elements of Victoria’s regulatory regime intended to aid the achievement of building standards—the building permit and building practitioner registration systems. It considers the rationale for these regulatory systems and identifies issues of concern 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 consumers may face (identified in chapter 3 as potentially justifying some regulation) and to achieve minimum standards. Regulation can specify what is to be permitted, or it can allow everything except that which is specifically prohibited. In pursuit of minimum standards (where consumers may not be well informed and where it is difficult to specify what should be excluded), the former approach may be more effective.

The building permit and practitioner registration systems represent complementary arms of a dual system designed to achieve minimum building standards.¹ 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 that the building design and building work complies with regulated standards before building work commences, and at prescribed stages in the building process.

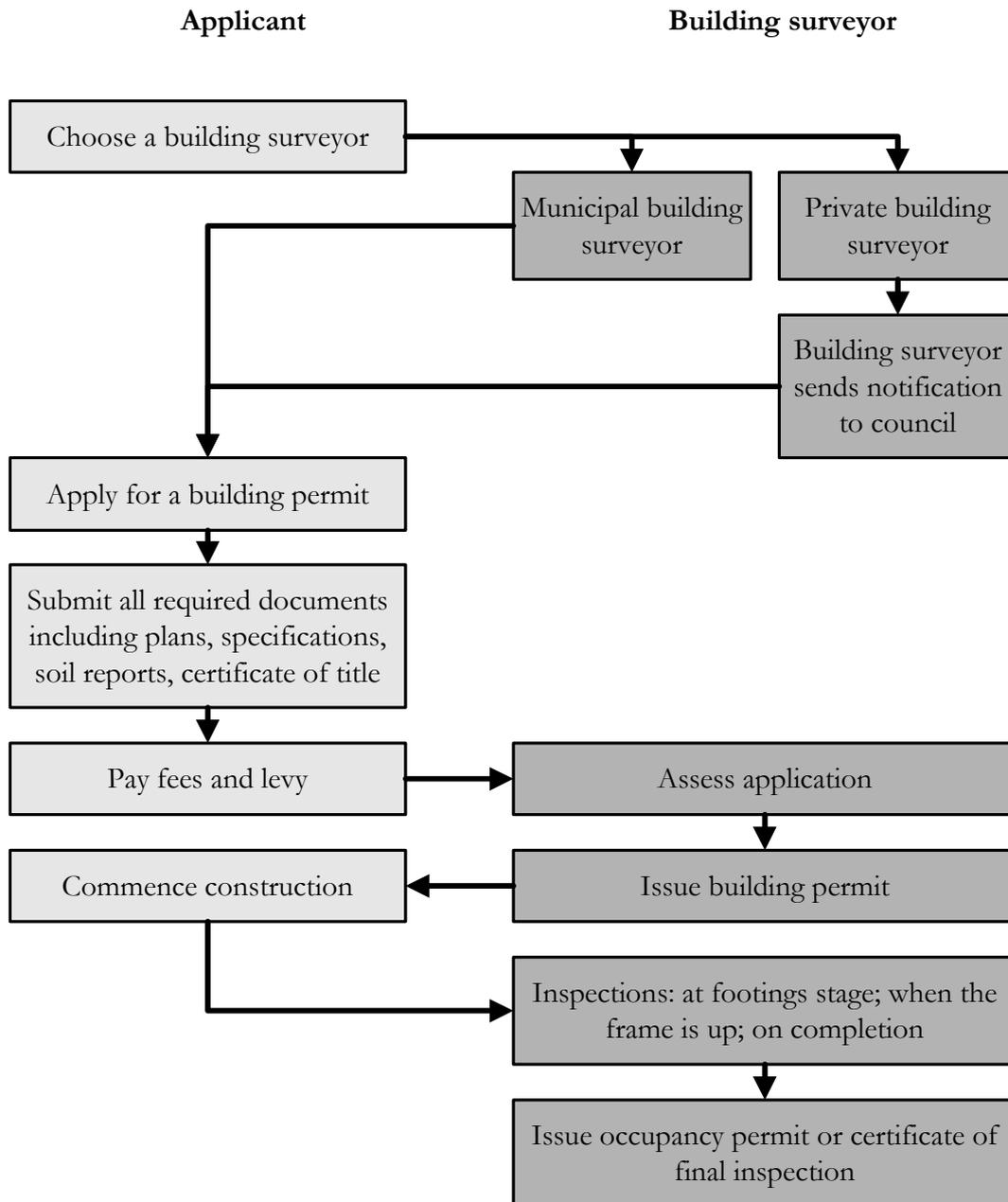
The effectiveness and efficiency of this dual system will depend on the levels at which the parameters of the permit and registration systems are set. That is, the effectiveness and efficiency of permits and registration will depend on the size and type of jobs requiring a building permit (section 6.2); the coverage of practitioner registration and the required qualifications (section 6.3); and how the dual system (of permits and registration) is monitored and enforced (section 6.4). The competition impacts of the dual permit and registration system are discussed in section 6.5.

¹ The regulatory system for housing construction includes a number of components that operate together to achieve minimum 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.

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. The building permit system may be considered to be the fulcrum of the regulatory system because it is the gateway to applying regulations.

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). The impact on competition of the building permit and registration system is discussed in section 6.5.

The second, a report on the building permit and occupancy permit process, submitted 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 have been implemented (for example, changes to the exemptions from the requirement to obtain a building permit, which are discussed in the next section); some are in the process of being implemented; and others are still being considered.

BOX 6.1 **Building and occupancy permit process report recommendations**

Themes to emerge from the recommendations included:

- streamlining administrative processes—for example, through standardised forms, fees, and processes for interaction between key parties
- improving information provision—including proposing the creation of a central database and information centre, provision of guidance material and greater disclosure on permit documentation
- clarifying relationships—for example, proposing that the owner appoint a building surveyor
- strengthening compliance—for example, through selected audits of building permits, and issuing pro-forma notices and orders
- reviewing aspects of the building and occupancy permit process—for example, the exemptions from the requirement to obtain building and occupancy permits (the report also recommended the \$5000 cost threshold be removed), and the report and consent process.

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 will be 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, building work not requiring a building (and occupancy) permit was outlined in table 1.6 of the Building Regulations 1994. 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 on the scope of building work (defined in terms of specific physical characteristics of the building and/or building work and its impact on structural soundness and safety) rather than a combination of the physical characteristics of the building work and the previous \$5000 threshold (the exemptions are outlined in schedule 8 of the Interim Regulations).² The recent change is consistent with the research report prepared for the Building Commission 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) and Pitt and Sherry 2004, p. 14)

Some inquiry participants shared the view that the former exemptions were difficult to understand, for example, the Royal Australian Institute of Architects

² 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 on the previous \$5000 limit, implying the need for some garages, carports and pergolas to have a permit.

(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 the specification of '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). At the same time, some inquiry participants believe that some building work should be exempted from requiring a building permit. The Housing Industry Association (HIA) suggested that the list of exemptions could be expanded, for example, proposing that minor kitchen renovations in excess of \$5000 should be exempt because they are cosmetic rather than structural, as are landscaping and house painting (transcript 7 March 2005, p. 42).

The Building (Interim) Regulations 2005 have removed the monetary threshold applying to some types of buildings. It appears that renewal, repair or alteration of part of a building up to any value can now be exempt from requiring a permit if the work does not affect safety or breach various other conditions. This change appears consistent with the HIA's proposal that minor kitchen renovations should be exempt, and more generally with the principle that regulation should be the minimum necessary to address a problem. On the other hand, the requirement for interpreting the impact of buildings on safety or structural soundness (that concerned some participants in the inquiry) is maintained. Moreover, a monetary threshold could arguably recognise financial risk to consumers as well as safety risk. In any event, work that is valued over \$5000 requires a major domestic building contract, which in turn calls up the requirement that the builder entering the contract is a registered practitioner.

The regulatory impact statement (RIS) prepared for the Building (Further Amendment) Regulations 2003 suggested that the \$5000 exemption be removed since 'it is believed that the value of a project is not a relevant consideration in terms of whether regulations should apply. The exemptions in question were, in any case, subject to various other limitations.' The RIS did not include quantitative analysis of the costs and benefits of removing exemptions 'since statistics are, by definition, not kept in relation to exempt works' (BC 2003d, p. 11).

It is difficult to find the appropriate balance between prescription and performance-based regulation and to specify the size and type of job to which

building permits should apply. The choice should be informed by consideration of factors such as:

- the extent (if any) to which the interpretation required under the former approach was creating problems and will be lessened by the new approach
- the extent to which the characteristics of exempt building work identify lower risks to safety
- the relationship between a monetary component in the threshold and an acceptable risk to consumers
- changes in administration and compliance costs between the previous and new regulations.

Inquiry participants gave limited attention to discussing this matter in their submissions. Accordingly, the Commission is unable to judge whether the recent changes will improve the degree of understanding about when permits are required.

Request for information

The Commission requests information about the advantages and disadvantages of defining exemptions on the basis of the type of building compared with a combined approach using a monetary cost threshold (provided the job does not adversely affect factors such as public safety) supported by other exemptions (relating to the physical characteristics of the building work).

6.3 Practitioner registration and licensing

Along with the building permit and inspection system, practitioner registration³ and licensing is intended to contribute to the achievement of good building outcomes and to strengthen consumer confidence in the building industry. It seeks to do this by ensuring that 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. (Issues related to insurance requirements are considered in chapter 7.)

³ The Building Act 1993 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 are able to 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).

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 regulations (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

The legislative and regulatory basis for practitioner registration and licensing, and the responsible bodies, were described in chapter 4. Box 6.2 summarises the arrangements.

Box 6.2 Regulatory framework for practitioner registration and licensing in Victoria

The Building Practitioners Board (BPB) 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.

The Office of the Chief Electrical Inspector (OCEI)⁴ registers electrical contractors and licenses electrical 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 (s.176(6)) of the Building Act.

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.

⁴ The Victorian Government announced on 21 March 2005 that the Office of the Chief Electrical Inspector will be amalgamated with the Office of Gas Safety and the pipelines safety functions of the Department of Primary Industries, to form Energy Safe Victoria.

The Building Practitioners Board (BPB) is responsible for registering most building practitioners in Victoria, registering approximately 16 200 building practitioners in 2004 (BC 2004d, p.16). Some practitioners have multiple registrations and the total number of registrations is higher than the number of individuals registered. The BPB issued a total 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	9948	9753
Domestic builder – manager	245	218	204
<i>Subtotal</i>	<i>11 125</i>	<i>10 809</i>	<i>10 757</i>
Commercial builder	4047	4075	3910
Demolisher	190	195	198
Building inspector	399	389	387
Building surveyor	477	477	463
Draftsperson	2001	1958	1989
Engineer	1682	1637	1640
Quantity surveyor	101	101	100
Temporary structure	122	123	116
<i>Subtotal</i>	<i>9019</i>	<i>8955</i>	<i>8803</i>
TOTAL	20 144	19 764	19 560

Source: Sub. 26, p.4

The Plumbing Industry Commission (PIC) registers and licenses plumbers. There were 19 361 plumbers registered and/or licensed with the PIC in 2003-04 (PIC 2004a, p. 22). The OCEI registers and licenses electrical trades, with the main categories relevant to housing construction being licensed electricians, electrical inspectors and electrical contractors. The OCEI 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. Qualification requirements are summarised in box 6.3. The insurance market and the requirements of insurers are discussed in chapter 7.

Box 6.3 Qualifications

Registered building practitioner—The BPB 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 BPB
- **domestic builder (limited)** has a certificate issued by the BPB 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
- **building surveyor** has a university degree in building surveying, and three years practical experience, to the satisfaction of the BPB.

Plumbers—The Plumbing Regulations 1998 outline the qualifications and experience required for licence or registration. Applicants for 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.

Source: Building (Interim) Regulations 2005; Plumbing Regulations 1998 (Part 3); BPB, sub. 26.

6.3.2 Issues related to practitioner registration

Issues regarding practitioner registration considered in this section include:

- the threshold value of building work, above which a builder undertaking the work must be registered
- competency requirements for registered practitioners
- the process for changing building practitioner categories requiring 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 most building work in excess of \$5000 (box 6.4). Registration is also required for any building work involving the re-blocking, restumping or demolition of a home, irrespective of its 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.

Box 6.4 Cost thresholds in the housing construction regulatory framework

Practitioner registration

The Building (Interim) Regulations 2005 (r. 1810) 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

Most domestic building work over \$5000 also requires the builder and consumer to enter into a major domestic building contract under the *Domestic Building Contracts Act 1995* (Vic.) (s. 3), which in turn requires that the builder entering into the contract is a registered builder (s. 29).

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 specific physical characteristics of the building and/or building work (schedule 8).

Building permit levy

The Building Act 1993 (s. 201) imposes building permit levies which are payable in relation to applications for building permits where the cost of the building work exceeds \$10 000.

The level at which the registration threshold is set will have implications for the cost and effectiveness of the registration system. If the skill requirements for registration are excessive relative to the characteristics of the job for which registration is required, for example, registration may unduly restrict competition. This is a particular concern where the registration body is made up of current industry practitioners, given that the registration process can create barriers to entry and be inflexible to changing market conditions (PC 2004c, p. 207).

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 to which this is a 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 a building practitioner.

The costs and benefits of restricting competition on the one hand, and protecting consumers from incompetent practitioners on the other, should be balanced when setting the registration threshold. Equally, the entry threshold should be balanced against the alternatives (such as more rigorous auditing arrangements or higher penalties for faulty work) that may achieve the same outcomes (PC 2004c, p. 207).

Setting an appropriate threshold combination of competencies and size of job is complicated. Relevant factors to consider 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 a consumer is able to make judgements about the capability of a practitioner and the skills required; the costs of the registration system; and consumers' willingness to take on risk. Factors such as the ability to assess practitioners and their appetite for risk will vary between people. This means that a single threshold combination of skills and type or size of job will necessarily be an arbitrary simplification—lower than is optimal for some consumers and higher for others. Nevertheless, such simplification cannot be avoided.

The idea of relating a monetary threshold to registration is appealing, on the grounds of simplicity. A 'one size fits all' approach may be warranted if there are not substantial benefits from a more complicated approach, that might, for example, set different thresholds for trades that involve different risks. The \$5000 threshold, for example, has not changed since 1993 even though prices (as measured by the consumer price index or the index of building material prices)

have risen by about 30 per cent since then.⁵ Hence, the threshold has fallen considerably in real terms. If the 1993 threshold were reset to restore its real value, it would need to be increased to \$6500.

After such an adjustment, however, a \$6500 threshold for registration would be below the thresholds for building work for which the building permit levies are payable (\$10 000) and for domestic builders' warranty insurance (\$12 000), but above the threshold requiring a major domestic building contract (\$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 consumers⁶. The insurance threshold was previously set at \$5000 (chapter 7).

Having all thresholds at the same level would reduce the complexity of the regulatory arrangements. The Commission invites comments about whether there is any reason why it should not recommend in its final report that all four thresholds be aligned, initially at \$12 000 in line with the current insurance threshold but with provision to increase this threshold over time in response to further information.⁷ This would imply that the risks to consumers of building work below these thresholds were acceptable.

Qualification requirements are the other component of the registration threshold, outlined in box 6.3. The Building Commission has recently introduced a continuous professional development program (CPD) for registered practitioners. According to the promotional material for this program:

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] NSW 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)

The Building Commission appears to be foreshadowing the possible introduction of compulsory CPD. This, however, would increase the threshold qualifications for registration and could have a substantial effect on the costs and benefits of registration. The case for public scrutiny of these costs and benefits is

⁵ 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, 2005e).

⁶ Warranty insurance also provides protection against the cost of non-completion of a contract.

⁷ This would leave the zero threshold in place for re-stumpers and demolishers.

as strong for changes in requirements for compulsory professional development as it is for other forms of regulation.

Draft finding 6.1

The simplicity of a threshold value of building work, above which practitioners must be registered, has appeal. It is also desirable, however, that the threshold reflects current costs and be set at the highest level compatible with regulatory objectives and consumer acceptance of risk. Consistency in the threshold values applied across the housing construction regulatory framework (with limited exceptions such as re-stumpers and demolishers) could benefit consumer and building practitioner understanding of the regulation, and could assist compliance.

Request for information

The Commission requests information on particular impediments to it recommending in its final report that the thresholds (for practitioner registration, major domestic building contracts, paying the building permit levies and builders' warranty insurance) be aligned, initially at \$12 000 but with the provision to increase these thresholds over time in response to further information.

Competency requirements for practitioners

In addition to proposals to extend coverage of the registration system to new trades, inquiry participants also raised concerns about the extent to which competency requirements for some trades already requiring registration may be contributing to labour shortages.

Metal roofing

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 leading to installation delays and considerably higher costs. Further, they considered that the requirement for installers to be qualified plumbers is contributing to the shortages. Participants also noted that only a small proportion of plumbers and plumbing apprentices currently choose to specialise in metal roofing (sub. 23, p. 4) and that the shortage of appropriately skilled labour increases costs and delays installation (by between one and three months) (transcript 9 March 2005, p. 195).

A full plumbing qualification (BCP 310103) involves a four-year apprenticeship, including about 1000 hours training in six plumbing disciplines—water supply, roofing, draining, gasfitting, mechanical services and sanitation—with approximately 200 hours focused on roofing. In comparison, installation of concrete or tiled roofs requires approximately 300 hours of training. Roof rejuvenators—who overspray or paint metal or tiled roofs—require no qualifications (sub. 23, p. 4).

Inquiry participants commented that Victoria was the only state to require a full plumbing qualification to install metal roofing (sub. 23, appendix 1; sub. 46, p. 4). The RMRIAV, BlueScope Steel, the Australian Steel Institute and the Building Products Innovation Council all called for the introduction of a specific metal roofing qualification, (as offered in other jurisdictions) to address skill shortages. Participants commented that a specific metal roofing qualification—Certificate III in Roof Plumbing (BCP 30303) as part of the new Plumbing and Services Training Package—was developed and endorsed by the Australian National Training Authority and key industry stakeholders on 15 October 2003 (sub. 23, p. 5). This qualification would still involve a four-year apprenticeship, but there would be a greater training focus on roofing issues (around 700 hours) (sub. 72, p. 4).

Arguments to support the removal of the current regulatory requirement to obtain a full plumbing qualification include:

- This would facilitate an increase in the supply of building workers able to install metal roofing. Restricting the installation of metal roofs to fully qualified plumbers reduces the supply of workers able to install metal roofing. There is some evidence to suggest this is leading to higher (labour) costs and delays in installing metal roofs. It was argued that these delays are more significant in regional Victoria where the relative supply of plumbers is worse and where plumbers are required to travel greater distances (transcript 9 March 2005, pp. 197-8).
- Introducing a specific roofing qualification would increase the supply of appropriately skilled labour by providing another entry into the discipline. Even if the specific roofing qualification involved a four-year training commitment (comparable with the current plumbing qualification), it would provide a greater component of roofing-specific training. Inquiry participants, including the RMRIAV (sub. 23), Master Builders Victoria (sub. 88, p. 10), the Building Products Innovation Council (sub. 46, p. 4), and the Australian Steel Institute (sub. 21, p. 4), argued that the introduction of a specific metal roofing qualification would reduce the delays and additional costs currently associated with metal roofing. BlueScope Steel and Stoddart Victoria (sub. 72, p. 4) argued that specific metal roofing apprenticeships would enable apprentices to be more productive sooner.

The RMRIAV argued that a specific qualification would improve the quality of metal roofing installations and reduce demand for follow-up work (sub. 23, p. 5). It may also 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 (RMRIAV sub. 23, p. 4).

- There is evidence that skill shortages and the resultant cost increases and delays are less in other jurisdictions that have a specific roofing qualification. BlueScope Steel suggested, for example, that metal roofs cost approximately \$4500 more than concrete or tile roofs in Victoria, but that the cost differentiation was between zero and \$2500 in other states. Similarly, BlueScope Steel noted delays of one to three months installing metal roofs in Victoria, compared with a maximum two to three weeks in other states (transcript 9 March 2005, p. 195). The Commission has not been able to examine whether other factors contribute to these cost and time differences.
- BlueScope Steel and Stoddart Victoria also suggested that the availability of a specific roofing qualification would support existing initiatives to promote the metal roof industry and thereby address issues about the industry's attractiveness (sub. 72, p. 3).

Arguments against removing the current regulatory requirement to obtain a full plumbing qualification include:

- Representatives of the Plumbing Division of the Communications, Electrical and Plumbing Union argued that roofing is part of a water retention system through which environmental sustainability objectives may be addressed. The introduction of 5 Star energy efficiency and other environmental sustainability initiatives is increasing the focus on recycling rainwater. Consequently, roofs are increasingly acting as catchment areas for water for use in the house and garden. The Communications, Electrical and Plumbing Union representatives argued that training in plumbing systems is necessary and that a reduced reliance on plumbing skills may limit the scope to exploit water conservation opportunities (transcript 7 March 2005, pp. 144–8). The Commission observes, however, that plumbers will have processes in place to address these issues with other trades where houses have tiled roofs. It is not clear why metal roofs would, or should, be different.
- Recognising that the building industry is cyclical, members of the plumbing industry commented 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).

In summary, the fact that alternative roofing materials can be installed without a full plumbing qualification suggests that the benefit of continuing to restrict metal roof installation to fully qualified plumbers is questionable. Introducing

additional pathways into the industry, while retaining the option of obtaining a full plumbing qualification, should assist in addressing the current skill shortages. The current plumbing apprenticeship module appears to be a possible starting point. An extra component to the roof tilers' qualification could also be considered. The Commission notes that participants proposed sub-trade Certificate II courses (HIA sub. 58, p. 29) and pre-vocational courses (RMRIAV sub. 23, p. 5) as possible means to impart initial skills in a shorter timeframe.

Draft finding 6.2

The net benefit in continuing to restrict the installation of metal roofing to licensed plumbers is questionable. The present arrangements raise the price of installing metal roofing, impose delays in its installation and act to disadvantage metal roofing in competing with other roofing types.

Draft recommendation 6.1

That the installation of metal roofing is not confined to plumbers, and that a new roofing qualification that imparts the necessary skills for metal roofing in the minimum time be developed. The current plumbing apprenticeship module appears a useful starting point and might serve as a module in a longer roofing qualification.

Brick paving

The HIA commented on observed skill shortages in the 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. 5, pp. 28-9) The HIA suggested that more people would be attracted to the industry if training was more relevant to their needs and the needs of their employers. For example, the HIA suggested 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. The Commission seeks evidence about whether a shorter specialised course would be appropriate for paving and/or other trades.

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 currently conducting a review of building practitioner registration categories (box 6.5). The discussion paper for this review states that during consultation, there were suggestions to increase the scope of registration but not to reduce 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) supports 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.

Box 6.5 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’.

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 has advised that a number of 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—investigating whether the benefits of registering bricklayers, carpenters, concreters and plasterers would outweigh any associated costs
- (2) Registration effectiveness measurement—developing a framework to measure the effectiveness of Victoria’s building practitioner registration system
- (3) Practitioner attribution (energy and accessible design)—investigating the feasibility of attributing energy rater/designer and accessible building designer competencies to existing registered practitioners.

Source: BC and BAC 2003, p. 6; BC (pers. comm., 15 June 2005).

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.

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.

The Commission 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. The registered builder has a strong incentive to ensure that the tradespeople used are competent. Where a consumer or an owner-builder contract directly with these trades for work in excess of \$5000, a building contract that provides some safeguards for the consumer is required.

This is not to preclude 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. Currently, the Minister for Planning establishes the classes of building practitioners that are required to have insurance through an Order published in the *Government Gazette*, a process that does not allow for independent scrutiny of changes. Such scrutiny would be provided if changes to registration categories were justified through a regulatory impact statement.

Draft recommendation 6.2

That future changes to the classes of practitioner registration be subject to a regulatory impact statement to assess their costs and benefits. Any extension of registration should meet competition policy objectives that require new regulations to demonstrate a net public benefit, and are the least-cost way to achieve the Government's objectives.

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 in the construction industry as a whole (chapter 2), suggesting that part-time work may become attractive to a growing proportion of the workforce. Many 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. One option could be a taper in registration/licensing fees for older workers wanting to work part-time, in order to remove the small disincentive that these fees otherwise impose on part-time practitioners in the industry. (This could be inconsistent with recovering the costs of registration from fees unless these costs are lower for older workers.) There may be other aspects of the regulatory framework that discourage participation by part-time practitioners.

Draft recommendation 6.3

That the Building Practitioners Board (or successor) should 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.

Registration of companies

Corporate or unincorporated bodies such as companies, businesses or 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 provided that at least one director or partner is a registered building practitioner in that category. This 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. This proposal is now being considered in the current registration category review (BC and 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). In the absence of compelling reasons to the contrary, the Commission will consider recommending company registration in its final report.

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, part of the registration process. The Act provides for an owner-builder to be issued with only one certificate of consent for carrying out domestic building work in any three-year period. 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.⁸ It is less certain that the restrictions placed on owner-builder activity will yield net benefits and the Commission considers that the amended owner-builder regulatory arrangements should be evaluated in two to three years. 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 vigorous enforcement of 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).

⁸ From the owner's perspective, becoming an owner-builder has significant consequences including:

- higher premiums for building inspections—guidelines issued by the Australian Institute of Building Surveyors suggest 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 BACV. (These 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).

Draft recommendation 6.4

That by July 2007, the Building Commission monitor and report publicly on the impacts of the new owner-builder regulations embodied in the *Building (Amendment) Act 2004*, and that the Government use this information to review the Act. This review should consider non-regulatory alternatives to the present arrangements.

Other unregistered builders

Consumer Affairs Victoria suggested 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 sub-contractors 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)

The BPB 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. 6)

While Consumer Affairs Victoria did not provide any evidence to support the assertion that only just over half of Victoria's builders hold registration, it is likely that a number of practitioners are unregistered:

- as noted, unregistered builders may be operating as owner-builders, which the 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
- tradesmen 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. The Commission has not seen evidence that proves or disproves

Consumer Affairs Victoria’s estimate of the number of unregistered builders, but considers that this does not indicate a breakdown of the system of equivalent magnitude. As Consumer Affairs Victoria points 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).

While it is difficult to estimate the number of unregistered builders operating illegally, the BPB has suggested that one way is to gather information through an audit program. An indicator of the extent of problems associated with such activity is the number of complaints about defective work undertaken by unregistered builders. The way that 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 system must be enforced. This means ensuring that those who should be regulated are being regulated and that 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.⁹ A targeted, risk-based approach may well achieve a higher return from the ‘enforcement dollar’ than less targeted strategies. Such an approach is likely to involve:

- collection of information about compliance with regulation and the consequences of non-compliance
- an assessment of the risks that may be emerging and the costs of addressing these risks based on this information
- a monitoring and enforcement program that is based largely on these risks, so that the burden of enforcement falls most on high-risk businesses but also contains a random element as a check
- early warning before enforcement activity (to allow businesses to correct problems before going to court) to cut the administrative burden
- using any lessons learned from the enforcement process.¹⁰

⁹ Beston, for example, pointed out the costs of complying with the PIC audits (sub. 7, p. 1).

¹⁰ Some of these components are drawn from Hampton (2005).

6.4.1 Monitoring and enforcing building permits

Issuing building permits and subsequent inspection of the building work is the process through which compliance with building standards is monitored and enforced. Participants raised four issues that could affect the effectiveness of the building permit process:

- (1) the role of building inspections
- (2) a possible conflict of interest for building surveyors
- (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 points out that the role of inspections is magnified by the number of sub-contractors (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 RAlA and Archicentre Limited submission stated, for example, 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 be 'lighter' where consumers understand their role.

The Building Commission recognises this issue and has posted a useful consumers guide on its website (BC 2005a) explaining the role of the building surveyor and of 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 in relation to occupancy permits, stating what they do, and do not, represent (BC 2003e, p. 3). The Building Commission also writes to each person who has been issued with a building permit. While this letter focuses on the dispute settlement role of BACV, it could also include an explanation of the role of inspections and building surveyors.

Draft finding 6.3

Information on the role of the inspection process, building surveyors and the certificate of occupancy, that is, what they are intended to achieve and what they are *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 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 which has remained relatively unchanged over the past five years (BC 2004d, p. 11). 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 (DSE) 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 DSE suggests 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, typically the builder) to select the building surveyor. The Australian Institute of Building Surveyors recommended legislative change to this effect. (sub. 41, p. 8).
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 certifier from a pool of accredited certifiers
- returning some or all building surveying to councils
- making the owner's choice of building surveyor dependent on their acknowledgement that they understand the building surveyors' role and responsibilities.

While a conflict of interest appears to 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. This could be achieved simply by expanding the letter the Building Commission already sends to permit holders, but this letter should be sent when a person applies for a permit (not when it is issued) so that the applicant has the option of changing the building surveyor.

Increased consumer awareness of the roles of building surveyors and inspections will make consumers aware that it is their responsibility to ensure compliance with the building contract. The consumer will also be in a better position to assess whether the building surveyor is fulfilling his or her responsibilities.

Draft recommendation 6.5

That the Building Commission include information about the role of the inspection process and certificate of occupancy (what they are intended to achieve and what they are not intended to achieve) and the roles and responsibilities of building surveyors in its current letter to applicants for building permits.

Council enforcement responsibilities

Although the Building Act requires the building surveyor to ensure compliance with a building permit, under s. 212 of the Act a council is responsible 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, s. 30). Municipal building surveyors file this information. A municipal building surveyor 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 (MAV) 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 has been approved by a private surveyor' (sub. 64, p. 3). The MAV noted that the Victorian Municipal Building Surveyors group has prepared the municipal building control intervention filter criteria guideline to assist councils determine when they may need to intervene in building work where a private building surveyor has been appointed by a property owner.

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 what was previously a role performed by local government. Councils are, therefore, a potentially important check on the performance of building surveyors.

Request for information

The Commission seeks information about the frequency with which councils are required to address matters that have been approved by a private surveyor.

Auditing building surveyors

Notwithstanding the role of local government and better-informed consumers in monitoring the performance of building surveyors, some 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 certifiers 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)

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 work often 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 the files of municipal building surveyors which (as mentioned) 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 (short building season), and coastal regions (appropriate use of sheds) were audited. A minimum of four audit programs was scheduled for 2004-05. 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 [*Domestic Building Contracts Act 1995*] DBC Act (sub. 41, p. 10)

The RAI and Archicentre Limited also considered that there was inadequate auditing of the quality of workmanship. Their suggestion for addressing this was to increase the number and comprehensiveness of building inspections (sub. 40, p. 9).

At the start of this inquiry, the Commission was alerted to the potential significance of the issue of auditing of building practitioners by the Auditor-General Victoria's 2000 report. 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 BPB to fulfil its legislative responsibility for monitoring the conduct and ability to practise of practitioners (Auditor-General Victoria 2000, p. 61).

The Commission was also aware of what appeared to be a sharp contrast between the auditing effort of the Building Commission, the PIC and the OCEI:

- The OCEI reported that 500 000 jobs were certified during 2003-04 with 39 000 audits undertaken by specialist inspection companies (OCEI 2004, p. 11).
- The PIC certified 283 000 jobs and audited 15 730 (PIC 2004a, p. 26). (Not all these audits relate to housing.)
- The Building Commission conducted 102 office-based audits of domestic builders in 2003-04. In one-third of the cases, the office-based audits were followed by one or more site inspections. While the audit program found matters needing builders' attention, it reported that none were of significant concern (BC 2004a, p. 24).

Given this contrasting experience and the comments by the Auditor-General, the Commission raised the question of whether the level of enforcement activity is appropriate in its issues paper. The Building Commission responded in its submission to the inquiry 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)

The Building Commission commented that:

- the Metropolitan Fire Brigades Board reported that there were three preventable deaths in domestic fire incidents in 2003-04
- Kidsafe reported that in 2003-04 no children aged under five died as a result of immersion incidents in private outdoor swimming pools in Victoria
- the number of complaints about professional conduct and related enforcement activity is small compared with the number of permits issued.

The PIC gave a more complete description of its audit strategy in its response to the issues paper (box 6.6).

Box 6.6 Plumbing Industry Commission enforcement strategy

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. The PIC carried out 15 730 audits of compliance certificates and 2859 inspections of underground sanitary drainage projects in 2003-04.

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

(continued next page)

Box 6.6 **Plumbing Industry Commission enforcement strategy** (continued)

- 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.

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. There were 14 disciplinary hearings, 28 prosecutions and 56 notices and orders issued in 2003-04.

Source: Sub. 84, pp. 76-8.

The Commission was unable to 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 those 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 receives information about practitioners' performance from councils and also from complaints made directly to it or via the BACV. This information is then used to inform decisions about whether investigations should be made about particular complaints or audits undertaken (possibly on a random basis) where information has revealed an issue that warrants attention
- an annual program is in place to audit domestic builders.¹¹ In 2003-04, the program specifies a minimum 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. Builders are selected randomly, with about 70 per cent from Melbourne
- 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)
- the allocation of resources to enforcement is determined in the Building Commission's annual planning process, but is not reported publicly.

Table 6.2 Building Practitioner Board inquiries 2003-04

	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>
Total inquiries held	24	26	42
Case proven / found guilty	24	26	42
Reprimand	19	16	34
Fine	15	12	33
Costs awarded against practitioner	17	16	33
Registration suspended	3	1	1
Registration cancelled	3	1	0

Source: BC 2004a, p. 24

This approach to strategy seems to have a number of the desirable features outlined but it is difficult to assess the effectiveness and efficiency of the strategy from publicly available information. Because the Building Commission is a public

¹¹ The audit may have an office-based and site-based component. In the former, the audit checks the builder's compliance with obligations under the *Domestic Building Contracts Act 1995*, and other factors such as awareness of the Building Code of Australia. The site-based component assesses compliance with regulated standards, and is therefore a check on the performance of both the building practitioner and the building surveyor.

entity funded largely by a levy paid for by consumers, the Commission believes that the rationale for the strategy and its funding, together with an assessment of the outcomes of the strategy and expenditure, should all be published regularly. It should also cover lessons and any consequential regulatory changes. The Commission argues in chapter 10 that there are significant benefits from public reporting of performance against specified performance indicators; similar benefits would also be achieved in this important area of the Building Commission's and the PIC's responsibilities.

Performance reporting could include publication in the annual report of data such as:

- the rationale for the amount of funds allocated to the various instruments available for encouraging compliance with regulations
- the rationale for the audit and investigation strategy—how the focus of audits and investigations are determined, the rate of audit and investigation and outcomes
- the types of breaches identified
- the outcomes of inspection in each of these areas.

Draft recommendation 6.6

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 to permit assessment of these strategies and identify any lessons from these strategies.

6.5 Impacts on competition

The terms of reference request 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 system affects competition in a number of ways. Consumer Affairs Victoria describes 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 can, however, 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 to collect information about builders' skills. This reduction of transaction costs should encourage market transactions, expand the size of the market and aid competition.

While there are forces working in opposing directions and while 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, it will be argued that the height of the barrier has come down with increased competition among insurance providers (chapter 7).

That said, competition could be undermined by expansions in the regulatory framework, through reductions in 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 should 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 for building practitioners required under Victorian regulation. 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 ongoing need for regulation to protect consumers, and the effect of that regulation on the supply of building practitioners and housing affordability.

7.1 Introduction

The *Building Act 1993* (Vic.) requires that certain building practitioners have insurance cover for their work.¹ 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 practitioners’ insurance, housing affordability, and the ability of practitioners to ply their trade (and thus on the supply of builders).

In the light of these changes, and a subsequent maturing of the insurance market in Victoria, it is appropriate to examine the regulation of practitioners’ insurance to answer some threshold questions. Is, for example, 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?

¹ In accordance with the provisions in part 9 division 3 of the Act.

Most of the submissions received by the Victorian Competition and Efficiency Commission 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.

In the following discussion, the Commission has focused mainly on builders warranty insurance, with a lesser focus on plumbers insurance and professional indemnity insurance. Reflecting concerns expressed in submissions, this emphasis also appears appropriate in view of the pervasive influence of warranty insurance and the significant economic and personal costs recently associated with it.

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, drafts person, 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 (temp. 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 F.

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 with the introduction of the Domestic Building Insurance Scheme. The Victorian and New South Wales governments jointly developed the scheme for consistency under a 10-point plan, with the agreement of insurers (DSE, sub. 84, p. 26). Some of the changes were precipitated by the collapse of HIH and the general flow-on effects to insurance markets arising from the 11 September 2001 terrorist attack. Other changes occurred in response to shortcomings in (then) existing arrangements, and were informed by evidence before contemporary inquiries into domestic building insurance.²

The changes were designed to stabilise the domestic building insurance market while still providing a high level of protection to consumers.³ The new arrangements include the following:

- Homeowners can claim against their policy only as a last resort, such as when the builder is dead, 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)—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 maximum cover for the total aggregate of claims was increased from \$100 000 to \$200 000.

² For example, the National Review of Home Builders Warranty Insurance and Consumer Protection 2002, conducted by Professor Percy Allen.

³ Building Commission undated C.

- The Victorian and New South Wales governments agreed to attempt to harmonise builders warranty insurance.
- The two governments agreed to harmonise insurance reporting requirements.
- A \$10 000 000 cap was introduced for claims against a single builder (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. 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 all domestic and commercial building permits.

In addition, the Victorian Government established a catastrophe fund, for claims above \$10 million arising from the insolvency, death or disappearance of any single builder (Wong 2002, p. 35). The fund is supported by contributions from insurers and is effectively a re-insurance arrangement. It has helped to re-establish a viable market in Victoria for builders warranty insurance.

The Domestic Building Insurance Ministerial Order specifies the policy coverage of builders warranty insurance (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 s.8 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 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).

In 2004, the Victorian Government introduced more stringent eligibility criteria for providers of builders warranty insurance (box 7.2). These were designed to ensure 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 [APRA]), 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) or (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 E.

Against this background of regulation and change, inquiry participants highlighted concerns relating to:

- whether insurance should be mandatory
- whether last resort insurance is appropriate and whether it compromises consumer protection
- 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.

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 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 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 Housing Industry Association (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—provides 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 and, as such, 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 on what they should be aware of.

A more fundamental problem, as the HIA noted, is that consumers enter into 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 sought to determine a potential builder's financial state, a builder whose business was '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.

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 competence and 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 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 of its cultural and institutional framework, it is hard to see how a voluntary offering of insurance could overcome the information problems noted above. 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 would not fully appreciate the value of an insured builder and, to that extent, would 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)

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 and intractable characteristic of the housing construction sector.

Information provided to the Commission during the inquiry indicated consumers are an ill-informed group when it comes to warranty insurance. They are generally unaware it exists for their protection and unaware of the limited extent of the cover it provides.

This is in marked 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 is attracted to the idea that consumers should be provided with similar information on builders warranty insurance at the beginning of a contracted job. If this were possible via the provision of a simple brochure along the lines of that produced for plumbers insurance, this could be provided at minimal cost.

Draft recommendation 7.1

Builders undertaking a job for which builders warranty insurance is required should, at the start of the job, provide their client with a document that contains a brief description of the insurance and what it covers (similar to that provided for plumbers insurance).

Benefits and costs

Benefits

Builders warranty insurance provides benefits to consumers where their builder disappears, dies or become insolvent before their building is completed or any defects are fixed: of these three events, the incidence of insolvencies⁴ is the most prevalent.

A measure of at least part of this risk may be inferred from data provided on the number of domestic builders who became insolvent across Australia over the

⁴ 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).

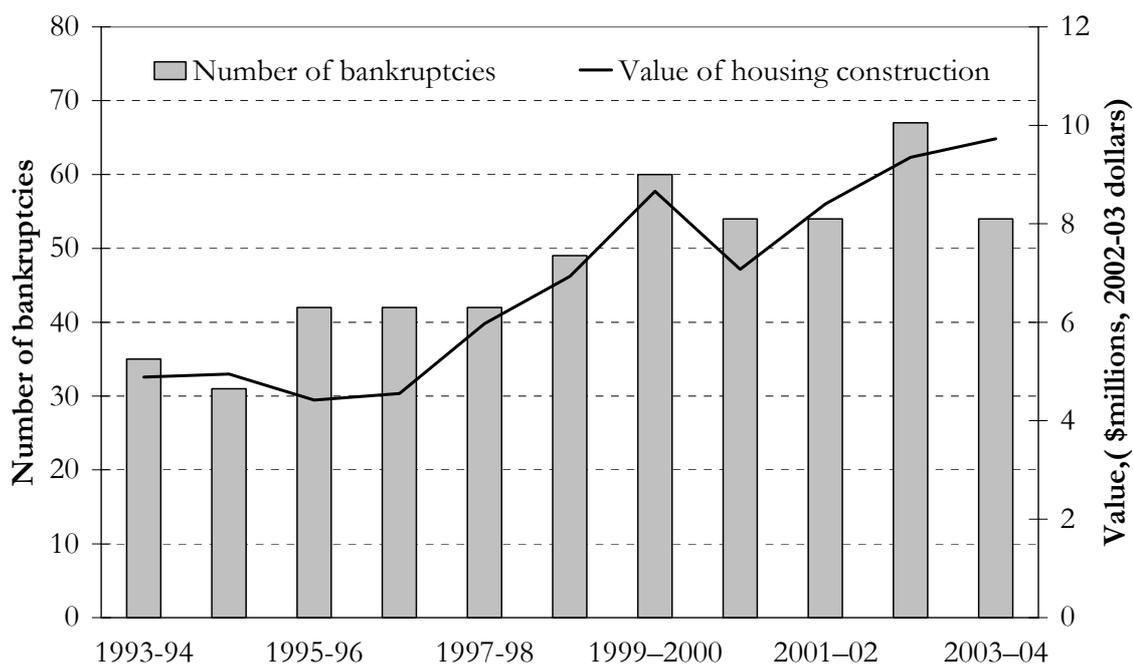
period 2000 to July 2004 (table 7.2). Given Victoria's share of the nation's domestic housing market is around 30 per cent, the data suggest the number of Victorian builder insolvencies ranged from around 90 in 2000 to about 50 in 2004 (for the half year to July). These estimates are broadly confirmed by data on business insolvencies in the Victorian construction industry for the period since the introduction of the Building Act (figure 7.1). The data in figure 7.1, however, is an understatement of the total level of insolvent failure as it measures only bankruptcies.⁵

Table 7.2 Builder insolvencies across Australia: 2000 to July 2004

	2000	2001	2002	2003	2004 (to July)
Insolvencies	300	350	290	190	160

Source: Vero undated, p. 2.

Figure 7.1 Business insolvencies in the Victorian construction industry



Source: Insolvency and Trustee Service Australia, cited in BC undated A, A2-12.

⁵ For unincorporated businesses, there are no comprehensive data available that measure the number of businesses closing as a result of insolvency. However, business failures can be estimated from business-related bankruptcies (Bickerdyke, Lattimore and Madge 2000, p. 33)

These figures suggest, at current levels of housing activity and under a mandatory insurance regime, that around 0.5 per cent of builders in Victoria may become insolvent on average in any year. While the risk of this occurring 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.

It is reasonable to expect, however, that should activity in the housing construction sector turn down from its cyclical strength, the number of business failures 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 and Madge 2000, p. 52). An increase in business failures coincident with declining economic activity is a generally evident phenomenon.⁶ In such circumstances, the benefit to consumers from warranty insurance could be expected to increase commensurately. The recent decline in aggregate building permits, 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. This preventative intervention can thus help to reduce the incidence of builder insolvencies. Without mandatory insurance, the incidence of insolvencies is likely to 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 just 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).

⁶ 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 (GDP) growth and failure, even after controlling for all of the firm-level characteristics (Bunn & Redwood 2003).

Costs

The costs arising from mandating warranty insurance have two main elements. The first is the direct cost of each policy borne by consumers. The second is 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 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).

However, evidence provided by insurers (and discussed later in this section) suggests this figure considerably exaggerates the increase in premiums. That is not to deny that premiums have increased since the collapse of HIH, but it is important to put any increase in context. While premiums have risen substantially, much of this increase 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 a less rigorous screening of high risk builders.

Some inquiry participants, such as the Builders Collective of Australia, claimed the premium increases were the exercise of virtual monopoly power by the largest insurer remaining in the market following the collapse of HIH (sub. 38, p. 5). However, a significant number of insurers have entered the market over the past year or so—there are now eight insurers—with the result that competition in the provision of warranty insurance has increased markedly. In addition, an Australian Competition and Consumer Commission (ACCC) investigation of perceived anti-competitive arrangements, along with the subsequent action by Vero⁷ in offering its product to the Master Builders Association has also improved competition in the market (sub. 38, p. 8). Accordingly, the Commission considers that a lack of competition in pricing and product offering is unlikely 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 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, and is trending down. For a \$250 000 house, this 0.49 per cent represents an average cost of \$1225. Moreover, Vero noted that this average in Victoria is below the national average

⁷ Vero (Vero Insurance Limited) was formerly known as Royal and Sun Alliance Insurance Australia Limited.

of 0.57 per cent and significantly less than the average in New South Wales (0.86 per cent). It also noted the Victorian average is significantly less than the average in Queensland (0.70 per cent). But as the Queensland scheme extends to so-called first resort claims, a direct comparison is not so useful.

To put the average premium cost in context, recall that warranty cover extends for six years for structural defects and for two years for other defects. Using the example of the \$250 000 house, the average \$1225 insurance premium therefore costs about \$205 a year over the life of the policy covering structural defects.

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. These requirements mean some builders have had to restructure their asset holdings or take out bank guarantees to qualify for the level of insurance sought. Industry participants raised concerns about the cost of restructuring their assets to qualify for warranty insurance policies, particularly where this has required builders to place a significant proportion of their financial assets within their business structure. Moreover, the incidence and burden of such requirements is relatively greater for small businesses. As McCormick Builders and Property Power noted:

... insurance companies make eligibility for [home owner'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)

To a large extent, however, application/compliance costs are likely to be one-off, upfront costs. While they may be initially 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, given its ongoing nature. In this regard, L&F Holdings provided the Commission with its experience following a request in August 2002 from its insurance provider that they 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)

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)

Costs of this magnitude imply bank guarantees could range from 0.4 per cent to 0.8 per cent of the value of a house. For a \$250 000 house, this corresponds to costs of \$1000 to \$2000. However, the Commission received no comprehensive data on the number or proportion of builders affected by this requirement, or on the cost involved in a typical bank guarantee. Accordingly, it is unable to judge the scale and relative importance of this cost for the industry as a whole.

The Commission did, however, receive ample evidence of the personal and economic costs to 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. Chiwest 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. (Chiwest 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)

It is clear that the operation of the warranty insurance market following the HIH collapse has imposed a personal and economic cost on many (generally small) building firms. While clearly a significant cost to those builders, the cost of lost activity 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 evidence from submissions suggests such excessive costs are largely a feature of the past. Colmac Homes noted that there are still problems with the current system, 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). Furthermore, 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 Master Builders Association of Victoria (MBAV) summarised the position when it noted:

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 intractable 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.

Draft finding 7.1

On balance, mandatory builders warranty insurance appears justified in view of the intractable 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, 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 Building Advice and Conciliation Victoria (BACV).

The Commission received a range of views on the effect of these changes on consumer protection. Some inquiry participants 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). Similarly, MR Constructions stated that ‘the [warranty insurance] policies are virtually worthless to consumers’ (sub. 78, p. 2). 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 then existing practice.

Two questions need to be answered: has the change seriously eroded consumer protection? And, if it has, is a return to so-called first resort cover feasible?

Regarding the first of these questions, 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 if not always immediately). This does not occur today, because consumers’ claims on their extant builders do not go through an insurer. Current arrangements might thus be viewed as lessening consumers’ ‘bargaining power’ to obtain redress.

However, the changes also established a range of services available through BACV, designed to provide a substitute for insurer oversight and to facilitate the resolution of disputes (box 7.3). 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 BCAV and VCAT in the event that there are problems with the home and the builder is still trading. (sub. 58, p. 20)

Box 7.3 **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 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.

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:

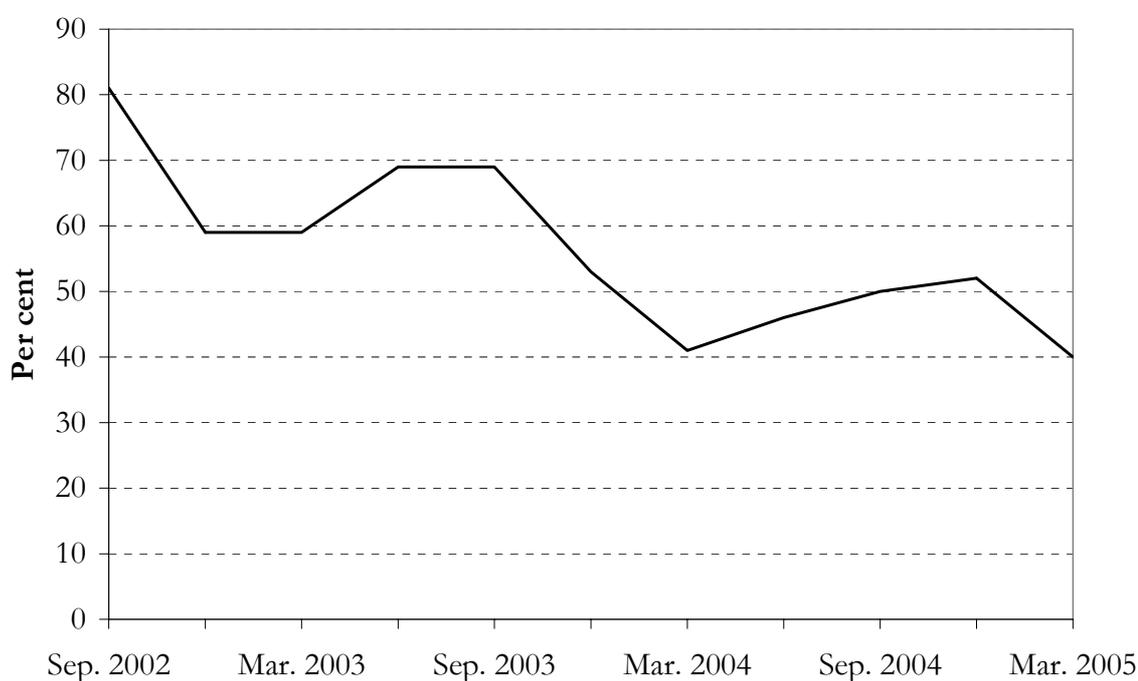
This can be costly and time consuming for all parties involved and leaves consumers questioning exactly what they are paying for (and being covered against) when provided with warranty insurance. (sub. 49, p. 8)

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 generally providing an effective avenue for consumer protection. In 2003-04, for example, BACV received 20 120 telephone or written enquires 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,⁸ with the owners valuing items in a dispute at between \$28 000 and \$218 000 (The Allen Consulting Group 2005, pp. 29–30, 33).

The success of BACV in resolving disputes has fluctuated between 80 per cent in September 2002 and 40 per cent in March 2004, and averaged around 60 per cent (figure 7.2). 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 7.2 **BACV resolution rates**



Source: BC undated A, S3-05 BACV resolution rate.

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 7.3). 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.

⁸ 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.

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, for example, has 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)

Draft finding 7.2

The change in the cover of builders warranty insurance to ‘last resort’ has not been associated with a material loss of consumer protection for events formerly covered under so-called ‘first resort’ cover. Recourse under the *Domestic Building Contracts Act 1995* (Vic.) and the establishment of dispute resolution services through Building Advice and Conciliation Victoria provide an effective substitute.

7.2.3 Are current exemptions appropriate?

Some inquiry participants questioned whether existing exemptions from warranty insurance are appropriate. Two areas of particular concern related to multi-storey buildings and architect/engineer-led projects.

Multi-storey buildings

As noted above, 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 of Australia 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.) also 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 (s.9AE(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, it must be acknowledged that in some cases the developer and the builder will be the same entity, albeit separated by a corporate veil.

Regarding the other risk covered by warranty insurance—the rectification of defects—the HIA considered that here, too, high-rise dwellings were 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. For example, the developer or overseas owners might hold voting rights, or the appointment of the body corporate manager may pre-date the unit holders’ involvement. As a generalisation though, a body of unit holders should be able to bring more resources to bear to pursue a case for rectification than an individual owner.

Moreover, the case for mandatory warranty insurance for the construction of multi-storey residential property is poor 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 completion risk 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.¹¹ 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.

¹¹ See for example, Bickerdyke, Lattimore and Madge 2000, pp. 18–19.

The Commission's view is that the absence of 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. Accordingly, mandatory warranty insurance is not warranted for this segment of the housing market.

Further, mandatory insurance for high-rise dwelling construction is likely to 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)

Draft finding 7.3

In view of the characteristics of high-rise construction and, to a lesser extent the protection afforded consumers under the *Sale of Land Act 1962* (Vic.), the Commission considers the current exemption of multi-storey dwellings from mandatory warranty insurance is appropriate.

Architect/engineer-led construction

The Master Builders Association of Victoria 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)

and:

... 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 (box 7.4), 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 should the builder die or disappear, or become insolvent.

Box 7.4 Consumer benefits from RAlA/MBAV contracts

Royal Australian Institute of Architects (RAIA)/MBAV building contracts protect the client, in that the consumer:

- pays only for work completed
- payment to the builder is on a ‘cost to complete’ basis, as assessed by the architect. Payment usually occurs 6–8 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.

Draft finding 7.4

Architects and engineers generally face the same intractable problems as faced by average consumers in assessing the financial health of a builder and in determining the risk that a builder might become insolvent. The 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.¹² 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)

¹² 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.

A key 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 Commission considers that a repeat of the HIH scenario is unlikely given the evident maturing of the insurance market in Victoria, coupled with stricter prudential oversight by Australian Prudential Regulation Authority (APRA) (itself a legacy of the HIH debacle).

Other features motivating calls to implement a Queensland-type scheme in Victoria are the apparent ease of access to insurance and lower premiums. Evidence to the Commission indicates that access was a major problem in the recent past under private provision, but has improved markedly. 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). 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. Accordingly, the Commission does not consider the Queensland scheme offers compelling advantages in this regard.

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). But evidence presented by Vero suggests this is not generally the case (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.¹³ 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 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)

¹³ 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.

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).

The monopoly provision of insurance (as with any product or service) also 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)

More fundamentally though HIA supports the conclusion reached by several inquiries into the regulation of warranty insurance, that there is a conflict of interest in the body that provides the warranty insurance also being the licensing and regulatory authority. (sub. 58, pp. 21–2)

The Commission is in accord 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 private insurance pool would increase the volatility of risk in the pool and, at the same time, reduce economies of scale. Private insurers' costs (and premiums) in other states would thus be likely to rise if Victoria adopted a government-run scheme.

Finally, although private provision has been associated with enormous upheaval, the evidence of recent entrants into, and the maturing of, the market indicates that upheaval is now largely behind us. Moreover, the Victorian Government has since encouraged insurers to make a market, and it would be a breach of faith to renege on that stance. 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 current arrangements.

Draft finding 7.5

The Commission is not convinced that a shift from the private competitive provision of insurance to a government monopoly provider would, in aggregate, deliver superior outcomes for Victoria's housing construction industry.

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 risk categories of builder, and a comparison with Queensland's single rate scheme (table 7.3). The Queensland rates broadly equate to Vero's category 3.

Table 7.3 Average premiums: 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	Multi storey	369	496	853	1880	1128
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 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 has fallen from 0.55 per cent since January 2003 (figure 7.4).

Figure 7.4 **Victoria: average premium for Vero policies, as a proportion of average contract value**



Source: VERO, sub. 71, p. 15

Changes in Victoria's warranty insurance market provide good cause to believe that the stability and maturation of the market will continue. Central to this belief is the growth in the number of providers, even though Vero still appears to have a major share of the market. At May 2005, eight warranty insurance providers were operating in the Victorian market: Vero Warranty, Australian Home Warranty, CGU, Lumley, Building Ethics Australia, AXA, QBE and Australian Unity. This is far from the days following the collapse of HIH, when Vero was effectively the only insurer. In addition, the number of brokers offering warranty insurance has grown rapidly in recent years—a move that has strengthened competition in the market.

Warranty insurance might also add indirectly to the cost of housing via the costs incurred by builders to obtain that insurance. As noted, for some inquiry participants, the implied costs in obtaining a bank guarantee ranged from 0.4 per cent to 0.8 per cent of the value of a building contract. For a \$250 000 house, these figures correspond to costs of \$1000 to \$2000. However, the inquiry received no comprehensive data on the number or proportion of builders affected by this requirement, or on the cost involved in a typical bank guarantee. Accordingly, the Commission cannot comment on the scale and relative importance of this cost for the industry as a whole.

Warranty insurance thus appears to add about 0.5 per cent to the cost of a building contract via premiums. In some cases (albeit an unknown number), 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. We should thus be 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 might be comparable in Australia is beyond the resources of this inquiry. Suffice to say that the additional cost of mandatory insurance (relative to being voluntary) would, for aggregate housing construction, be significantly 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 decline as a proportion of construction value in future. Moreover, compared with the alternative of voluntary warranty insurance, mandatory insurance is unlikely, in aggregate, to have a significant impact on housing affordability.

Draft finding 7.6

The Commission considers that mandatory insurance imposes a modest cost on dwelling construction, and a cost likely to decline as a proportion of construction value in future. Moreover, relative to voluntary warranty insurance, mandatory insurance is unlikely, in aggregate, to have a significant impact on housing affordability.

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 limits imposed on business turnover by that insurance. The second concern relates to the possible effect of the insurance arrangements on impeding new entrants (particularly young builders) to the industry.

Effect on builders generally

The Master Builders Association of Victoria (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)

Similarly, the Builders Collective of Australia claimed:

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)

Several inquiry participants gave examples of the difficulties they (as builders) faced in obtaining insurance or insurance for the value of work they wished to undertake. These difficulties clearly restricted their ability to provide building services to the housing construction market (box 7.5).

Box 7.5 **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 5 months after HIH went bankrupt and more than 4 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 sub-contractors 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)

A subset of the supply shortage induced by warranty insurance is the claim that it has pushed builders unable to get cover (or cover for sufficient turnover) into the owner–builder segment. However, information provided by the Builders Collective (from a review of the New South Wales home warranty insurance inquiry—Tyler 2004, p. 5) suggested this is not substantiated:

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. (sub. 79, p. 5)

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 on-going protection and quality assurance during the building process. (sub. 74, p. 9)

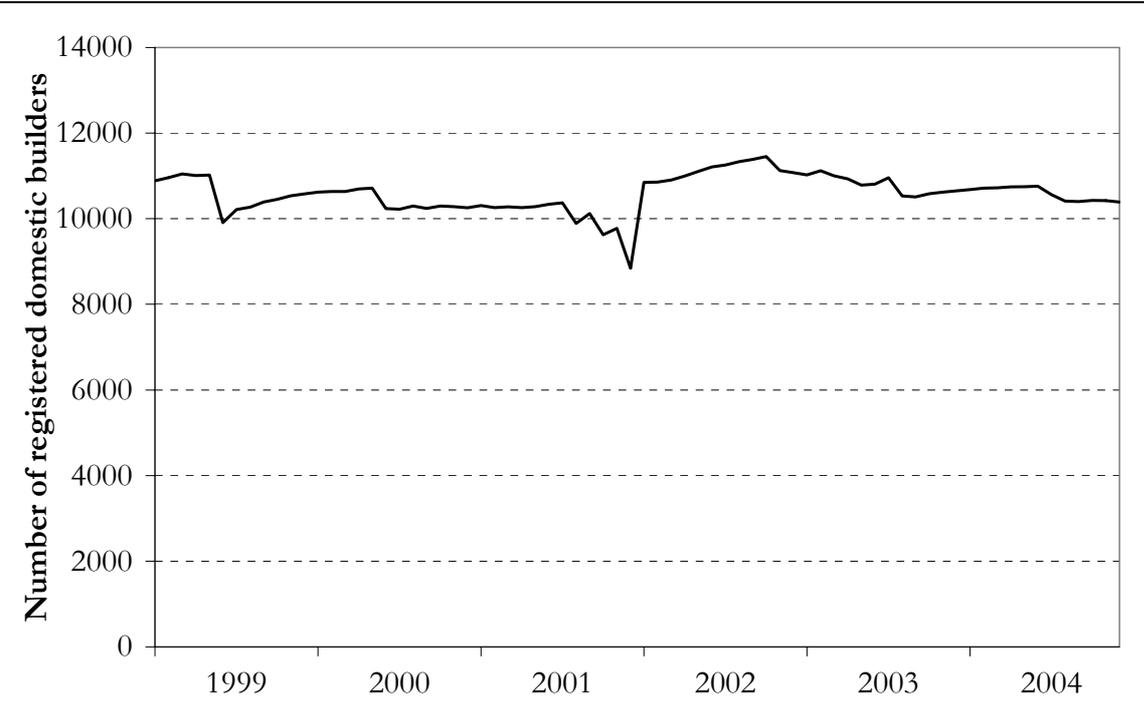
The maturation of the market has also led to improvements in product offerings and service from the former dominant provider, Vero. Vero noted that it has introduced Express Assess, a service for 80 per cent of builders with an annual turnover of \$2 million or less. The product offers a simplified assessment and application form and a 72-hour turnaround time (sub. 72, p. 12).

In short, there is evidence of a maturing market, with new entrants, 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.

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 1998-99 to 2003-04 (figure 7.5).

Figure 7.5 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 HHH, 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)

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, 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)

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, replicating those expressed in a recent New South Wales inquiry:

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 sub-contractor. 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 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. Against a backdrop of such changes, 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)

Draft 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 significant adverse impact that mandatory insurance has had on some builders' capacity to work, the effect of this regulation on the total supply of registered builders appears to be relatively small.

7.3 Owner–builders warranty insurance

Part 9, 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 of completion. The insurance cover becomes effective from the point at which the property is sold and is valid for six years. The maximum claim under an owner–builder policy is \$200 000—a level corresponding to that offered under builders warranty insurance. The purchaser of an owner built house thus has redress for the same value of defective work that becomes apparent after the sale as would a purchaser of a house built by a registered builder.

The case for mandatory owner–builders 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–builder built housing also face similar potential costs associated with any 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 of the security that a defects inspection report provide. As such, they do not incur those costs associated with restructuring their assets.

Draft 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 10 regulation and consumer protection

Owner–builders are required to fill out a ‘Form 10’ and submit it to the Building Practitioners Board. A completed Form 10 should list all registered building practitioners who have worked on an owner–builder project where the value of their work is over \$5000. The Master Builders Association of Victoria noted that Form 10s are important for conferring consumer protection because all tradespeople who are contracted to do work in excess of \$12 000 for a particular job are required to carry warranty insurance.

The Master Builders Association of Victoria noted, however, that this mechanism is generally not used or policed. The result, it claimed, is that ‘Consumers are left exposed because existing legislation is ignored’; accordingly, MBAV requested that ‘this administrative shortfall be addressed as a matter of urgency’ (sub. 49, p. 8).

However, the ‘consumers’ most affected in this case are the owner–builders themselves, because they will generally be living in the property initially. They will thus bear the cost of any rectification if the practitioners they employed do not fix any defects, or if they cannot locate the practitioner and thus access their warranty insurance. And should the owner–builder sell the property within six years, the purchaser would be covered by the owner–builder’s own warranty insurance if defects requiring rectification emerge.¹⁴

Given that an owner–builder assumes responsibility for engaging the building practitioners to work on their project, it is not clear why a Form 10 is needed. It is also not clear that the Form 10 requirement provides any meaningful protection to consumers who are not the owner–builder. Moreover, it is

¹⁴ Insurance companies will not issue an owner–builder warranty insurance unless a defects inspection report has been completed.

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.

Draft finding 7.9

The requirement for owner-builders to fill out a Form 10 (on the basis that it provides consumer protection) appears unnecessary.

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 include the provision for mandatory insurance requirements for licensed plumbers to be set by ministerial order. The Licensed Plumbers General Insurance Order 2002 (box 7.6) comprehensively prescribes the nature of the policy (DSE, sub. 84, p. 81).

Box 7.6 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 because 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. Some examples of 'defects' in clause 14 are:

- a failure to carry out the work in a proper and workmanlike manner and 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.

The Plumbing Industry Commission noted that insurance requirements are also drawn to the attention of the consumer by compliance with s.221ZPA of the Building Act. 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 contains a brief description of 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 defective work, 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).

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 associated with 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. As noted in the submission from DSE:

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 7.7) plays a major role in minimising claims.

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). It also did not receive any submissions that the cost of insurance is excessive relative to the benefits it accords consumers (again, with the exception of the industry association claiming that this is the case in some circumstances). Anecdotal evidence reported by the

Plumbing Industry Commission indicates that most sole trader plumbers presently pay an annual premium of no more than \$1000 (DSE, sub. 84, p. 84).

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, this has ensured accessibility to policies and has not been an issue for plumbers (DSE, sub. 84, p. 84).

Box 7.7 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.

While plumbing insurance appears to provide appropriate consumer protection at a reasonable cost, the Commission does not have sufficient information to confirm this. Accordingly, the Commission invites inquiry participants to comment on the benefits and costs of this regulation in their response to this draft report.

Request for information

The Commission invites inquiry participants to comment on the benefits and costs of mandatory plumbing insurance for housing construction.

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 related to the work of its members. Specifically, it raised 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 presently operates in the market (sub. 4, p. 1).

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, 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 are generally in a position to 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, on the limited information provided to it, the Commission is unable to judge on this matter.

Request for information

The Commission invites inquiry participants to comment on the benefits and costs of mandatory plumbing insurance for air conditioning and mechanical services installed in commercial, industrial and high-rise residential buildings.

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, the insurance market has experienced major changes that have affected the availability, affordability and number of providers of indemnity insurance. Particularly significant 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 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)

This improvement was acknowledged by the Department of Sustainability and Environment, which stated ‘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. High premiums, however, remain an issue despite recent evidence to suggest 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, its effect on practitioners’ capacity to work and its role in restricting innovation 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 Building Appeals Board claimed:

... 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)

The Commission did not receive sufficient information, however, to judge on the overall effect of indemnity insurance in this regard.

Request for information

The Commission invites inquiry participants to comment on the influence that insurance arrangements might have on the propensity of insured practitioners to pursue innovative performance-based solutions to meet building standards.

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 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 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 as 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 for all consumers the intended level of protection.

Draft finding 7.10

A potential weakness in the consumer protection offered by mandatory insurance is the absence of any requirement that a provider of professional indemnity insurance must meet an approved standard of prudential fitness.

Requiring professional indemnity insurers to meet similar requirements to those applicable to providers of warranty insurance would address this potential weakness. The Commission is mindful, however, that it received scant information on the costs or practicality of requiring eligibility criteria for providers of indemnity insurance. It may be that administrative costs in monitoring and deciding on eligibility are excessive relative to the benefits that might be derived from this measure. Accordingly, to assist it in reaching a final view on this matter, the Commission invites inquiry participants to comment on this issue.

Request for information

The Commission invites inquiry participants to comment on the cost or practicality of requiring eligibility criteria for providers of indemnity insurance (similar to the criteria applicable to warranty insurance providers).

Part C

8 Improving the regulatory framework

This chapter outlines potential improvements to the regulatory framework described in Chapter 4. It focuses on two main areas. First, it assesses the objectives of the *Building Act 1993* against best practice principles and examines how those objectives might be improved. Second, it examines existing processes for assessing new regulations 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 regulations 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 1993* (Vic) against the best practice principles of regulation outlined in chapter 1.

In the long term, the quality of the regulatory framework will depend on the extent of scrutiny applied to existing regulation to ensure it is still needed, and to any new regulation to ensure it is introduced only if warranted and then in the best way of the available alternatives. Sections 8.4 and 8.5 outline possible improvements to the processes for assessing new regulations.

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 three main reasons. First, 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 regulations 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; and
- articulate parameters that can guide regulatory action. (Network Economics Consulting Group 2001, p. 14)

Second, 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 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 retarding structural change, obstructing convergence between sectors or leading to structural rigidities, fragmenting government policies and actions and the risk of ‘capture’ by those being regulated (OECD 2003, p. 5).

Third, 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 and Ward 2004, p. 16)

The problems that can arise from poorly defined objectives—the creation of uncertainty, the absence of accountability and poor regulatory focus—are

magnified if a regulator is required to pursue objectives that conflict. 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, amenity and to constructing environmentally and energy efficient buildings. It was also pointed out in Chapter 4 that under s.221ZZZV of the Building Act, the Governor-in-Council may 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 these objectives should lead to the desired outcomes. The following principles appear particularly relevant:

- Regulations 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 the objectives they are intended to achieve are also understandable. They are more likely to be the minimum necessary if regulation itself is not an objective. And it will be easier to hold regulators to account if their objectives are clearly defined and 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 important aspects:

- (1) Few of the current objectives of the Act or Regulations 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

Few of the current objectives are defined in the Building Act or the Building Regulations, 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 in the Building Regulations. In the second reading speech introducing the Building Bill, the Minister for Planning suggested that the Bill ‘will provide improvements to the health, safety and amenity of people who use buildings’, but he did not define 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 and ventilation. 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. (www.lexisnexis.com.au)

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 Productivity Commission noted similar problems with the definition of amenity in the Inter-Government Agreement that underpins the Australian Building Codes Board. 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, and 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 it has been regulating building quality by supporting continuous 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 are not mentioned in the Building Act (unless 'amenity' is interpreted particularly broadly). By indicating that it is regulating quality, the Building 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 is regulating 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 possibility that such consumer confusion could arise may be increased by the interaction between the Building Act and the *Domestic Building Contracts Act 1995* (Vic). The former focuses on certification of minimum standards, while specifications in building contracts are the product of agreement between the builder and the consumer. Consumer Affairs Victoria 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)

Given this possible source of confusion, it seems particularly important that the Building Commission describes its role as enforcing minimum standards rather than quality.

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' (s.4). 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 make decisions about the size of the costs that builders (and consumers) should be required to incur in total and in relation to individual attributes. That is, regulators will need to judge the relative importance of each attribute. But the Building Act does not provide any guidance on the relative importance of the various objectives or on how

regulators should determine this importance. It is arguable that regulators should not have to make such trade-offs:

The trade-offs 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)

The Export and Infrastructure Taskforce suggested, in the context of economic regulation, 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 trade-offs is minimised, objectives are typically defined at a level of generality that requires the regulator to judge the level of building performance to be targeted through regulation:

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 further 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 make trade-offs between 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 associated with higher performance.* These costs may differ between, for example, safety and environmental improvements to a building.
- *The benefits associated with higher performance.* Similarly, the costs of increasing safety may differ from those associated with an increase in environmental performance.

The requirement to assess these issues suggests 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, misinformation 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.

Draft finding 8.1

Assessing the regulated level of performance is difficult for any regulator, even within the most well specified regulatory framework. The difficulties are likely to be multiplied if the outcomes that the government wants the regulator to target are not specified clearly and if little guidance is provided as to the relative importance of different objectives.

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 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 2005, pp. 4–7). The argument for limiting regulation to the minimum needed to address the problem is that this approach is consistent with 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.¹

The Victorian Government has 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 2005, p. 34)

The significance that the government attaches to housing affordability is also demonstrated by the grants that it provides to first home buyers. Inquiry participants also 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)

In the face of such comments, it is noticeable that 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 potential effect on costs of having no objective in the Act aimed at minimising the cost of regulation to that needed to achieve its objectives is compounded by the inclusion of instruments as objectives. Including regulatory instruments as objectives 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

¹ A regulated outcome that is efficient, in the sense of providing the maximum net benefits, may increase the cost of housing above the level that it would be if there were no regulation. That is, the objectives of maximising efficiency and affordability may sometimes conflict with each other.

building practitioners and plumbers’, ‘accreditation of building products’ and ‘issuing building and occupancy permits’ simply enshrine regulation as an objective in itself and are unlikely to encourage regulators to explore less intrusive approaches. This is inconsistent with the approach 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 2005, pp. 3–4)

Draft finding 8.2

Including regulatory instruments as objects 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, pp. 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 2005, pp. 3–5).

Accountability is harder to achieve if the meaning of objectives is ambiguous or if there are inconsistencies between different objectives, which would create ambiguity about which desired outcome is most important. When such ambiguity exists, regulators have difficulty developing a clear set of benchmarks against which their performance can be assessed. As noted, ambiguity and inconsistencies between objectives are present in the Building Act and Regulations (as discussed further in chapter 8).

As mentioned in chapter 4, seven of the statutory objectives specify the instruments or approaches that can be used under the Building Act. The issue with these objectives is not that these instruments are inconsistent—chapters 5, 6 and 7 suggested that they complement each other—but rather that instruments should not be specified as objectives. As also pointed out, one objective specifies the achievement of a competitive building and plumbing industry: this is not

necessarily inconsistent with the regulatory instruments specified in the other objectives, and implies that the form of regulation in the industry needs to be implemented with regard for its potentially adverse impact on competition.

Turning to the two objectives of the Building Act that specify five outcomes (health, safety, amenity, energy and environmental efficiency), the Royal Australian Institute of Architects (RAIA) pointed out:

A fully sealed five star energy efficient rated home has many benefits both in energy and cost saving; however, it also tends to create microclimates that can cause serious illness. (sub. 40, p. 12)

That is, there may be a tension between achieving the energy efficiency objective and protecting the safety or health of those who use buildings, although the Commission cannot assess how significant this might be.

There might also be some inconsistency between the outcomes that are explicit in the Act 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 based on the view 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, trade-offs 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 other 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 trade-offs between objectives such as energy and economic efficiency means that performance assessments become as much about the trade-offs as about the achievements of an objective.

8.2.4 Can the objectives of the Building Act be improved?

The objectives of the Building Act are open to different interpretations, may 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 8.3 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 currently included in s.4 of the Building Act should not be part of the objectives section of the Act, but rather should be listed elsewhere. Box 8.1 indicates what these instruments might encompass.

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.

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.

Draft recommendation 8.1

The instruments that can be used to achieve the revised objectives of the *Building Act 1993* should be set out in the Act separately from the objectives.

Reducing the number of outcomes

In addition to removing the instruments from the objectives section of the Building Act, reducing the number of outcomes would be a further improvement. This would reduce the number of ‘targets’ to be achieved with the instruments permitted under the Building Act, and would reduce the requirement for regulators to make trade-offs between the various objectives. A number of options are feasible, involving differing reductions in the number of desired outcomes.

Option 1: Maintain five outcomes

A minimalist approach to change would be to replace the 10 objectives of the Building Act with a statement that includes all of the attributes in the current objectives in s.4(b) and (c). 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.

This approach would clarify the focus on health, safety, amenity and environmental and energy efficiency. Deleting the other eight objectives would reduce the mixture of instruments and outcomes that characterises the present 10 objectives.

This option reduces, but does not eliminate, 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 contrary argument is that 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 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’ attention on achieving outcomes that maximise net benefits to society, rather than simply improving standards.

This proposed objective has a substantial weakness, however, because it includes five different attributes (health, safety, amenity, and environmental and energy efficiency) and makes little progress towards reducing the obligation on regulators to make trade-offs between the objectives.

Option 2: Remove environmental efficiency from the objectives

A second option, which would partially address this weakness, 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 the construction of houses or from houses themselves, it would be addressed by the *Environment Protection Act 1970*. Moreover, even if the environmental efficiency objective were removed, four attributes would remain.

Option 3: Remove environmental and energy efficiency from the objectives

A third option is to remove the reference to energy efficiency, in addition to the reference to the environment. If these two attributes were removed from the Building Act's objectives, a new section could provide that Regulations made under the Act should have regard for the government's energy efficiency objectives as they relate to building. Section 221ZZZV of the Building Act may do this already, in respect to plumbing, by giving the Governor-in-Council the power to make regulation with respect to energy efficiency, environmental efficiency and water efficiency. This option would be consistent with the approach suggested by the Organisation for Economic Cooperation and Development (OECD) 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 further below).

Option 4: Remove environmental and energy efficiency and amenity from the objectives

Option 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. This change 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 defined in a way that provides more guidance in a building context, to correspond with its meaning 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. This would leave some room for interpretation, which is desirable, to allow some

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 attribute, which have to be approved by the minister, they will clarify what is to be achieved by way of outcomes 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

Given these considerations, the Commission's view is 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, with amenity defined 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.

This proposal would both (1) reduce the number of objectives that regulators are required to target and (2) would provide guidance on the relative importance of the objectives that remain. The Commission's proposal attaches a particular priority to different outcomes; the government may have different priorities.

Draft recommendation 8.2

That the Victorian Government simplify and clarify the current objectives of the Building Act, replacing the current objectives with:

- (1) achieving minimum standards of buildings, in order 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.**

The Act should define health, safety, amenity, environmental efficiency and energy efficiency. Amenity should be narrowly defined, to correspond with the meaning in the Building Code of Australia and the Plumbing Code of Australia.

The Commission is seeking comments about 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 outlined in recommendation 8.2 would reduce this problem by clarifying that health and safety, and amenity objectives have the highest priority
- notwithstanding this prioritisation, the government would need to provide more guidance on how to make trade-offs between objectives
- ‘amenity’ should be removed from or retained in the Building Act as an objective.

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 very 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, ministerial direction or an agreement between the minister and the regulator), on the priority to be accorded to particular objectives 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.

The *Australian Securities and Investments Commission Act 2001* (Cwth) illustrates how the minister may provide guidance on the importance of different objectives. Under s.12 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 *Government gazette* and tabled in each House of Parliament.

Additional transparency is provided by the requirement that ASIC must report each year on the specific goals it has pursued, the priorities it has followed, its progress towards achieving these goals, the performance indicators it has used, and progress against these indicators (section 138 of the Act).

Guidance could also be provided 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 well-informed choices.²

Regulators would be encouraged to apply instruments consistently with these principles if they are required to explain in their annual report how they have done so.

Draft recommendation 8.3

The Victorian Government should provide, where necessary, additional guidance on how regulators are to apply the instruments permitted under the *Building Act 1993* to achieve the Act's objectives. This guidance 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 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 well-informed choices.**

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

² These tests are based on those suggested by the Productivity Commission (PC 2004c, pp. 358–9) for the Australian Building Codes Board.

Draft recommendations 8.1, 8.2 and 8.3 would:

- sharpen regulators' focus on outcomes
- provide more precise direction for the regulators administering the Building Act, by reducing the number of objectives
- 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. But the 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 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 new obligations to enable an assessment of the community costs and benefits. The benefits of such scrutiny include allowing for estimates of benefits and costs to be tested and identifying unintended effects of the regulation.

8.3.1 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 in itself provides a forum for scrutiny.

8.3.2 Regulations

Building Regulations are subject to requirements under the *Subordinate Legislation Act 1994*. In most cases, an RIS must be prepared, exposing Regulations to scrutiny. The public release of RISs has been important in identifying deficiencies in the analysis in these documents.

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 (s.9A Building Act). 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 s.19 of the Planning and Environment Act, fall short of the consultative requirements of the Subordinate Legislation Act. The Planning and Environment Act does not require, for example, consultation with housing industry groups.

The Commission considers, therefore, that the s.9A exemption from the obligation to prepare an RIS should be removed by legislative change to delete s.9A. RISs would then need to be prepared for proposed new Regulations 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’ (State Government of Victoria 2005, pp. 4–13.)

Draft recommendation 8.4

That the exemption from the obligation to prepare a regulatory impact statement, as provided by s.9A of the *Building Act 1993*, should be removed.

8.3.3 Building Code of Australia

The Australian Building Code Board 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 Building Code of Australia should preclude the retention of widely used practices within Victoria. This section considers variations to the Building Code of Australia initiated by Victoria.

The Inter-Governmental Agreement that established the Australian Building Code Board 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)

The National Association of Steel-Framed Housing Inc. pointed out:

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. 1)

National uniformity could, however, rule out local variations that may be warranted by local circumstances, such as climate. Nevertheless, it seems inconsistent that amendments to the Building Regulations are subject to the RIS process, while state based amendments to the BCA, which are called up by the Building Regulations, are not. 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.

Draft recommendation 8.5

That Victorian variations to the Building Code of Australia should 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 (DSE sub. 84, p. 12). In chapter 5, the Commission found that 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, a former chair of the Australian Building Codes Housing Board, commented that for each of the housing standards directly called up in the BCA, there are 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 enforced. (sub. 66, p. 4)

The Productivity Commission reviewed the role of Standards Australia International (SAI) in its report into *Reform of building regulation*. 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 was 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 Australian Building Codes Board 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. 273)

The Commission considers that this recommendation is consistent with good regulatory process and, over time, would help to address inquiry participants' concerns about standards.

Draft recommendation 8.6

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 at an early stage in the development of standards that are expected to be referenced in the Building Code of Australia and that are likely to have non-minor effects.

8.3.4 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 (s.188(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 (s.188(2)). Guidelines are a more flexible instrument than Regulations, because they can be introduced or amended without an RIS. They are thus exposed to less scrutiny before being introduced. If guidelines have unintended effects, those who are represented can make representations to the minister for change, but this 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*. 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, necessarily guarantee better or more cost-effective regulatory outcomes. With limited resources for preparing RISs, there is a trade-off 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:

- s. 4(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)

8.3.5 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 local planning scheme and a building Regulation are inconsistent, that the local planning scheme prevails. Consequently, a myriad of variations to housing construction requirements may exist across Victoria, unless the minister withholds approval for planning amendments that create undesirable regulatory inconsistencies.

Examined in isolation, if building Regulations are subject to an RIS process, consistency would be achieved by making planning scheme provisions that override the building 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 would, however, have implications for local government powers and relationship with the Victorian Government that extend beyond the housing construction sector and 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.

8.3.6 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. 5). The Property Council of Australia, however, commented that it:

... strongly believes that the processes for introducing new regulations 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 state 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, such changes may have implications for local government 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 should report on a timetable for implementing the Government’s intention to consider an appropriate scrutiny process for local laws.

8.4 The regulatory impact assessment process

As noted earlier, the Building (Interim) Regulations 2005, made under the Building Act, are a key element of the regulatory framework.³ 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 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 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. 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). Consequently the Regulations grew from 147 pages in 1998 to more than 209 pages in 2005.

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.

The current (interim) building Regulations expire on 13 June 2006 so 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 regulation) 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 for public comment, with the proposed Regulations, 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

³ The Plumbing Regulations 1998 and the Building (Legionella Risk Management) Regulations 2001 were also made under the Building Act.

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).⁴

Box 8.2 lists the Building Regulations for which RISs have been prepared.

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: BC 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 in two RISs
- the extent of these problems was quantified in two RISs and partially in three RISs
- a good explanation of the operation of the proposed regulation was provided in ten RISs and partially in two RISs

⁴ The analysis will be available on the Commission's website (www.vcec.vic.gov.au).

- 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 regulation were identified in three RISs and partially in two RISs. These were carefully assessed in three RISs and partially in one RIS
- the proposed regulation was compared with options involving less regulation in two RISs, and partially 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 the proposal (State Government of Victoria 2005, 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, there are a number of areas where the government has signalled that it is expecting more consistently robust analysis. 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 the higher level review of the overall regulatory framework that has been undertaken for this inquiry.⁵ The 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.

⁵ 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* and the allocation of responsibilities between those bodies. This examination is aimed at answering whether these arrangements are likely to lead to the minimum regulatory effort that is consistent with the scale of the problem 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 1993* (Vic.). In addition to specifying objectives, the Building Act sets out almost 50 functions that the regulatory bodies are required to undertake in pursuit of these objectives. This chapter considers whether the many functions prescribed for the regulatory bodies 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 problems intended to be addressed. It addresses three questions:

- (1) Should the regulators not be undertaking any of the large number of current functions?
- (2) Should the regulators take on any new functions?
- (3) Is the current division of responsibilities between 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 the building regulators with a best practice 'template' of functions for independent regulators, but it is not aware of such a template. The UK Better Regulation Task Force in a recent report about independent regulators, 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 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.

The chapter compares options with the current situation. For all these options, the Commission presumed that the administration and enforcement of the

regulations remain with regulators that are independent rather than part of a government department. With the right institutional arrangements, having regulation of housing construction administered by an independent regulator 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 only be achieved if the regulator is held accountable for the pursuit of clear objectives specified by government, operating independently but within a framework that details 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 to support this model as the foundation of the proposed arrangements. This chapter considers whether changes to some details of the current model would improve outcomes.

9.2 Are there any current functions that the regulators should not be undertaking?

9.2.1 Current Functions

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).

A number of the functions of the BPB, BACV and the BAB listed in tables 9.1 and 9.2 outline those 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 Commission considers that registration/licensing and

dispute resolution are ‘core’ regulatory functions that regulators should undertake, and it does not discuss them further in this chapter.

Table 9.1 Functions of the Building Commission and related entities

Building Commission	<ul style="list-style-type: none"> (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. (p) Any other function conferred by or under this or any other Act or under any agreement to which the State of Victoria is a party.
Building Regulations Advisory Committee	<ul style="list-style-type: none"> (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. (b) Accredite building products, construction methods or designs, components or systems connected with building work for the purposes of this Act and the Building Regulations. (c) Advise the minister on any matter referred to it by the minister. (d) Any other functions conferred by or under this or any other Act.
Building Advisory Council	<p>Advise the minister on:</p> <ul style="list-style-type: none"> (a) the administration of the Building Act and the Regulations (other than part 12A) (b) the impact on the Building Regulations system of Regulations made under any other Act (c) issues relating to the building permit levy (d) any matter referred to it by the minister.
Building Advice and Conciliation Victoria	Provide free advice and assistance to help consumers and builders resolve and prevent building disputes.
Building Practitioners Board	<ul style="list-style-type: none"> (a) Administer registration system for building practitioners. (b) Supervise and monitor the conduct and ability to practice of practitioners. (c) Make recommendations to Minister about qualifications for registration. (d) Undertake other functions conferred by the Act or the Regulations.
Building Appeals Board	Determine disputes and appeals arising from the <i>Building Act 2003</i> .

Source: *Building Act 1993*, ss. 183, 196, 208 and 211.

Table 9.2 **Functions of the Plumbing Industry Commission and the Plumbing Industry Advisory Council**

Plumbing Industry Commission	<ul style="list-style-type: none"> (a) To administer plumber licensing and registration system created by this part (b) To promote the maintenance of adequate levels of competence among plumbers (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) (d) To advise the minister on the impact on the plumbing industry of other Acts and regulations (e) To monitor and enforce compliance with technical standards applying to the plumbing industry, including standards applying to materials, installations, construction and maintenance (f) To promote plumbing practices that protect the health and safety of consumers and the integrity of water supply and wastewater systems (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 (h) To promote the resolution of consumer complaints about work carried out by plumbers (i) To seek the views of the plumbing industry and other interested groups on the effectiveness of this part and the Regulations (j) To coordinate the preparation of draft proposals for regulations under this part (k) To conduct or promote research into matters relating to the regulation of the plumbing industry (l) To promote better plumbing standards, both nationally and internationally (m) To liaise with any organisation established to promote national plumbing standards (n) To provide information and training to assist people and bodies in carrying out functions under this part or the regulations (o) To provide an information service with respect to plumbing (p) To accept any gifts or donations of money or other property by deed, will or otherwise (q) To advise the minister on any matter referred to it by the minister (r) Generally to carry out any other function or duty given to it, or imposed on it by this Act or any other Act
Plumbing Industry Advisory Council	<ul style="list-style-type: none"> (a) Provide advice to the minister. (b) Provide advice to the Plumbing Industry Commission.

Source: *Building Act 1993*, ss. 221ZZV and 221ZZXC.

Rather, the chapter focuses on those functions of the Building Commission and the PIC that do not relate clearly to the administration and enforcement of regulations but could, depending on how they are interpreted, require regulators to:

- provide policy advice (functions (a)–(e) for the Building Commission and functions (c), (h) and (i) for the PIC)
- undertake or promote research (functions (f) and (j) for the Building Commission and PIC respectively)
- promote improvements in standards (functions (g) and (k) respectively).

With 50 functions allocated to the regulators, it is not feasible to discuss all of them 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 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 to 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 BPB 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 BPB 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, would seem to invite shortfall and to complicate performance measurement (chapter 10). The 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 Should the Building Commission and Plumbing Industry Commission provide policy advice?

Providing policy advice typically involves a process with a number of steps, which 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 is a crude simplification of an iterative process that normally involves many more steps. The question that needs to be considered is whether regulators such as the Building Commission and the PIC should have any involvement in this process and, if so, what form that involvement should take.

The Building Commission is closely involved in policy development (box 9.1). While elected governments, not regulators, should determine policy objectives, 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 the ways in which, and the extent to which 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 governments 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 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' (BC undated B, pp. 6 and 7).

The Building Commission's annual report also includes 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'. (BC 2004a, pp. 14–17)

The main argument for involving regulators in policy development is their first hand expertise in policy implementation. They may be particularly 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 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 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'). This may occur because if regulators are perceived to be heavily 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 role 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 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.

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 that need 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 limited 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 the problem. It may even become aware of a problem before it becomes evident to others. It may also have views on how the 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.

Draft finding 9.1

Primary responsibility for developing new policy proposals is not an appropriate function of independent regulators, although regulators should be consulted and should have the opportunity to bring potential problems to the attention of the parent department and to identify technical implementation options.

9.2.3 Should the Building Commission and the Plumbing Industry Commission coordinate the preparation of draft proposals for Regulations?

A further question is whether the Building Commission and the PIC should continue to coordinate the preparation of proposals for Regulations. Frequently, this involves the preparation of a regulatory impact statement (RIS). The Victorian Competition and Efficiency Commission considers that regulators should not undertake the primary carriage of this function for two reasons:

- (1) 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.
- (2) The development of RISs should be interwoven with policy development. Preparing an RIS involves the same steps that make up 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 regulation.

Draft finding 9.2

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.

Nonetheless, under specific remit from the parent agency responsible for draft proposals for Regulations, the regulator could be tasked to assist in settling technical aspects of the Regulations.

If it was accepted that the Building Commission and the PIC, as the regulators, should not be the government's primary policy advisors, are changes in their functions required? While it is not clear which, if any, of its functions provides the basis for the Building Commission's involvement in policy advice, the five functions in box 9.3, when taken together, might have this effect.

Box 9.3 Functions of the Building Commission relevant to providing policy advice

- (1) To keep under regular review the administration and effectiveness of this Act and the Regulations
- (2) To advise the minister on amendments to improve the administration and effectiveness of the Building Act and the regulations
- (3) To advise the minister on the impact on the building industry of other Acts and Regulations
- (4) To seek the views of the building industry and other interested groups on the effectiveness of this Act and the Regulations
- (5) To coordinate the preparation of draft proposals for Regulations under this Act.

Source: Building Act 1993.

The PIC does not have the functions listed in box 9.3, although it is required ‘to advise the minister on the making of regulations under this part’ and ‘to advise the minister on any matter referred to it by the minister.’

The Commission does not consider that it should draft alternative functions for the regulators. It is possible, however, that the number of functions listed in box 9.2 could be reduced and that their meaning could be clarified to indicate that the Building Commission’s role is to provide advice on the administration and effectiveness of Regulations, in response to requests from the minister.

Draft recommendation 9.1

The Building Commission and the Plumbing Industry Commission should not have primary responsibility for providing policy advice to the minister on the regulation of housing construction, although they should be consulted on the implementation of regulation. The commissions’ functions should be re-drafted to make it clear that they are not responsible for policy advice, although they may comment in their annual reports on the effectiveness of the Building Act.

9.2.4 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. For example, in its corporate plan, it suggested:

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. 2)

This leadership role is also highlighted in the Building Commission's 2003-04 business plan:

In partnership with key industry stakeholders, the [Building] 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 [Building] 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 2004a, 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 aspects of leadership seem entirely consistent with the Building Commission's role as regulator. It is part of the Building Commission's role 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 quite 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 may not be 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 may become 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 this role, the two entities 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 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 particular reason to think the industry cannot find leadership from market outcomes and its own enterprise.

Draft finding 9.3

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.

9.2.5 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 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)

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 9.4). The PIC had a less ambitious program, using its research and development monies to fund overseas scholarships for apprentices and teachers of plumbing, and to support selected candidates to complete their apprenticeship.¹

Box 9.4 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 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 summarised expenditure and described some of the projects undertaken during 2002-03 and 2003-04. The PIC's annual report provides information about expenditure on research, but it is not complete.

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. Specific 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.²

¹ 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).

² The Industry Commission suggested these arguments as possible justifications of central funding of rural research. (Industry Commission 1995, pp. 708-27).

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 well 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 way to approach this issue is to classify research and development projects into different types. Many classifications are possible, but the following may be useful in the current context:

- *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 a reasonable interpretation could be 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 to understand the emissions from houses.
- *Research that lifts the productivity of products and processes in the building industry.* A project to boost the uptake of information technology by builders could 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 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 general research to lift industry productivity, this would seem to be an issue for an industry department, which 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 considers 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 that it would not require 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
- expenditure by the Building Commission and the PIC on research is reported publicly, either through their annual reports or through special reports. These reports should identify the objective and anticipated cost of each new project and how performance will be evaluated. For projects that have been 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 to the attention of the government in their annual reports.

Draft recommendation 9.2

The Victorian Government should:

- **provide guidance on the types of research project that can be undertaken by regulators, in the context of matters relating to regulation in the industry**
- **assess research proposals of the regulators and fund them as appropriate.**

The Building Commission and Plumbing Industry Commission should:

- **evaluate all research projects that are funded, in terms of how the projects have contributed to the operation of the regulatory system**
- **report publicly any expenditure on research into matters relating to regulation of the housing sector, either through annual reports or through a special report. This report would show the objective and anticipated cost of each new project and how performance will be evaluated. For projects that have been completed during the year, expenditure and the results of the evaluation should be reported.**

9.2.6 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 current 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 the additional costs to be 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, this would remove the justification for the commission 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 regulations are imposed only when their benefits exceed their costs.

A less extensive option would be to remove the promotion of better building standards *internationally* from this function in the Building Act. The link between improving building standards in other countries and improving building outcomes within Victoria seems remote.

Draft recommendation 9.3

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.'

9.3 Should regulators take on any new functions?

9.3.1 Allocating resources between the regulatory bodies

The way that resources are allocated between the regulatory activities and bodies can have a significant impact on the character of the regulatory system and its outcomes. The entity that controls the allocation of resources is thus in a powerful position.

Inquiry participants expressed different views about how resources should be divided among different activities:

- Consumer Affairs Victoria, 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). Others, however, might suggest that regulators should focus on enforcement rather than education.
- 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.
- 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’. A report by the Auditor-General into the operation of the Building Commission questioned its ‘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 [Building] 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 bodies, should be established to set direction and long term policies and 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 should be convened to provide advice to 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 establishing a new audit committee to assist the coordination of relevant activities of management, the internal audit function and the external auditor (BC, pers. comm., 26 April 2005). The Building Commission produces an annual budget, which is approved by first the BAC and finally the minister.

The Victorian Competition and Efficiency Commission cannot judge whether this approach addresses the Auditor-General's concerns (which were partly motivated by a desire to increase accountability) within the framework of the existing Building Act and Regulations. It has reservations about the requirement that the BAC approve the Building Commission's budget, given that the building industry is heavily represented in the BAC.³ As pointed out, to comply with the government's regulatory objectives, the regulator may have to undertake actions that conflict with the industry's commercial interests. It might also have a view about the emphasis given to different regulatory instruments that is not shared by the industry. Given this possibility, the community seems more likely to be confident in the complete 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 Victorian Competition and Efficiency Commission perceives merit in considering the Auditor-General's suggestion that a coordinating forum should set the direction for budget allocation.

The integrated approach to resource allocation sought by the Auditor-General would be enhanced if the Building Commission published (1) the amount of funds being allocated to the various regulatory entities and (2) the reasons for the priorities underlying the allocation. This seems particularly important, given that these 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 would enhance their independence. Their independence is questionable, however, if funds are allocated to them 'as the commission considers appropriate' under s.200(5)(a) of the Building Act.

³ Members of the BAC include the Building Commissioner; a person nominated by the minister administering part 4 of the *Project Development and Construction Management Act 1994* (Vic.); a person nominated by the minister administering the *Country Fire Authority Act 1958* and the Minister administering the *Metropolitan Fire Brigades Act 1958* (Vic.); a person nominated by Melbourne City Council; one person from each of the Royal Australian Institute of Architects, the Institution of Engineers, the Master Builders Association of Victoria, the Housing Industry Association and the Property Council of Australia; two people nominated by the Australian Institute of Building Surveyors; one person nominated by the Municipal Association of Victoria; one person with experience in the building industry; a legal practitioner; and one person who can represent the interests of users of building services (*Building Act 1993*, s.210).

Moreover, 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.

Draft recommendation 9.4

The Building Advisory Council should not approve the Building Commission's budget before it is submitted to the minister for approval. The commission's annual report should detail both the funds allocated to each regulatory entity and function, and the rationale for the allocation.

9.3.2 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)

Consumer Affairs Victoria argued that priority should be given to improving consumer information. Providing information to consumers about the regulatory framework enhances their capacity to comply with that framework and should reduce 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, if necessary, complain, 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. As mentioned, the Building Commission has an extensive education campaign about the Building (Amendment) Act. The requirement in the statutory function 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

statutory function should be redrafted, to make it explicit that the regulators should provide information to consumers as well as building practitioners.

Draft recommendation 9.5

The Building Commission's and Plumbing Industry Commission's functions should be redrafted to encourage 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.

9.3.3 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 \$420 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.⁴ 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 turning out to be different than expected
- inform the choice of research and development projects, if the Building Commission and the PIC retain this function
- inform the development of policy
- inform building practitioners.

Given that the estimates 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 only need to be provided only every second or third year. It may be a larger effort to estimate the costs of new Regulations, although the method should be developed in the relevant RISs.

⁴ The components of the costs of regulation that should be included in these estimates are described in Appendix C.

The regulatory agencies are probably best placed to prepare these cost estimates, because they are the custodians of the necessary information. 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 report low estimates of the costs of regulation, where there is a choice. Requiring the publication of the assumptions and method used to calculate the estimates would reduce, but not remove, this concern. Having the estimates checked by an independent source would be an additional test.

Draft recommendation 9.6

The Minister for Planning should request that estimates are published every third year of the extent to which building regulations add to the cost of building houses. The method and assumptions used to develop the estimates should also be published. If the Building Commission or the Plumbing Industry Commission prepares the estimates, those estimates should be verified by an independent source.

9.4 Can the division of functions across the regulatory entities be improved?

The following functions need to be undertaken to encourage the efficient and effective operation and evolution of the regulatory framework:

- administering and enforcing the regulatory instruments permitted under the Building Act
- 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 into 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. In all of these options, the regulator's role is to 'administer regulations'. Administering Regulations, however, involves a large number of different tasks, undertaken in two different areas (building and plumbing). As explained in chapter 4, these functions are currently divided between the Building Commission, the BPB, the BAC, the BRAC, the BAB, and the PIC. The option of merging the PIC and the Building Commission is discussed later in the chapter.

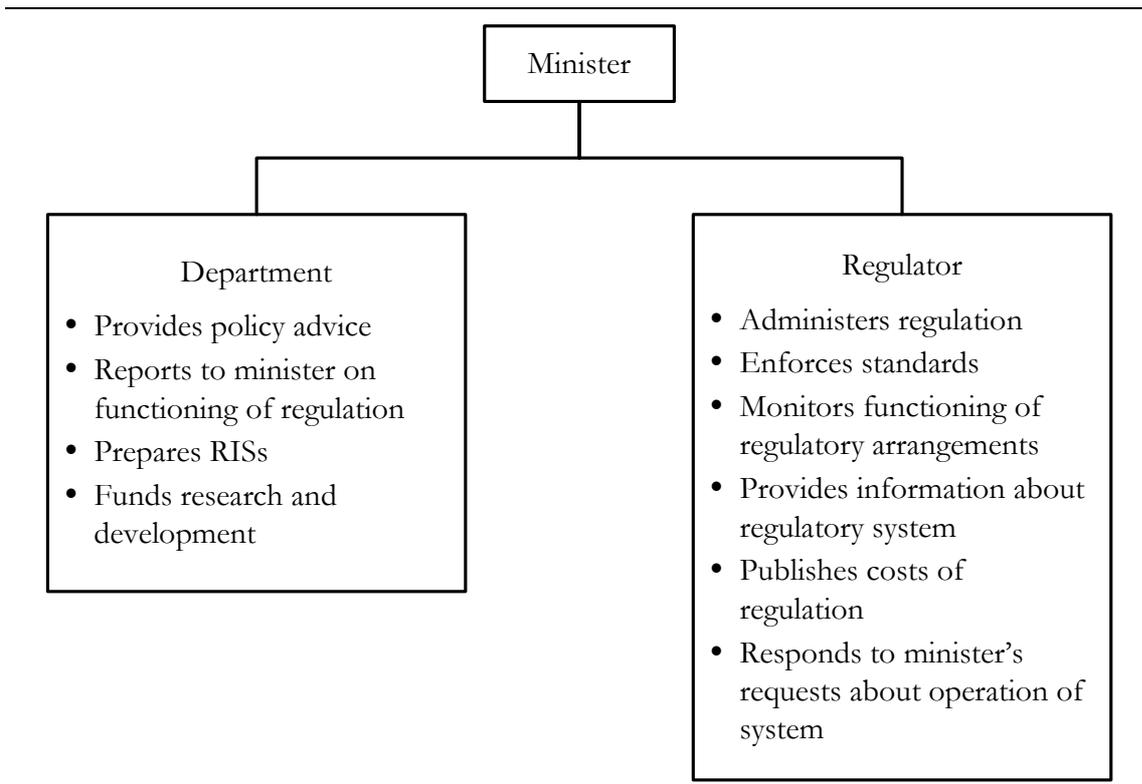
9.4.1 Separating the regulatory, leadership and policy roles

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. 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 would be wise to consult with the Building Commission and the PIC. 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), these could be undertaken by an appropriate department.

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. Accreditation, currently undertaken by the BRAC, would need to be undertaken by the Building Commission.

Figure 9.1 **Role allocation: option 1**



How significant would be the government's loss of the advice from the BAC, the BRAC and the PIAC? The Victorian Auditor-General assessed the role of the BAC in 2000, concluding that:

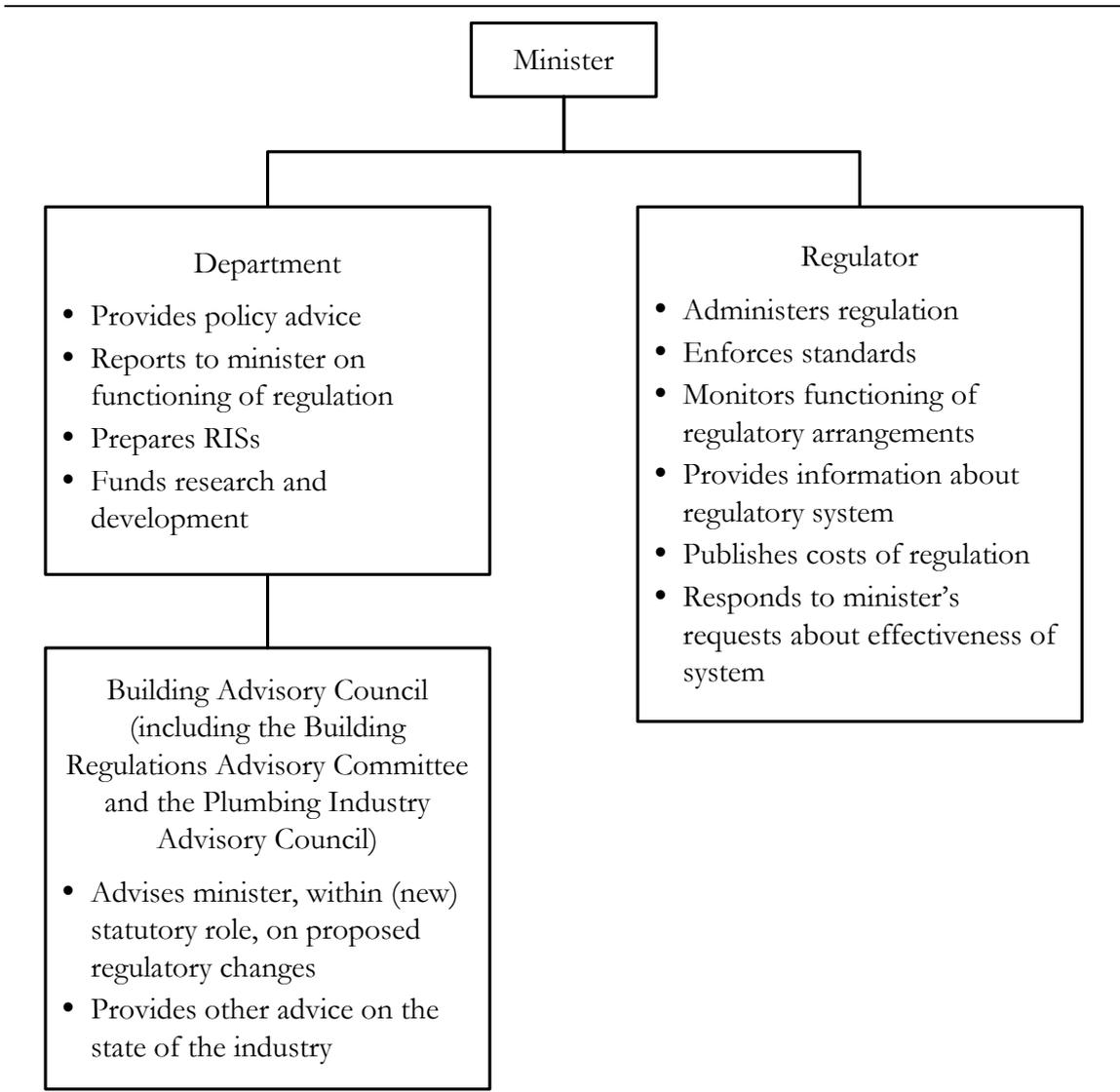
Given the extent of the overlap and ambiguity between the responsibilities of the council and the [Building] Commission, and the minimal advice provided to the minister in recent times, we are not convinced that there is a demonstrated need for the Council to exist in its current form. (Auditor-General Victoria 2000, p. 96.)

The Commission has not received any information about the extent to which the BAC's and BRAC's advice adds value and about what would be lost if the two entities were abolished, or about the costs of maintaining them. Given the significance of the industry, the government seems likely to gain some benefits from having access to stakeholders' views about the impacts of regulations through entities such as the BAC, the PIAC and the BRAC. While there is a risk that industry members will promote regulation that benefits their interests, they may also question the merits of regulation more than would either the regulators or the department. Adding more consumer representatives to the BAC should promote further questioning. Even without an advisory body such as the BAC, the industry will always want to make its views known to the minister. The question is whether the process can usefully be institutionalised. This depends, in

part, on the costs of running the advisory bodies—these costs are not publicly available.

Handing primary carriage for policy to the department would work effectively only if the department developed sufficient policy capability. The important policy role that the Building Commission has performed in recent years may have led to a diminished policy capability in this particular area in the department. Rebuilding this capability could involve transferring people with policy skills from the Building Commission to the department.

Figure 9.2 **Role allocation: option 2**



Option 2: Merge the BRAC, the BAC and the PIAC, and have the relevant department provide policy advice

A second option is to maintain a merged BRAC, BAC and 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. The merged entity's advice would help the relevant department to develop proposals about issues that the minister agrees should be addressed. The regulator would administer the proposals that are implemented. The new advisory body, since its membership is drawn from outside the public service, 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.

The advisory body could be chaired by someone from its membership of industry experts or by a senior official from the department.

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 both for providing policy advice on issues that need to be addressed and following them through to the development and implementation of policy proposals. In other words, the merged entity would undertake the roles typically undertaken by a government department.

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 are performing policy roles into the new organisation
- creates an organisation with a single focus.

The option also has some disadvantages, however:

- Setting up an organisational structure around an amalgamated BAC, BRAC and PIAC could open up concerns that the industry is dominating policy advice. In 2000, the then Chair of the BAC listed several weaknesses with the BAC, including that various industry interest groups nominate the members and therefore the body is not in a position to make independent judgements or give impartial expert advice, particularly given that consumers and those who pay the levy are not represented (Auditor-General Victoria

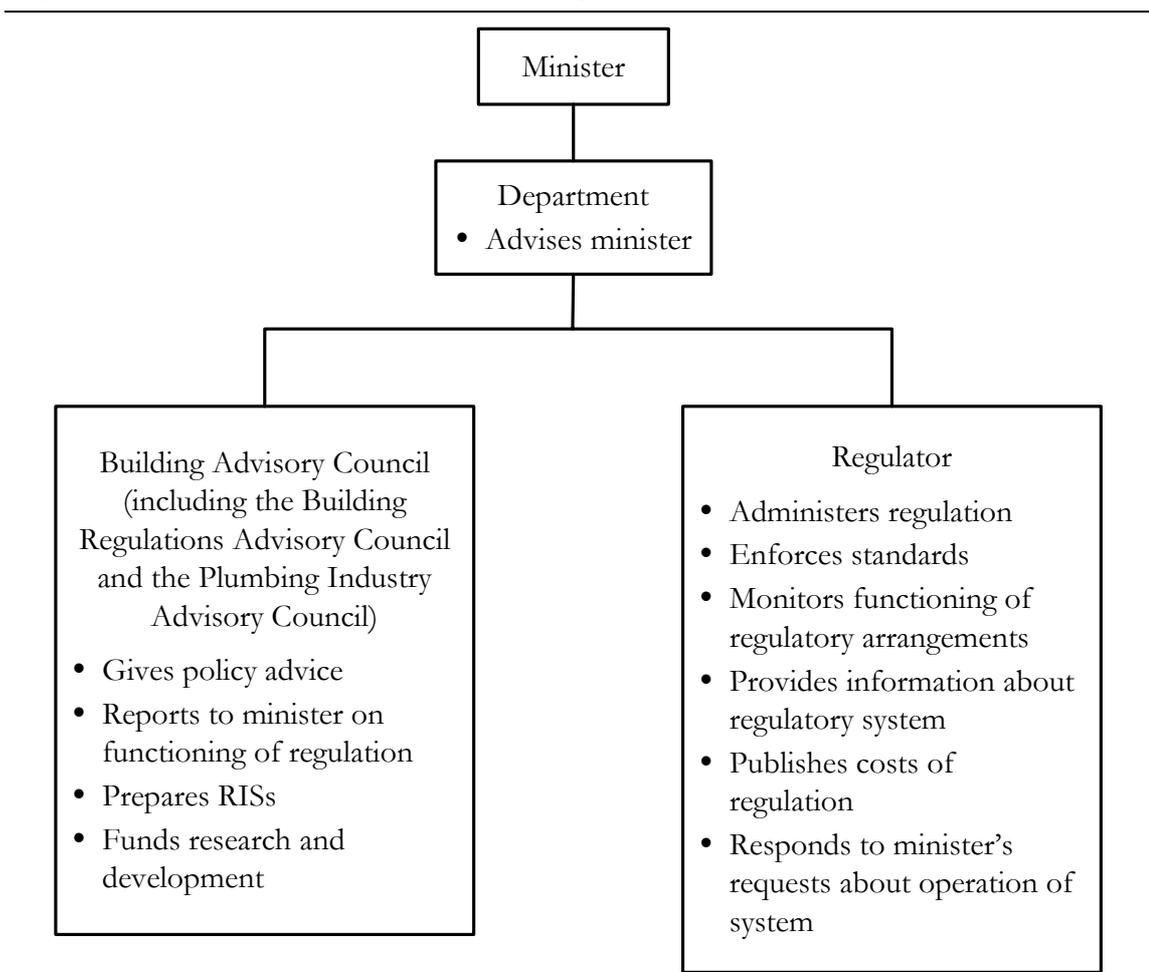
2000, p. 96). The City of Boorandara made a similar observation about the BRAC:

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. At the same time, 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 akin to 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 appropriate for them as well.

Figure 9.3 Role allocation: option 3



The Commission's view

The Commission favours option 2, compared with the current situation in which the Building Commission takes on both policy advice and 'leadership' roles. Option 2 separates these roles, but without creating the new 'mini-department' under option 3. For option 2 to succeed, appropriate policy capability would need to exist in the relevant department. Some policy capability should already exist; if it needs to be expanded, some Building Commission staff who currently undertake this role could be transferred to the department.

Under all of the options outlined above, 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? Should the Building Commission and the PIC be merged?

9.4.2 Licensing and registration

The Commission has considered three issues in relation to licensing and registration; whether:

- (1) licensing and registration for building practitioners and plumbers should be undertaken by one organisation
- (2) licensing and registration should be undertaken by an independent statutory entity or by the industry regulator
- (3) there is sufficient separation of the bodies responsible for licensing and registration and for hearing appeals against occupational licensing decisions.

A single licensing and registration authority?

A number of inquiry participants supported rationalisation of 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). Consumer Affairs Victoria 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 Building Practitioners' Board 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)

In a recent paper about occupational regulation in general, Ms Fiona Smith (Chairperson of the Business Licensing Authority (BLA)) and Mr Stuart Ward (a member of the BLA) argued that the advantages of centralising occupational regulation within the BLA 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)

Merging the occupational licensing functions of the BPB and PIC could have similar benefits.

The PIC was opposed to 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)

The Commission has insufficient information to assess whether the benefits of merging the licensing function, within either the BLA or the BPB, would exceed its costs. The Department of Sustainability and Environment, Consumer Affairs Victoria, the Building Commission and the PIC are in the best position to estimate the cost savings that would be achieved from these merger options. Nevertheless, the similarity of the functions suggests there should be some cost savings, while the problems identified by the PIC should not arise if the merger is limited to the registration function.

At this stage, the Commission favours merging the licensing and registration functions for building practitioners and plumbers, but it is seeking further information about the costs and benefits of both this option and the option of merging the function within the BLA. This information would assist in determining whether licensing/registration of building practitioners and plumbers should be combined in a single agency.

Request for information

The Commission seeks information about the costs and benefits of merging the registration and licensing functions of the Building Commission and the Plumbing Industry Commission within either the Building Commission or the Business Licensing Authority.

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 Commission has not been able 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 that has been mentioned in the context of the Business Licensing Authority is that:

The BLA is 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 and Ward 2004, p 13)

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 Commission welcomes further information about the advantages and disadvantages of these different approaches.

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 a further option, worth considering 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 Building Practitioners Board (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 Building Appeals Board (BAB), which can consider new evidence as part of the appeal process. Both the BPB and the BAB exist within the Building Commission, although they are separate statutory entities. The BAB is not a specialist occupational tribunal, as it also considers, for example, appeals relating to building permits, appointment of building surveyors, determination relating to protection work and building notices.

The Auditor-General's report on building control in Victoria examined the operations of the BAB against a series of 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 over its operations and procedural fairness to all parties (Auditor-General Victoria 2000, p. 71).

The report noted that the co-location of the BPB and the BAB staff may give the appearance of a lack of a clear separation between the two bodies, but found that as staff of the BPB are not involved in advising on appeals, there is very little risk associated with these arrangements. (Auditor-General Victoria 2000, p. 70)

It 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 and suggested the establishment of a database of previous decisions to assist the Board in reaching consistent decisions and provide some assurance for participants and the public.

The Commission has no reason to question the procedures or outcomes of the BAB when hearing appeals. It is, however, attracted to the complete separation of registration and appeals procedures, which would bring appeals and disciplinary procedures into alignment with those applicable to other registered occupations in Victoria. The Commission has no reason to think that the appeals function has been anything other than independent. However, the co-location of staff of the BPB and the BAB is likely to create a perception that the two bodies are linked. Complete administrative separation of the registration and appeals functions, by giving the appeals function to VCAT, would remove this risk. Based on the information at hand, the Commission considers that there is a case for complete administrative separation. The Commission intends to return to this issue in the final report.

9.4.3 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 that the responsibility of the new Office of Energy Safety extends well beyond housing construction, the Commission does not consider that amalgamating the Office of Energy Safety with the Building Commission and the PIC would yield net benefits, at least at this time.

However, the Building Commission and the PIC both focus on the building construction sector and the case for amalgamation seems potentially stronger. The following are possible arguments in favour of combining the two regulators:

- Given that the plumbing and building activities regulated by the Building Commission and the PIC are involved in the construction of buildings, having a single regulator, which can take a ‘whole of building’ perspective, could have advantages.
- There could be capital and operating cost savings—for example, indivisible costs associated with licensing functions or call centres could be spread across a larger customer base.
- Building practitioners and plumbers might find it less costly to deal with a single regulator.
- There could be increased flexibility to divert resources into particular regulatory activities.
- There may be slightly less 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, inspectors, 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.

From the available information, the Commission has not been able to reach a conclusion about whether the PIC and the Building Commission should be merged. However, the recent appointment of the chair of the Building Commission as chair of the PIC provides an opportunity to explore the cost savings of combining the two organisations.

Draft recommendation 9.7

The Government should task the chair of the Building Commission and Plumbing Industry Commission to identify opportunities for cost savings from merging the two commissions' activities without loss of effectiveness.

9.4.4 The way forward

Because there are so many regulatory bodies, with such a large number of functions, there are many options for changing roles and responsibilities. Section 9.4 has covered only the most obvious options.

Based on its analysis and the limited information it has seen thus far, the Commission favours:

- merging the advisory role currently carried out by the BAC, the BRAC and the PIAC into the BAC
- assigning accreditation of products and processes to a work group within the Building Commission
- making a department responsible for policy advice relating to regulation of housing construction. In developing its advice, the department would be expected to consult with both the Building Commission and the BAC.

These options are put forward as draft recommendation 9.8. The Commission is particularly keen to receive quantitative information on the costs and benefits of these and other options outlined in section 9.4. This information might include:

- the sources and proportion of overheads in budgets
- the proportion of building practitioners, plumbers and building owners who deal with both regulators
- capital and operating cost savings from merging various activities
- the costs associated with combining regulators.

Draft Recommendation 9.8

That the Victorian Government should streamline advisory bodies:

- **The Building Advisory Council, the Building Regulation Advisory Committee and the Plumbing Industry Advisory Council should merge.**
- **A government department should provide administrative support for this new entity, under budget arrangements approved by the minister.**
- **A new entity should be established within the Building Commission to undertake the accreditation role currently provided by the Building Regulations Advisory Committee.**
- **A government department should be responsible for providing policy advice about the regulation of housing construction, but in consultation with the Building Commission and the Building Advisory Council.**

9.5 Towards an improved regulatory framework

The Commission believes that the changes to the regulatory framework outlined 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 it 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 currently being reported by the main regulatory bodies, summarises evidence on their 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 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 Commission encourages 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).

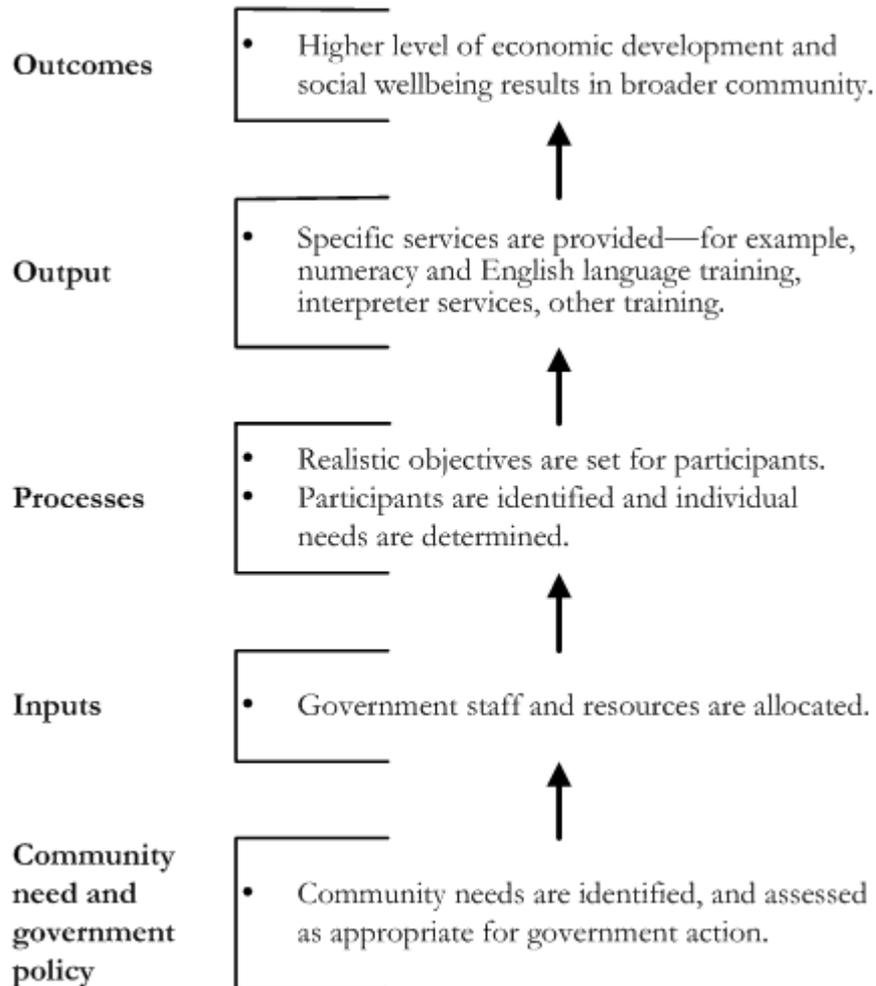
In addition to the role of performance reporting in increasing accountability, the same groups perceive it as a management tool that:

- 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 an analysis of 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, which helps 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 HM 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)

Performance measures should be unambiguously defined and easy to understand.

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 that they are 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’ for them
- there is a tendency to focus on what is easily measurable rather than what is important¹
- 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 (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 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 would not be revealed by time series data.

A second approach (which can overcome this problem) is for the organisation to benchmark itself against similar organisations. However, public comparisons can result in pressure on organisations to focus on indicators where they may lag behind others but which may not be the most important—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 will have accounting, human resources and information technology functions, for example, and comparisons

¹ The Export 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. (Export and Infrastructure Taskforce 2005, p. 41)

of the 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, 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 terms of reference, the Commission reviewed the Building Commission's corporate plan for 2002–07, which sets the direction for the organisation over the five-year period, and the business plan for 2003–04, which specified the activities that the Building 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'. 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 2002c, 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 Building Commission, and the outcomes in the Building Act. The first of the three outcomes that the Building Commission is seeking ('the quality of Victoria's buildings in terms of safety, habitability, accessibility and sustainability') is reasonably close to the two outcomes specified in the Building Act. However, it does not include amenity, and it has added references to accessibility and habitability. These words are not defined in the corporate plan. 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 is not explained.

Only one of the 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 8.1 measures the efficiency of the Building Commission's regulatory processes, in terms of either the costs to the commission of administering regulation or enforcing regulations, or the costs to building practitioners of complying with regulation.
- None of the indicators measures progress in achieving the desired health, safety and amenity regulatory 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 Commission reviewed the information provided in the Building Commission's annual report and its quarterly reports to the Minister for Planning.

The Building 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.

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 (BAB) decisions, the number of registered building practitioners, Building Practitioners Board (BPB) inquiries and dispute resolution. The statistics are mostly not identified as performance indicators in the corporate plan.

The Commission has not been made aware of separate performance reporting by the Building Advisory Council (BAC), the Building Regulations Advisory Committee (BRAC), the BPB, the Building Advice and Conciliation Victoria (BACV) and the BAB, beyond that in the Building Commission’s annual report and quarterly report to the Minister.²

Draft finding 10.1

The Building Commission has established a corporate planning framework. The objectives specified for the Building Commission in this plan are consistent with planning and shaping the industry in addition to regulating it, and are only loosely related to the objectives of the Building Act, which are imprecise. The Building Commission has established a performance indicator framework but is making limited use of quantitative measurement of its performance against these objectives.

10.4 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

² The BRAC 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 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 (Attachment1). Specific data for the measurement of long term impacts of the regulations is expected to be available in the future through the *Pulse* project conducted by the Building Commission to measure industry outcomes and performance. (sub. 57, p. 4)

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 believes that the health and safety outcomes of Victoria's plumbing system are the 'fundamental performance measure for the PIC', but points out that responsibility for these outcomes is shared with other regulatory bodies; in particular the Office of Gas Safety has 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)

In relation to health and safety outcomes associated with 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, which has been attributed to a plumbing fault, is evidence of this risk. The PIC does not publish any indicators relating to health and safety outcomes associated with other types of plumbing.

With respect to the level and efficiency of compliance, performance indicators reported by the PIC include:

- 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 number of investigations and prosecutions entailing non-compliance with the certificate and/or drainage requirements
- the time efficiency of the certificate and drainage inspection compliance requirements, which the commission sees as one measure of its efficiency in administering compliance certificate and inspection compliance³
- 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

³ 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 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 commission 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 who hold at least one licence or registration. Given that the PIC cannot check whether every plumbing job is carried out by the correctly licensed or registered person, it relies on the number of licences, registrations and accredited people as a good 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% 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%. (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. 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.

Information against a number of these indicators is provided in the PIC’s annual reports.⁴ 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.

Draft 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 Conclusions about the performance of the Building Commission and related entities

A crucial test of the appropriateness of the performance indicators—on which the Commission is required 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 well-structured performance reporting framework, but has been working within a legislative framework in which the outcomes it is required to achieve are set in general terms and potentially conflict with each other. In this context, it is not surprising that the Building 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 8). The Building 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 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

⁴ 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.

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 any apparent major adverse outcomes.

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)

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 are 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)

(continued next page)

Box 10.1 Inquiry participants' comments on the performance of the Building Commission and related entities (continued)

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. (NASH, 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)

Draft finding 10.3

It is not possible to draw firm conclusions from published performance information 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 Building 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.

10.6 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 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)

10.7 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 PIC to review their performance reporting framework;⁵ the current frameworks were implemented three years ago and their 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 database to develop its performance reporting framework, although Pulse was not developed for performance evaluation. Rather, the Building Commission describes Pulse 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 may be useful for developing performance indicators for the Building 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 information about a number of indicators that could be developed as measures of its performance.⁶ Table 10.2 provides illustrations and indicates the regulatory body for which the indicators seem most relevant.

⁵ 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)

⁶ Many more indicators are available in Pulse than are reported in table 10.2, but were not developed for use as performance indicators.

Table 10.2 Possible performance indicators reported in Pulse

<i>Regulatory agency</i>	<i>Pulse 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 BPB
	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 BPB inquiries and number of practitioners investigated by the BPB	
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 BAB
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 (Measure Listing)

The list of indicators in table 10.2 is long, but would need to be supplemented with, for example, indicators to measure the performance of the BAC and the BRAC, and the Building Commission's contribution to the health, safety and amenity outcomes specified in the Building Act. In addition, while some indicators may provide insights into the performance of the BPB, Victoria's Auditor-General suggested in 2000 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).

Draft recommendation 10.1

The Building Commission and the Plumbing Industry Commission should review their reporting frameworks to ensure they indicate how well the organisations 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 public reports of their performance against these indicators should be provided on an annual basis, beginning in 2006-07.

10.8 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, which focuses more on the efficiency with which resources are used.

Elsewhere in this report, the 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 being spent on these projects in 2003-04).

Draft recommendation 10.2

The annual reports of the Building Commission and the Plumbing Industry Commission should provide more information about the allocation of funds to the related regulatory bodies, and the rationale for this allocation and for expenditure on research and development. The Building Commission's annual report should provide more information about its expenditure on special projects.

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 (BPB), the Building Appeals Board, the Building Advisory Council, the Building Regulations Advisory Committee, the 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 the problems associated with poorly defined objectives and a lack of transparent 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 principal, the level of charges may affect the competitiveness of different types of businesses 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 Victoria. Where cost recovery charges can have a significant effect, however, is 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 the problems associated with poorly defined objectives and a lack of transparent 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 requiring 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 by 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, there is no existing framework in Victoria to provide an objective basis for assessing these concerns. Victoria does not have a cost recovery framework against which the Victorian Competition and Efficiency Commission could assess arrangements in the housing construction sector. The *Victorian guide to regulation* (State Government of Victoria 2005) 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.) (s.188) 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 recent draft inquiry report on *Regulation and regional Victoria*, the Commission concluded that there is scope to improve the clarity of cost recovery arrangements in Victoria. The Commission pointed to a need for additional guidance to be provided to regulatory agencies about 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.

To undertake an assessment of 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 they should be designed. It applies to regulatory charges—that is, the charges used by regulators to recover the costs of administering regulation. The framework is summarised in box 11.1 and is described in more detail in appendix B. The following sections apply the framework to fees and charges in the housing construction sector.

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 the boards established under the Building Act. All money received by the Building Commission must be paid into this fund. Monies paid into the fund comes from three main sources:

- (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 the associated regulators and is intended 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, payable to fund BACV
- (3) a building permit levy of 0.032 cents for every dollar of the cost of building work over \$10 000, payable to fund insurance liabilities arising from the collapse of HIH.

In addition, a variety of fees are prescribed under the Building Regulations. These include fees for requests for information relating to building permits, lodgement fees, Building Appeals Board fees, building product accreditation fees and cooling tower system annual registration and renewal fees. Some of this revenue is collected on behalf of other agencies. Cooling tower registration fees are collected by the Building Commission and transferred to the Department of Human Services. The building permit levy collected for the HIH rescue package

is paid into the domestic building (HHH) administration fund, which is administered by the Housing Guarantee Fund Ltd.¹

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.

The Building Commission also transfers 43.4 per cent of the BACV building permit levy to the domestic building fund administered by Consumer Affairs Victoria. Half of the registration fees for domestic builders are forwarded to Consumer Affairs Victoria and the Victorian Civil and Administrative Tribunal to maintain the domestic building list.

The Building Act, s.188(1)(a) provides that the minister may issue guidelines for fees charged under the Act. The Act states that ‘Guidelines relating to the fees

¹ The HHH levy is not considered further in this chapter because it is not a cost recovery charge and is due to expire.

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 Act². Guidelines relating to fees may specify maximum or minimum fees and different fees for different classes of case (s.188(2)(a) and (b)). The guidelines have differing degrees of force:

- council or private building surveyors may have regard for the guidelines (s.188(4))
- the BPB and the Building Commission must have regard for the guidelines (s.188(5) and (6)).

As an example, the guideline relating to BPB 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),² 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>
	(\$)	(\$)
Revenue from operating activities		
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
Total revenue from operating activities	15 669 104	17 955 863
Other revenue	582 279	702 422
Total revenue	16 251 383	18 658 285

Source: BC (2004a).

² 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>
	(\$)	(\$)
Expenditure on ordinary activities		
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
Total expenditure from ordinary activities	15 674 848	17 772 093

Source: BC (2004a).

Table 11.3 Plumbing Industry Commission revenue

	<i>2002-03</i>	<i>2003-04</i>
	(\$)	(\$)
Fees		
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
Total revenue	8 273 424	9 201 602

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 not explained in the annual report. 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>
	(\$)	(\$)
Expenses from ordinary activities		
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
Total expenses	8 155 857	8 798 383

Source: PIC (2004a).

11.4 Should the regulators 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 is 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 regulations are intended to benefit those in the industry, particularly consumers. Others are designed to benefit third parties, like the neighbours of those undertaking building work or the general community. The Building Commission is involved in:

- 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* 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 projects on 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).

Some of the 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:

- contributing to the development of the housing construction industry overseas
- developing new policy proposals and providing policy advice to government.

On the first area, 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 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, a more transparent approach to meeting these sorts of government requests is for the government to fund activities directly; for example through a direct payment to the Building Commission.

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, pay for these activities. This approach, however, is inconsistent with 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 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. 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. (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 claims 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 the activities of the regulators 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 regulators are inappropriately funding some activities 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. If a beneficiary pays model is adopted the extension of cost recovery to activities that benefit third parties is also questionable.

Draft 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 HIIH levy and the BACV levy should be transparently reported, and that the HIIH 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 (DSE) 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 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 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 the costs of the activities is weak. The DSE 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)

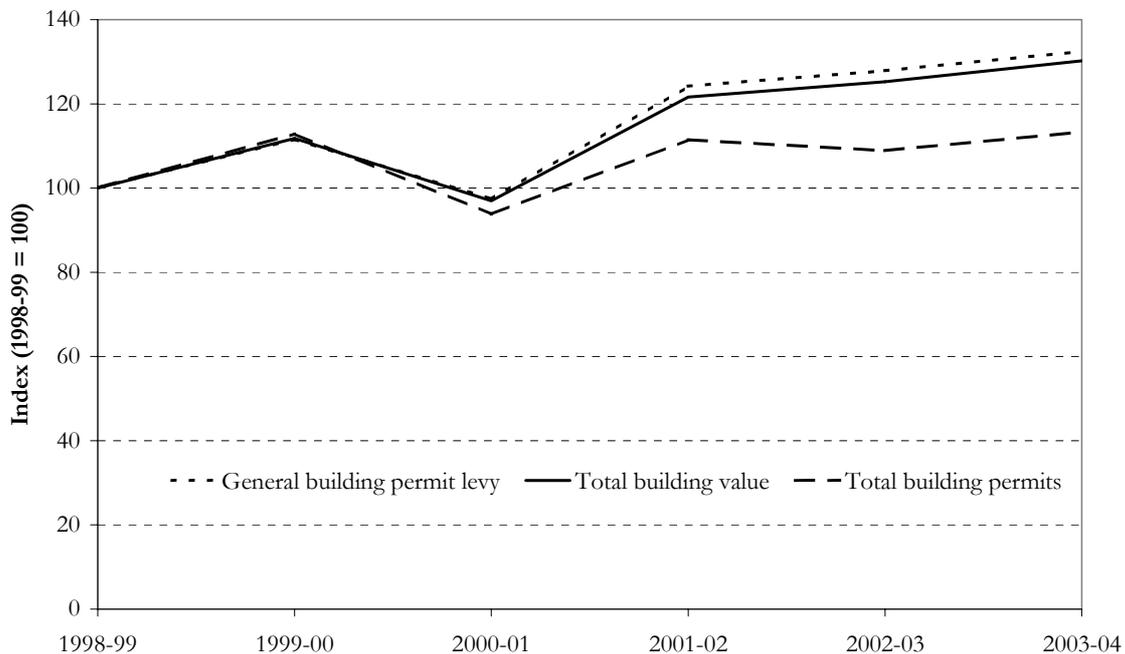
These fees are, however, above licence fees in some other industries. The annual licence renewal fee charged by the Building Practitioners Board (\$180) is high compared to those for some other occupations. According to information from the Victorian Institute of Teaching, the annual registration fee for a teacher in Victoria is \$60. This compares with the annual registration fees for nurses (\$80), architects (\$150) and medical practitioners (\$375) (Victorian Institute of Teaching 2005). The DSE, 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. 31-32).

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 revenues 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. The rise in the real value of the building levy has been substantial. BIS Shrapnel estimated that new housing starts in Victoria would fall by about 20 per cent over the next two years (Gordon 2005). If this happens, the effect of this decline 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 2005, pp. 29-30)

Figure 11.1 **Real value of building construction,^a the general building permit levy and building permits**



^a 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.

Source: BC 2004a, 2002a, undated A and ABS 2004b.

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:

It 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. (Macellan 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 the 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 that would be involved in administering it may not be justified, particularly given that surveyors would, presumably, already pass on to consumers the cost of collecting levies as part of the cost of the surveyor's services. It is less clear how councils currently recover these costs.

Draft 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 various regulatory activities are not understood nor 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. 17). 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. In the Commission's view, it is thus inappropriate for the BACV levy to apply to permits for activity not formerly subject to that warranty insurance.

Draft finding 11.3

The application of the Building Advice and Conciliation Victoria (BACV) levy is not linked to the activities that the BACV services are related to. It is inappropriate for the BACV levy to apply to all building activity, rather than just to that formerly covered by so-called 'first resort' home builders warranty insurance.

Accordingly, the Commission considers that the BACV levy should not apply to all building permits. Rather, it should only apply to those permits for residential construction—that is, for activity formerly covered by the so-called 'first resort' builders warranty insurance. The Commission is not able to comment on the specific cost implications of this recommendation. This is because neither the submissions nor the published accounts of the agencies responsible for the BACV service provide sufficient financial information for the Commission to form a view on this matter.

Draft recommendation 11.1

The Building Advice and Conciliation Victoria levy should only apply to building permits for residential building activity—corresponding to 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 is funded through 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; and 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 accessing specific regulatory activities. It 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 in fees and charges that are stifling competition or innovation. The PIC, in its RIS on the proposed Plumbing Regulations 1998, 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 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 builders. This context should be considered in 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 the charging system used. This risk is particularly high for the Building Commission because of its reliance on levies on the value of building activity. Without detailed information on cost recovered activities, 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 levy is not transparently linked to Building Commission costs or regulatory activities. This potentially generates a range of problems, many of which have been discussed. These problems 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).

Draft 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 discretion of

the Building Commission. Fees for the registration and licensing of tradespeople involved in plumbing and electrical installation work are set in Regulations. Some local government charges are set in Regulations (such as fees for requests for information relating to building permits and lodgement 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, the 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 the revenue collected by the Building Commission have been subject to an RIS process. Chapter 8 discussed the 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 activities undertaken by the Building Commission 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 and the PIC. It noted deficiencies in the current arrangements and recommended that more information be reported in annual reports about the allocation of funds to related regulatory bodies and the rationale for this allocation, and on expenditure on research and development. The Commission also recommended that both agencies should review their frameworks for reporting performance and have performance indicators linked to the outcomes sought under the Building Act.

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 subject these levies to scrutiny.

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 DSE 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.

Draft finding 11.5

There are no formal processes in place for transparently assessing the costs and benefits of many significant cost recovery arrangements or 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 report on the inquiry into *Regulation and regional Victoria*, concluded that there is scope to improve the clarity of cost recovery arrangements in Victoria. The Commission pointed to a need for additional guidance to be provided to regulatory agencies about 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 inquiry 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.

Draft 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 clear guidance from the Victorian Government on the model it wishes to use for cost recovery, and substantially more information on the activities undertaken by the Building Commission and the costs of those activities. However, there are some indications that there is scope for a significant reduction in the 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 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 levies³ to be halved.

The Commission also identified deficiencies in local government cost recovery arrangements in its inquiry into *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 2005, 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.

³ Excluding the HIIH levy, which is not a cost recovery charge but is anticipated to expire.

Draft 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 the range of activities undertaken by the Building Commission (consistent with the 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 alternative mechanism to ensure that the costs and benefits of these fees are fully analysed**
- **establishing a program to monitor and review the effectiveness and ongoing appropriateness of the charging arrangements.**

Two options 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 significant cost recovery arrangements by housing construction regulators. The information reported to the Department of Treasury and Finance and published in the budget papers should be able to be reconciled against the information provided in the regulatory agency's annual report.

Draft 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. Each housing construction agency should report annually on its cost recovered activities and revenue, and on the implementation of the Victorian Government's cost recovery guidelines. This information should be reported in the budget papers.

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 notes 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 2004b)

These contributions can be raised for a range of state and local government-provided infrastructure, such as roads, stormwater systems and community facilities. Development contributions 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, where charges under the system apply, they 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 associated with the provision of reticulated water, sewerage and drainage facilities under the *Water Act 1989* (Vic.). Only the development contribution system, however, is within the Victorian Competition and Efficiency Commission's terms of reference.

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.¹

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 feature 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—s.62 enables the application of conditions on a planning permit for development to recover the cost of the impact of that development where a need for works, services or facilities is necessitated by the development.
- (2) Negotiated voluntary agreements—s.173 agreements enable the responsible authority (which is usually the relevant council, but might also be a state government authority) to enter into 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 for the provision of works, services and facilities, from multiple landowners.

Development contribution plans are expected to be the main method used to levy new development for contributions under the system (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.

¹ 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 particular emphasis on the operation of development contribution plans. The review, which embodied extensive consultations,² 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 underlie 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 broad 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 contains a summary of the problems the review identified within 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 (PCA)—a long time critic of developer charges.

² The review included comprehensive consultation via workshops across metropolitan Melbourne and regional Victoria, and submissions. 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 believed 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 wishes 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 for inclusion in a development contribution plan, such as off-site environmental impacts or bringing forward 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 regarding justification for 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.

Source: DSE sub. 84, pp. 111–12; DCRSC 2001, pp. iii–iv, p. 9.

The PCA 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 2003b) 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 that 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 (MAV) 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 contribution 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 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.

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 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's view is 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. This same 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 Productivity 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 Productivity 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, as 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 in establishing 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 between efficiency, equity and administrative costs (PC 2004a, p. 167).

The Commission would expect that annual auditing of the operation of the development contribution system (proposed below) would also provide information on 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 PCA, for example, argued that using developer contributions to provide infrastructure delivers vastly inferior economic benefits than delivered by alternative measures. The PCA, on the basis of work it had commissioned, considered that if the objective of the state and local governments is to increase economic output, employment and community

wellbeing in the long run, they should eschew developer levies and choose a better instrument:

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 more efficient and cost-effective than developer contributions. 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, 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 cause of this problem is clearly stated by the National Office of Local Government: '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 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.

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 PCA 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 where this had occurred.

Langford Jones Homes criticised the imposition of many developer charges by local councils, claiming these 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)

Elsewhere, the Master Builders Association of Victoria (MBAV) 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 viewed the current system as having inadequate mechanisms to prevent abuses by councils. The Municipal Association of Victoria considered the reforms introduced by the state 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 the cost and timing of each item of infrastructure and the catchment it serves 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 also subjected 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:

- exhibiting the proposed amendment in the area for which the plan is proposed to apply
- receiving and considering submissions
- a review of submissions by an independent panel appointed by the Minister for Planning
- adoption of the development contribution plan amendment by council
- submission to the Minister for Planning for approval.

Further, to ensure there is accountability for the levies collected, the Act requires that if a development is not to proceed, 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 various arrangements provide grounds to believe the system, in theory, embodies sufficient transparency and accountability to prevent it being abused. But theory and practice do not always coincide, and 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, at either the individual council level or across the system more generally.

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 were 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 (annually) audit a 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. These 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 the 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 PCA commented that it:

... believes 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 Housing Industry Association (HIA) has 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 upfront charges and through property rates. (HIA 2003b, p. 38)

The DSE 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 of Sustainability and Environment 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 the inclusion of 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 Commission acknowledges the Act embodies requirements that would help 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. On this matter, 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.

Draft finding 12.1

The *Planning and Environment Act 1987* (Vic.) 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 embodied in the development contributions system that are designed to prevent abuses of that system. Independent monitoring of councils’ adherence to the requirements embodied in the Act and related guidance material is needed to identify how effective those requirements are, and if and where reform might be needed.

Draft recommendation 12.1

Local councils should in their annual report provide a statement of compliance with the Development Contributions Guidelines and ensure internal governance arrangements facilitate the monitoring of contributions for compliance with these guidelines. Disclosure of the collection and disbursement of development contributions within the annual report should be provided by local councils to facilitate transparency and accountability.

Draft recommendation 12.2

There should be an annual audit of a sample of councils to assess their adherence to the conditions of their development contribution plans, the relevant requirements contained 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.

State agency 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 DSE considered that these reforms address the shortcomings of the former system and will successfully relieve local government of the burden previously placed on them (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 only introduce an administrative efficiency 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 current arrangements are adequate to ensure state agencies are held 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 the management of levies is subject to the provisions of the *Financial Management Act 1994* (Vic.).³ 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

³ 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.

contribution plans—in particular, good practice with respect to account keeping for the purpose of collecting and tracking 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 on which to judge how well the arrangements are working.

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 were directly contributing to a reduction in the affordability of housing. This line of argument 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). The 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 provided an indication of 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.

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	
Total		32 507

Source: Spiller Gibbons Swan 2001, cited in DSE, sub. 84, p. 120

One significant change since this data was apparently 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.

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 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. (PC 2004a, p. 155)

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) what is the extent to which development contributions add to the cost of housing (and diminish affordability), or are they 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 terms of reference for this inquiry.

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.

Implementation issues

Reforms to the development contributions system introduced in 2003 were supported with accompanying guidance notes, a building practice note and ministerial order. 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 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 with regard to setting standard levies under off-the-shelf development plans. Guidance material for this is still being finalised by the Department of Sustainability and Environment. Given this lack of guidance material is impeding the implementation of some aspects of the reformed system, this material should be produced and made available as soon as possible.

Draft finding 12.2

Recent change to the development contribution system has not been accompanied by the timely supply of revised guidance material. The lack of this material is impeding the implementation of some aspects of the reformed system (notably the use of off-the-shelf development contribution plans).

Draft 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 as soon as possible.

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) designed 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 initially released in 2003—has yet to be updated.

For the most recent reforms, the current development contributions system is short on performance history. Therefore, it is premature 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 described in the Productivity Commission report on first home ownership (PC 2004a, p. 155).
- The system appears to lack a formal mechanism to monitor/audit how it is operating. Rectifying this would increase the likelihood that the system will perform as expected and would provide timely warning of where further reform might be needed. This should be achieved by improved council governance arrangements, greater public disclosure and independent audit reviews.
- Revised guidance material to support setting standard levies under off-the-shelf development contribution plans is yet to materialise. This appears to be impeding some councils from implementing aspects of the new system. This issue needs to be addressed immediately.

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 this draft report (section A.2). Inquiry participants will also have an opportunity to make new (or further) submissions prior to the delivery of a final report to the government.

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, the Commission held targeted meetings with industry and government representatives—including the Commission’s attendance of the Geelong and district section meeting of the Master Builders Association of Victoria in February 2005; and a roundtable of builders which was jointly organised with the Housing Industry Association in March 2005 (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. The Commission received 91 submissions from individuals and organisations (table A.1).

Table A.1 Submissions received

<i>Participant</i>	<i>Submission no.</i>
Action for More Independence & Dignity in Accommodation	11
Air Conditioning & Mechanical Contractors' Association	04
Alternative Technology Association	73
Architeam Cooperative Limited	39
ARROW	24
Australand Property Group	05
Australian Business Council for Sustainable Energy	32
Australian Conservation Foundation	54
Australian Glass and Glazing Association	77
Australian Institute of Building Surveyors–Victorian Chapter	41
Australian Liquefied Gas Association	90
Australian Owner Builders and Build Safe	62
Australian Steel Institute	21
Baglin, John/Plumbers Choice National Trade News	03
Beston SMD Ltd	07
BlueScope & Stoddart Victoria	72
BlueScope Steel Limited	48
BMG Plumbing	27
Bruce Hamer Homes Pty Ltd	20
Builders Collective of Australia	38, 79, 87
Building Appeals Board	74
Building Designers Association Victoria	43
Building Ethics Australia Pty Ltd	34
Building Practitioners Board	26
Building Products Innovation Council	46
Building Regulations Advisory Committee	57
Business Licensing Authority	61
CGU Insurance Limited	15
Chiwest Investments Pty Ltd	67
City of Boroondara	66
City of Melbourne	45

Table A.1 Submissions received (continued)

<i>Participant</i>	<i>Submission no.</i>
City of Wodonga	89
Civil Contractors Federation	47
Clark Homes Pty Ltd	06
Clarke, Travis	02
Colmac Homes	80
Communications, Electrical Plumbing Union–Plumbing Division	25
Consumer Affairs Victoria	91
Cronin Builders	51
Department of Infrastructure	63
Department of Sustainability and Environment	84
Disability Resources Centre Inc	42
Disability Support and Housing Alliance	59
Equal Opportunity Commission Victoria	75
Geelong & District Section of the Master Builders Association of Victoria	76
Gilbert, Barry	01
Glenvill Pty Ltd	08
Housing Industry Association	58
Insulation Council of Australia & New Zealand	28
JMS Home Builders Pty Ltd	82
Johnstone, Valerie	55
Langford Jones Homes	14
L&F Holdings Pty Ltd	83
Macedon Ranges Shire Council	50
Marsh Pty Ltd	30
Master Builders Association of Victoria	49, 88
Master Plumbers & Mechanical Services Association of Australia	12
McCormick Building Pty Ltd	33
Metropolitan Fire and Emergency Services Board and Country Fire Authority	53
Moreland Energy Foundation Ltd	13
M R Constructions	78
Mt Gisborne Plumbing and Drainage	10

Table A.1 Submissions received (continued)

<i>Participant</i>	<i>Submission no.</i>
Municipal Association of Victoria	64
National Association of Steel-Frames Housing Inc	35
National Electrical & Communications Association–Victorian Chapter	16
Office of Gas Safety	31
Office of the Chief Electrical Inspector	18
Plan Scan (Aust) Pty Ltd	44
Port Phillip Constructions	81
Power Property	85
Property Council of Australia	69
Reddo Pty Ltd	70
Residential Metal Roofing Industry Association of Victoria Ltd	23
Robert Knott & Co Pty Ltd	37
Roofing Tile Association of Australia Inc	60
SITA Environmental Solutions	17
Stewart, Chris	68
Stoddart Victoria	22
Stuart McLennan Associates	65
The Chairman of the Australian Building Codes Board	09
The Royal Australian Institute of Architects & Archicentre Limited	40
The Victorian Local Government Disability Planners Network	56
Timber Promotion Council	52
VERO Insurance Ltd	71
Victorian Council of Social Service	29
Yarra City Council	36
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 were 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 regulatory 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).

Table A.3 Stakeholder consultations

<i>Organisation</i>	
Archicentre Limited	Janvac Constructions
Australian Building Codes Board	Ken Weir and Associates
Australian Institute of Building Surveyors	Master Builders Australia Inc
Australian Owner Builders (Victorian Branch)	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
Building Commission	Plumbing Industry Advisory Council
Building Practitioners Board	Plumbing Industry Commission
Building Regulations Advisory Committee	Plan Scan
Business Licensing Authority	Productivity Commission
Clay Brick and Paver Association of Victoria	Property Council of Australia (Victorian Division)
Consumer Affairs Victoria	Royal Australian Institute of Architects (Victoria)
Department of Sustainability and Environment	Simonds Homes
Gumleaf Design Builders	Spacemaker Home Improvement Company
Housing Institute of Australia (Victorian Branch)	Vero Insurance Limited
Insurance Council of Australia (Southern Division)	

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 2001, 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.¹ 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 2005 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 administration. The Victorian Competition and Efficiency Commission’s

¹ 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.

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 2005, 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 2005) 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 2005, 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 2001, 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.² 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

² 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.³

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

³ 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 2001), 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 2005, 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 2005, 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 2001, 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 2005).

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 2005, 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 2005, 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 regulations are introduced, assessing the costs and benefits of existing regulation is also desirable when reviewing the regulatory framework.

Assessing regulatory costs and benefits is not straightforward because the information needed is generally not readily available. Further, identifying and measuring regulatory costs and benefits raises a number of challenging conceptual issues.

The Commission has been transparent about the data provided and assumptions made to allow the estimates presented in this appendix to be challenged.

Request for information

The Commission welcomes further responses from industry practitioners regarding the costs of complying with the selected regulations.

Copies of the Commission's survey questionnaire are available on the Commission's website, www.vcec.vic.gov.au, and from the Commission on request.

C.1 Objectives of this exercise

The objective of this exercise is to estimate the costs of Victorian and (selected) local government housing construction regulation. In particular, this appendix seeks to:

- provide an indicative estimate of the aggregate costs of housing construction regulation
- identify the relative significance of specific regulatory costs.

There is a lack of robust, consistent and comprehensive estimates of the cost of housing construction regulation in Victoria, and in Australia generally. There have been attempts to cost some elements of the regulatory framework, either as part of regulatory impact statements, or through industry surveys or other studies. There have been very few attempts, however, to estimate the overall cost of the housing construction regulatory framework. 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 therefore merit further consideration.

This appendix 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

Regulations 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 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 in order 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 regulations on the housing construction process.

In addition, there are costs incurred by state and local governments in administering and enforcing the regulations, which may be recovered (in full or in part) by fees or charges.

C.2.2 The Commission's approach

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. Recognising the complexities, the Commission offered to meet with 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 that may be better directed to other industry practitioners. The Commission sought the survey respondents’ responses to the second set of questions where relevant and where time permitted.

The Commission sought estimates of the capital costs, administrative costs and the efficiency costs of complying with the regulations. Estimating the efficiency losses that result from market distortions that the regulations might be causing proved to be difficult to estimate and, therefore, 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 over and above the costs that would be incurred if there was no housing construction regulation (box C.2). There may be unmeasured indirect costs due to barriers to competition and innovation.

The Commission has applied the same hourly rate to the survey respondents’ estimates of the administrative burden for consistency in treating administrative costs. The value used in these examples is \$40 per hour. This estimate is derived from the Australian Bureau of Statistics (ABS) data on average weekly earnings (ABS 2005b). The base wage values are adjusted by assuming a 50 per cent level of on-costs and a 38-hour working week.¹ The Commission welcomes feedback on the appropriateness of this approach.

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.

¹ The Commission used the overall measure of average weekly earnings rather than a construction industry-specific measure on the grounds that, particularly for larger builders, many administrative tasks may be undertaken by dedicated administrative staff rather than by the builder. This approach is also consistent with that used by the Commission in other exercises. Nonetheless, choosing the overall measure rather than a construction-specific measure does not have significant cost implications (the equivalent hourly rate for construction would be one dollar higher than the overall rate).

Box C.2 Estimating incremental costs

Ideally, the costs of regulatory compliance should only include the incremental costs of compliance, or the additional costs that are incurred over and above the costs that would be incurred if there was 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 under-estimated as a result (Rimmer and 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 builders' warranty 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, 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 sub-contractor or even an owner-builder. The cost of the regulation should ideally also include the cost of these indirect supply-side changes.

Clearly, the incremental costs 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'—what would happen if there was no regulation—with any certainty.

One option could be to look at a similar, but unregulated, market, for example, builders warranty insurance is not required for buildings over three storeys (with two or more separate dwellings) in Victoria. There are however likely to be a number of factors (in addition to insurance) that 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 may offer some promise, the complexity of the regulatory framework and the observation that it is continually evolving suggests it would be difficult to observe the effects of an individual regulatory change.

Recognising these challenges, the Commission asked the businesses to provide estimates of the cost of labour, goods and services, the administration time involved, and any other costs in complying with the regulations. The Commission 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—this 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

The Commission approached industry associations—the Housing Industry Association (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 for the Commission to meet with.

The Commission spoke with representatives from 12 businesses (table C.1). The sample included seven building businesses, ranging from small businesses conducting less than 10 jobs a year up to a large business constructing over 1000 houses each year; two building surveyor businesses; and three architects. The sample included businesses working exclusively in metropolitan areas; businesses working in both metropolitan and regional areas; and one business working exclusively in regional Victoria.

Table C.1 **Survey respondent profile**

<i>Practitioner</i>	<i>No. jobs per year</i>	<i>Region</i>	<i>Other</i>
Builder A	< 10	Metropolitan Melbourne	New houses, additions and alterations
Builder B	30–40	Metropolitan Melbourne	New houses
Builder C	30–35	Metropolitan Melbourne	Additions and alterations
Builder D	70–100	Metropolitan Melbourne	New houses, multi-unit developments
Builder E	> 1000	Metropolitan Melbourne and regional Victoria	New houses
Builder F	-	-	Commercial ^a
Builder G	30–35	Regional Victoria	New houses
Building surveyor A	1200 ^b	Metropolitan Melbourne and regional Victoria	New houses, additions and alterations
Building surveyor B	700 ^b	Metropolitan Melbourne and regional Victoria	New houses
Architect A	< 10	Metropolitan Melbourne	Additions and alterations
Architect B	< 10	Metropolitan Melbourne and regional Victoria	New houses, units, additions and alterations
Architect C	10–20	Metropolitan Melbourne and regional Victoria	New houses, units, additions and alterations

^a Not currently undertaking domestic building work but maintains domestic builder registration.

^b Number of building permits issued.

C.2.2 Indicative estimate of the cost of housing construction regulation

The survey respondents' estimates suggest that the selected Victorian and local government regulations represent *at least* 4 per cent of the value of an average house (estimates ranged from 4 per cent to 20 per cent) (table C.2). Based on the survey evidence, 4 per cent represents the *lower bound* of the estimates of the cost of the selected Victorian and local government regulations. The lower limit of the estimated cost of complying with the regulations is much higher for some survey respondents, in fact, the average lower bound of the estimates presented in table C.2 is 8 per cent. The Commission considers that 4 per cent is the lower end of the total cost of regulations, particularly given that survey respondents were not able to provide cost estimates for all the regulations identified and that information was not sought for all regulations affecting housing construction in Victoria.

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 \$10.5 billion in 2004. This suggests that housing construction regulation cost *at least* \$420 million in 2004. Noting the discussion above, however, this cost could be considerably higher.

The estimated cost of at least \$420 million does not include the costs of levies—the building permit levy (0.064 per cent), BACV levy (0.064 per cent) and 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 \$16.8 million in 2004. Including this estimate of the cost of the levies suggests that the cost to businesses of complying with the selected regulations was at least \$436.8 million in 2004.

While \$436.8 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's view is 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.

This appendix attempts to provide indicative estimates of the costs of regulations and identify those regulations where closer consideration of costs and benefits may be warranted. It does not attempt to determine whether the regulations are yielding net benefits.

Indicative cost estimates: new houses

Five builders engaged in 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 both the direct costs, additional expenses and administration time involved in complying with the specific regulations for an 'average' house.

Table C.2 indicates that, at an aggregate level, the participants' views of the costs of some of the selected regulations varies widely—from around 4 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 costs of an 'average' house for each respondent (the cost of an 'average' house ranged from \$150 000 to \$400 000). Further, there are a number of additional factors that are likely to influence the observed differences in the percentage cost estimate:

- Some survey respondents provided estimates of a wider range of costs than others, for example, survey respondents A, B, C and E provided estimates for the core set of regulations. Survey respondent D and the HIA submission, however, also provided estimates for some of the additional areas of regulation.
- The way that survey respondents estimated costs differed; for example, survey respondent B estimated the regulatory cost of building permits to be higher than that estimated by other survey respondents. Survey respondent B estimated the costs of obtaining a building permit today relative to that of 20 years ago (when less detailed information was required to obtain a building permit), noting that obtaining a building permit today includes incurring engineering costs, the costs of developing more detailed plans, and the costs of administration and delays that were not present 20 years earlier.
- The extent to which the cost estimates reflect the cost to the builder versus the final costs to consumers is also likely to differ. One survey respondent provided estimates of the costs of the regulations to consumers. These may reflect some markup to allow for profit and therefore may be higher than estimates of the costs faced by builders.
- The size of the survey respondents' businesses varies 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

	HLA ^a	New house A		New house B		New house C		New house D		New house E	
		Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)
Builders warranty insurance		2	2800	2–3	2500–4000	0.5	885 ^h	4.03 ^k	1300	1.5	734
Building permits		3			\$10 000–15 000 ^e	4		1	\$650–700 (metro) \$900–1000 (regional)	2	
5 Star energy efficiency	3300		10 000	16	10 000–18 000		250	22	10 250 ^l	2	6175–10 175 ^q
Water saving devices	2500				4500 ^f				150		r
Termite protection		1	500	5–6	1000–4000		1000	3	1200 (metro) 3000 (regional)	0.5	1800 ^s
Perimeter scaffolding	10 000–12 000	3	Single: 1000 Double: 6000 ^c	2–3	5000–15 000 ^g		4250 ^{*i}	3 (single) 6 (double)	Single storey 1500 Double storey 9000 (metro) 10 000 (regional) ^m		2000–3000 ^t
Electrical tagging	260		200								
Council property information	0–300			8–10	500		65 ^j		75	1	50 ^u
Temporary site fencing	900 full site 450 front	1	500	1	500–800		200	2.4*	900*(full) 60*(front) ⁿ	Not required	Not required
Rubbish containers and tipping fees	350–450				700–800		300	3	500		700
Sediment control measures	300–500				300–400		250	0.6*	80* ^o		100 ^v
Temporary vehicle crossing	b							0.3*	40* ^p		
Other											
Sub-total	17 160–20 210	10	15 000–20 000	34–39	35 000–62 500	4.5	7200	39.3–42.3	15 805–27 295	7	11 559–16 559
Certificates of compliance (plumbing)	60										
Temperature control valves	150							3	500		

Table C.2 Indicative cost estimates: new houses (continued)

	HLA ^a	New house A		New house B		New house C		New house D		New house E	
		Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)	Admin. time (hrs)	Other costs (\$)
Electrical safety switch	80							85–100			
Certificates of electrical safety	60										
Lockable meter boxes	250							100			
Mains powered smoke alarms								150 single 225 double			
Sub-total	600							3	835–925		
Total admin. d(\$)		400		1360–1560		180		1692–1812		320	
Total other (\$)		15 000–20 000		35 000–62 500		7200		16 640– 28 220		11 559–16 559	
TOTAL (\$)	17 760– 20 730	15 400–20 400		36 360–64 060		7380		18 332–30 032		11 879–16 879	
Average project value (\$)	150 000	400 000		325 000		150 000 – 200 000		200 000		170 000	
Share of average project (%)	11.8– 13.8	3.9–5.1		11.2–19.7		3.7– 4.9		9.2–15.0		7.0-9.9	

* This reflects the cost to the 'average' house, the actual cost is higher but is not incurred for all houses. ^a HIA (2003b) submission to the Productivity Commission Inquiry into first home ownership, pp. 93–4; ^b Estimate of \$82.50 to \$2570 including temporary vehicle crossing and other costs included elsewhere; ^c 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 prior to introduction of regulations; ^d Assuming administration time is costed at \$40 per hour; ^e 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; ^f Water tank; ^g Estimated cost ranges from \$5000 per single storey house up to \$15 000 for a double storey house; ^h 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); ⁱ Based on 60% of properties requiring scaffolding at a total cost of \$7080 (guard rail at \$1750 and scaffold at \$5330); ^j \$30 for property information and \$35 for stormwater drainage information; ^k Four hours per house plus one week a year (over 1500 houses) to maintain policy; ^l Estimate costs per house of \$10 000 to comply plus \$250 to obtain rating; ^m Estimate that use a guard rail on 50% of single storey houses and scaffolding on 100% of double storey houses; ⁿ Estimate of cost for 'average' house based on 20% of properties require front fence at total cost of \$300, and 60% require full site fencing at total cost of \$1500, and requiring 3 hours administration; ^o Estimate for 'average' house based on sediment control measures required for 20% of properties at cost of \$400 and requiring 3 hours administration; ^p Estimate for 'average' house based on temporary vehicle crossings required for 10% of properties at a cost of \$400 and requiring 3 hours administration; ^q 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. Estimates that approximately 20% of houses would achieve the 5 Star standard if this was not regulated; ^r The cost of solar hot water service included in estimate of the costs of 5 Star energy efficiency requirements; ^s Builder advised that 100% of houses would install termite protection if it were voluntary; ^t Applies to double storey houses only (proportion not available); ^u Nominal cost; ^v Silt fencing costs \$200 (\$100 to install and \$100 to maintain) and is required for 50% of houses.

Indicative cost estimates: additions and alterations

Two survey respondents engaged in constructing additions and alterations provided estimates of the costs of regulatory compliance. Their responses are listed in table C.3. Table C.3 presents the survey respondents' estimates of both the costs and administration time involved in complying with the specific regulations for an 'average' house for each of the respondents. Table C.3 also expresses the estimated costs of regulation as a share of the 'average' addition or alteration project.

While the sample is small, table C.3 indicates that, at an aggregate level, the costs of complying with the selected regulations as a proportion of the average project are broadly similar. Aggregation of the estimates provided suggest the cost of regulatory compliance ranges between 3.6 per cent and 5.5 per cent of the value of an average project for survey respondent A, and between 4.5 per cent and 6.7 per cent of the value of an average project for survey respondent B.

Table C.3 suggests that at an aggregate level, the costs of regulation as a proportion of the total project value for additions and alterations tend to be at the lower end of the equivalent estimates for new houses. There are a number of likely reasons for this observation:

- The extent to which regulations apply to both new houses and additions and alterations appears to differ; for example, the energy efficiency requirements differ between new houses and additions and alterations.
- The results reflect the experience of a small number of survey respondents and may not be indicative of broader experience.

Table C.3 Cost estimates: additions and alterations

	<i>Addition/ alteration A</i>		<i>Addition/ alteration B</i>	
	<i>Admin. time (hrs)</i>	<i>Other costs (\$)</i>	<i>Admin. time (hrs)</i>	<i>Other costs (\$)</i>
Builders' warranty insurance	1.7 ^a	800	2	2000
Building permits	40 ^b	-	3	-
5 Star energy efficiency	-	-	-	5000
Water saving devices	-	-	-	-
Termite protection	-	1000	1	500
Perimeter scaffolding	3	800–3500 ^c	3	Single: 1000 Double: 6000* ^f
Electrical tagging	-	500 ^d	-	200 ^g
Council property information	2–3	50	-	-
Temporary site fencing	-	-	-	-
Rubbish containers and tipping fees	-	-	-	-
Sediment control measures	-	-	-	-
Temporary vehicle crossing	-	-	-	-
Other	-	-	-	-
<i>Sub-total</i>	<i>46–47</i>	<i>3150–5850</i>	<i>9</i>	<i>8700–13 700</i>
Total admin. costs ^e (\$)		1840–1880		360
Total other costs (\$)		3150–5850		8700–13 700
TOTAL COSTS (\$)		4990–7730		9060–14 060
<i>Average project value (\$)</i>		<i>140 000–150 000</i>		<i>\$200 000</i>
Share of average project (%)		3.6–5.5		4.5–6.7

* This reflects the cost to the 'average' house, the actual cost is higher but is not incurred for all houses.
^a One hour administration per job, plus three days (24 hours) administration maintaining insurance policy divided by 35 jobs per year; ^b Estimated time to provide information required to obtain a building permit, including provision of more detailed plans and dealing with council officers; ^c Estimate for the average project based on 80% of single storey jobs requiring scaffolding at a cost of \$1000 and 100% of double storey jobs requiring scaffolding at a cost of \$3000-3500; ^d Based on cost of \$700 per year passed on by 50 sub-contractors, working 50% of their time with the business, on 35 jobs per year; ^e Assuming administration time is costed at \$40 per hour; ^f Average across all jobs, \$3500 = (0.5*1000)+(0.5*6000). Fifty per cent of jobs require guard rail at \$1000, 50% require 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; ^g Based on 50 tools, tagged four times a year at a cost of \$6 per tool divided by six projects a year.

Indicative cost estimates: practitioner registration/licensing

Registration and licensing requirements are another regulatory cost imposed on business. Unlike other costs considered in this appendix, registration and licensing acts 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 also incur administrative costs in meeting the requirements. Where practitioners are required to obtain insurance as a condition of registration the total administration costs can be significant, but the estimated administrative costs vary significantly. One builder indicated, for example, that a person within their business would spend two months a year obtaining eligibility for builders' warranty insurance. At the other extreme, another builder indicated the time involved in obtaining insurance was negligible.

Table C.4 **Estimated costs of practitioner registration**

	<i>Annual admin. for insurance (hr)</i>	<i>Admin. time (hr)</i>	<i>Admin. cost^a (\$)</i>	<i>Renewal fee (\$)</i>	<i>Total (\$)</i>	<i>Per project c(\$)</i>
Builder A		1	40	180	220	40
Builder B		2–3	80–120	180	260–300	10
Builder C	24 (3 days)	8 ^b (1 day)	1280	180	1460	50
Builder D		2	80	180	260	30
Builder E	40 (5 days)	8 (1 day)	1920	180	2100	0 ^d
Builder F	320 (8 weeks)		12 800	180	12 980	^e
Builder G		16–24 (2–3 days)	640–960	180	820–1140	40
Architect A	1		40	150	190	30
Architect B	1		40	150	190	20
Architect C	1		40	150	190	10
Building surveyor A	24 (3 days)		960	90	1050	0
Building surveyor B	24 (3 days)		960	90	1050	0

^a Assumes cost of \$40 per hour; ^b Time to register as both domestic and commercial builder; ^c Rounded to the nearest \$10; ^d Cost becomes negligible when allocated across the number of houses built or building permits issued; ^e Does not undertake any domestic building projects.

Table C.4 reports the estimated costs of practitioner registration. The cost estimates vary widely, largely due to significant differences in estimates of the 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). Because a number of registered practitioners may be involved in any one project however (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.

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:

- (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, it should be noted that these costs differ according to the size of house (for example, scaffolding costs are higher 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 for each respondent.

Survey respondents were also generally consistent in identifying the regulations that impose relatively low costs on business. The one notable exception concerns the issue of building permits, where one business estimated that current building permit requirements impose a significant additional cost. This estimate compared 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. The Commission does not dispute this estimate; however, it 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 costs of meeting the 5 Star standard could vary considerably according to the style of house, its orientation and other characteristics of the building site. Survey respondents generally estimated the costs of meeting 5 Star energy efficiency requirements to be high. Most of the new house builders estimated the additional cost of meeting the 5 Star standard to be between \$6000 and \$18 000. Expressed as a proportion of the cost of an average house for each respondent, the additional cost ranged from 2.5 per cent to 6.0 per cent (table C.5). The percentage cost estimates reflect differences in respondents' cost estimates and the cost of an 'average' house for each respondent.

There were, however, some exceptions. One builder ('builder C') considered the \$250 cost to obtain an energy rating the only additional cost imposed. 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.

It is not clear to what extent the cost estimates provided reflect the incremental costs faced by the whole industry. While 'builder C' considers that this requirement imposes very few incremental costs because planning permit conditions had required their business to meet this standard for the last four to five years, many builders would not have been subject to equivalent (planning) requirements. Other builders commented that consumers displayed a relatively high awareness of energy efficiency issues, and that in some instances, 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 prior to 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, while one builder did not provide an estimate of meeting energy efficiency standards, the other builder noted that consumers display a relatively high level of awareness of energy efficiency matters. It is possible therefore, that some, if not all of the costs estimated by this builder, are driven by consumers demanding these features.

Table C.5 **Estimates of the cost of 5 Star energy efficiency**

<i>Survey respondent</i>	<i>Average project cost (\$)</i>	<i>Admin time (hr)</i>	<i>Admin cost^a (\$)</i>	<i>Other costs (\$)</i>	<i>Total cost (\$)</i>	<i>Share of average project (%)</i>
<i>New house</i>						
A	400 000			10 000	10 000	2.5
B	325 000	16	640	10 000– 18 000	10 640– 18 640	3.3–5.7
C	150 000– 200 000			250	250	0.1–0.2
D	200 000	22	880	10 250 ^b	11 130	5.6
E	170 000	2	80	6175– 10 175 ^c	6255– 10 255	3.7–6.0
<i>Addition/ alteration</i>						
A	140 000– 150 000					
B	200 000			5000	5000	2.5

^a Assuming administration time is costed at \$40 per hour; ^b Estimate costs per house of \$10 000 to comply plus \$250 to obtain rating; ^c 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. Estimates that approximately 20% of houses would achieve the 5 Star standard if this was not regulated.

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 varies as a share of each respondent's average project cost, from 0.5 per cent to 1.3 per cent.² 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.

² The highest and lowest dollar cost estimates may not result in the highest and lowest percentage estimates due to differences in the participants' average project cost.

An assessment of the extent to which these estimates represent incremental costs is difficult. All builders (except one) suggested that 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.

Table C.6 Estimates of the cost of builders' warranty insurance

<i>Survey respondent</i>	<i>Average project cost (\$)</i>	<i>Admin time (hr)</i>	<i>Admin cost^c (\$)</i>	<i>Other costs (\$)</i>	<i>Total cost (\$)</i>	<i>Share of average project (%)</i>
<i>New house</i>						
A	400 000	2	80	2800	2880	0.7
B	325 000	2–3	80–120	2500–4000	2580–4120	0.8–1.3
C	150 000–200 000	0.5	20	885	905	0.5–0.6
D	200 000	4 ^a	160	1300	1460	0.7
E	170 000	1.5	60	734	794	0.5
<i>Addition/alteration</i>						
A	140 000–150 000	1.7 ^b	68	800	868	0.6
B	200 000	2	80	2000	2080	1.0

^a Four hours administration per house plus one week a year (allocated across 1500 houses a year); ^b One house administration per job, plus three days (24 hours) administration maintaining insurance policy allocated across 35 jobs per year; ^c Assuming administration time is costed at \$40 per hour.

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 2 metres. When estimating the cost of complying with this regulation, survey respondents typically distinguished between the cost for single storey houses, which often only require 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). Table C.7 also indicates the survey respondents' estimates of the cost of meeting this requirement, but does not allow for those houses where this is not required. Despite this, most of the estimates are provided on a comparable basis.

The survey respondents estimated that the cost of installing scaffolding for single storey new houses ranged from \$1120 to \$5120, or between 0.3 per cent and 1.6 per cent of the average project value. The percentage cost estimates reflect differences in respondents' cost estimates and the cost of an 'average' house for each respondent. Survey respondents estimated that the cost of installing scaffolding for double storey new houses ranged between \$2000 and \$15 120, or between 1.2 per cent and 5.1 per cent of the average project value. The wide range of the estimates reflects differences in the estimates of the cost of scaffolding, and differences in the average project value for each survey respondent. One survey respondent also estimated that the cost of scaffolding was higher in regional areas than in metropolitan areas.

All 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 will depend 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 accurately estimate the extent to which these represent the incremental costs faced by the whole industry.

Table C.7 Estimates of scaffolding

<i>Survey respondent</i>	<i>Average project cost (\$)</i>	<i>Admin time (hr)</i>	<i>Admin cost^a (\$)</i>	<i>Other costs (\$)</i>	<i>Total cost (\$)</i>	<i>Share of average project (%)</i>
<i>New house</i>						
A	400 000	3	120	Single: 1000 Double: 6000 ^b	Single: 1120 Double: 6120^b	Single: 0.3 Double: 1.5
B	325 000	2–3	80–120	Single: 5000 Double: Up to 15 000	Single: 5080–5120 Double: 15 080–15 120	Single: 1.6 Double: 4.6–4.7
C	150 000–200 000			Double: \$7080 ^c	Double: \$7080^c	Double: 3.5–4.7%
D	200 000	Single: 3 Double: 6	120–240	Single: 1500 Double: 9000 (metro) 10 000 (regional)	Single: 1620–1740 Double: 9120–9240 (metro) 10 120–10 240 (regional)	Single: 0.8–0.9 Double: 4.6 (metro) 5.1 (regional)
E	170 000			Double: 2000–3000	Double: 2000–3000	Double: 1.2–1.8
<i>Addition/alteration</i>						
A	140 000–150 000	3	120	Single: 800* Double: 3000–3500 ^d	Single: 920 Double: 3120–3620^d	Single: 0.6–0.7 Double: 2.2–2.6
B	200 000	3	120	Single: 1000 Double: 6000 ^e	Single: 1120 Double: 6120^e	Single: 0.6 Double: 3.1

* Not required for all houses and therefore represents the average cost to the 'average' house, the actual cost of the requirements is higher

^a Assuming administration time is costed at \$40 per hour; ^b Single storey houses require guard rail (cost \$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 would have spent \$2000 on alternative system prior to introduction of regulatory requirement; ^c Includes cost of guard rail (\$1750) and scaffold (\$5330) and required for 60% of properties; ^d Estimate that 80% of single storey jobs require scaffolding at cost of \$1000 and 100% of double storey jobs require scaffolding at cost of \$3000–3500; ^e Single storey houses require guard rail (cost \$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 would have spent \$2000 on alternative system prior to introduction of regulatory requirement.

Termite protection

Local councils may declare municipalities that are likely to be subject to termite infestation and therefore require termite protection be provided. As 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 this is required. Their estimates ranged from \$540 to \$4240, or between 0.1 per cent and 1.6 per cent of the average project. The percentage cost estimates reflect differences in respondents' cost estimates and the cost of an 'average' house for each respondent.

Table C.8 **Estimates of the cost of termite protection**

<i>Survey respondent</i>	<i>Average project costs (\$)</i>	<i>Admin time (hr)</i>	<i>Admin cost^a (\$)</i>	<i>Other costs (\$)</i>	<i>Total cost (\$)</i>	<i>Share of average project (%)</i>
<i>New house</i>						
A	400 000	1	40	500	540	0.1
B	325 000	5–6	200–240	1000–4000 ^b	1200–4240	0.4–1.3
C	150 000–200 000			1000	1000	0.5–0.7
D	200 000	3	120	1200 (metro) 3000 (regional) ^c	1320 (metro) 3120 (regional)	0.7 (metro) 1.6 (regional)
E	170 000	0.5	20	1800 ^d	1820	1.1
<i>Addition/alteration</i>						
A	140 000–150 000			1000	1000	0.7
B	200 000			500	500	0.3

^a Assuming administration time is costed at \$40 per hour; ^b Estimated chemical barrier costs between \$1000 and \$1200, while physical barrier costs approximately \$4000; ^c Estimates based on reticulation method in metropolitan areas (\$1200) and physical barriers in regional areas (\$3000); ^d Indicated that would install in 100% of houses if not required by regulation.

Survey respondents noted that the cost of termite protection differed according to the method, lower cost chemical methods and relatively higher cost physical barriers. One survey respondent estimated that the cost of providing termite protection was higher in regional areas because physical barriers were required. When this is considered, the estimates of the cost of termite protection were more consistent than the relatively wide range suggests.

Because not all municipalities currently require termite protection the incremental cost for all 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 are therefore likely to be lower than the cost estimates in table C.8, although it is not clear to what extent.

C.2.4 Contextual information

Survey respondents also provided useful contextual information regarding the operation of the housing construction regulation in Victoria. In particular, survey respondents 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 regulations from those imposed by planning regulations.

Complexity of the regulatory environment

A number of survey respondents noted that the complexity of the regulatory environment generally imposed costs on their businesses. This included the costs 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 was 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 in some instances a decision to grow the business 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, and the difficulties involved in obtaining it, were the sole reason for their business no

longer undertaking domestic building work. While the business is not currently undertaking domestic building work, the business continues to seek eligibility for builders' warranty insurance to maintain domestic builder registration. The business estimated one staff member would spend two months full time dealing with insurance companies to maintain eligibility.

Overlap between building and planning regulations

A number of survey respondents commented that planning regulations had the potential to add significant costs to housing construction, particularly because of delays imposed by the planning system. One survey respondent stated that the cost of planning regulations, and in particular the cost of delays, overwhelm all other regulatory costs.

Another builder provided the following example highlighting the high costs imposed by town planning requirements. The builder noted that unit developments required obtaining a planning permit, which imposed a number of 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 can not be supported by the ground floor walls, which in turn 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 a storm water detention system was approximately \$16 000 per dwelling.
- Obtaining a planning permit also involves engaging a planning consultant at a cost of \$2500 per dwelling.
- These 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 builders estimates of approximately \$10 000 per dwelling in complying with the selected building regulations.

A number of survey respondents raised issues highlighting the challenge of attempting to isolate the effect of planning regulations from the effects of building regulations. In particular, where a planning permit is required, it must be obtained before a building permit could be issued and 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 has its limitations because the estimates are based on different approaches, but nonetheless provides some basis for comparison. 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 Housing Industry Association (HIA) October 2003 submission to the Productivity Commission inquiry into first home ownership provided some 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. The submission estimated selected state regulation and local laws cost \$17 700 for an average new house (based on an average house of \$150 000 and therefore equivalent to over 11 per cent of its cost) (HIA 2003b, pp. 93-94).

The HIA submission included estimates of many of the same regulations estimated in this appendix. The principal difference in the approach taken in the HIA submission is that it generally did not include explicit estimates of the administrative costs businesses incur in complying with the regulations. It did, however, include administration associated with occupational health and safety requirements.

Table C.2 compares the HIA estimates with other estimates for the same regulations as selected for estimation in this appendix. At an aggregate level, the HIA estimates are broadly consistent with the other estimates presented in the table. The HIA data, however, 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 installation of a rainwater tank) appear to be at the low end of the estimates provided to the Commission. To the extent 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 others in the sample.

The HIA's estimates 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' (discussed further below). On the other hand, the HIA estimates for the costs of installing scaffolding appear to be at the high end, but within the range of estimates provided by other industry participants. Overall, considering differences in coverage of the HIA estimates, they appear to be broadly comparable with the 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 over and above 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 draw comparisons between 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 regulations; planning regulations were outside the scope of this exercise. Further, the Commission was unable to obtain a breakdown of the survey results to understand the composition of this estimate or to enable comparisons of 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 regulations and was similar in scope to the regulations considered in this appendix. The study 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 that are incurred in the construction of a typical house because of Victorian housing construction regulatory requirements. The study identified the costs incurred as a result of mandatory state and local government regulations, 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 200m², 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 large enough, not requiring a planning permit
- 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, 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 on a \$300 000 house.

Source: Davis Langdon Australia Pty Ltd 2005.

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 regulations

The Commission is also aware of some international studies on the cost of housing regulations. A survey by the United States 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 United States' 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—a broader range of issues than defined by the terms of reference for this inquiry.

5 Star energy efficiency requirements

There have been a number of attempts to estimate the costs of complying with 5 Star energy efficiency requirements (including the costs 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 there had been cost increases because of the 5 Star initiative. Over one-third of respondents (36 per cent) indicated that meeting the 5 Star requirements would increase costs by between 3 per cent and 5 per cent. Nearly one fifth of respondents (19 per cent) estimated costs had increased by between 6 and 10 per cent, and a further 13 per cent of respondents felt costs had increased by 10 per cent or more (Chant Link and Associates 2005, p. 47).

The form of the question asked in the survey differs slightly from that used by the Commission. The survey asked builders to estimate the costs in percentage terms. The 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 survey finding, that the costs of meeting the 5 Star requirements may vary (quite considerably) according to circumstances, is consistent with the Commission's observations. The median estimate of the survey is that the 5 Star initiative imposes additional costs of between 3 per cent and 5 per cent. This is 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 Commission range between 0.1 per cent and 6 per cent, with four of the five estimates for new houses between 2.5 per cent and 6 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 various improvement measures required to achieve the target performance standard. Improvement options considered 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 costs 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 because of the need to revise and redraft plans to ensure compliance. While the costs of revising and redrafting plans may represent a transitional cost that may reduce over time, it is possible that this 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 in some instances these estimates include the costs of installing rainwater tanks.

Regulatory impact statement, Plumbing (water and energy savings) regulations

The discussion of costs and benefits in the regulatory impact statement prepared for the 2004 amendments of the Plumbing Regulations 1998 (PIC 2004b) drew on the February 2004 Allen Consulting Group Report, *A benefit-cost analysis of prospective water efficiency, rainwater tank and solar hot water heating regulations*. 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 (over and above 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 \$5000 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. One survey respondent estimated that the cost to supply and install a solar hot water service was approximately \$4500 (before the rebate) but did not provide information to calculate how much of this cost is additional to a conventional hot water service. Further information is required to comment on the representativeness of this estimate.

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 incurred in 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 its design and location. Master Builders 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.

Cost estimates provided in submissions to the inquiry

Submissions made to the inquiry also provided estimates of the costs of complying with specific regulations, including 5 Star energy efficiency requirements, building warranty insurance, termite protection and metal roofing.

5 Star energy efficiency

Bruce Langford-Jones of Langford-Jones Homes estimated that where compliance is possible, it costs approximately \$10 000 to make a \$90 000 'lightweight' home comply with the 5 Star standard (sub. 14, p. 5).

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).

These estimates appear to be broadly consistent with the estimates provided to the Commission as part of this exercise.

Building warranty insurance

A number of submissions provided estimates of the cost of builders' warranty insurance premiums.

- The Builders Collective of Australia stated that the average premium was \$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 for a \$200 000 house would be approximately \$980, and the average premium for a \$300 000 house would be \$1470.
- MR Constructions stated that builders' warranty insurance premiums are typically at least \$3000 for the projects they undertake (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. It stated:

...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 \$2.5m 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).

Termite protection

The Royal Australian Institute of Architects and Archicentre Limited estimated that the average cost of pre-construction treatment of a home site by a pest contractor to be \$1500 (sub. 40, p. 10). This 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

While not featured elsewhere in this appendix, a number of submissions provided estimates of the costs associated with the requirement that metal roofs be installed by a licensed plumber.

Bruce Harmer Homes estimates that this requirement results in the cost of installing a metal roof being approximately \$4000 higher than a tile roof for an average sized home (sub. 20, p. 1).

Residential Metal Roofing Industry Association of Victoria Ltd states that in Victoria ‘most major builders charge new home buyers an average of \$4500 extra per home for a metal roof compared with concrete tiles’ (sub. 23, p. 5). It also states, however, that ‘material costs are generally \$1500 per home more for metal roofing’ relative to tiles (p. 6). This would suggest the incremental costs 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).

C.3.2 Concluding comments

Survey respondents’ estimates of the cost of meeting selected Victorian and local government housing construction regulations ranged from 4 per cent to 20 per cent of the cost of a house. Survey respondents’ estimates varied considerably, reflecting differences in the types of houses being constructed, the location of these houses and the profile of the survey respondents’ businesses and their individual experiences. The Commission has not attempted to test these estimates against house type composition—for example, the number of double storey houses, or proportion of houses in regional Victoria—or information on 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, for example, and based on a case-study approach, 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 regulations 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 there appears to be broad consistency in the estimated costs of compliance and where there is not. A lack of consistency in the indicative estimates may again indicate where there is merit in obtaining more information.

Table C.9 Source of regulatory requirements

<i>Regulatory requirement</i>	<i>Source of regulation</i>
Builders' warranty insurance	<i>Building Act 1993</i> (s. 102) and Domestic Building Insurance Ministerial Order, Victoria Government Gazette 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 to give consent and report for 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> s.44(2); Electrical Safety (Installations) Regulations 1999, r.410.
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

As noted earlier, 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.

To strengthen the indicative estimates presented in this appendix, the Commission welcomes feedback on the estimates reported and invites interested industry participants to complete the questionnaire.

References

ABCB (Australian Building Codes Board) 2003, *Memorandum of Understanding Between Australian Building Codes Board and Standards Australia International Limited*, Canberra.

—— 2004a, *BCA 2004: Building Code of Australia*, Volume Two, Canberra.

—— 2004b, *Protocol for the Development of BCA Referenced Document*, Canberra.

—— 2005, *ABCB Website*, www.abcb.gov.au (accessed June 2005).

ABS (Australian Bureau of Statistics) 2003a, *Private Sector Construction Industry 2002-03*, Cat, no. 8772.0, ABS, Canberra.

—— 2003b, *State and Regional Indicators*, Cat. no. 1367.2, ABS, Canberra.

—— 2004a, *Australian National Accounts: State Accounts*, Cat. no. 5220.0, ABS, Canberra.

—— 2004b, *Building Activity, Australia*, Cat. no. 8752.0, ABS, Canberra.

—— 2004c, *Dwelling Unit Commencements, Australia, Preliminary*, Cat, no. 8750.0, ABS, Canberra.

—— 2005a, *Australian Industry*, Cat, no. 8155.0, ABS, Canberra.

—— 2005b, *Average Weekly Earnings, Australia*, Cat. no. 6302.0, ABS, Canberra.

—— 2005c, *Construction Work done, Australia, Preliminary*, Cat, no. 8755.0, ABS, Canberra.

—— 2005d, *Consumer Price Index*, Cat. no. 6401.0, ABS, Canberra.

—— 2005e, *Producer Price Indexes*, Cat. no. 6427.0, ABS, Canberra.

—— 2005f, *House Prices Indexes*, Cat. no. 6416.0, ABS, Canberra.

ACCC (Australian Competition and Consumer Commission) 2005, *Public Liability and Professional Indemnity Insurance: Fourth Monitoring Report*, Canberra.

The Allen Consulting Group 2002, *Cost Benefit Analysis of New Housing Energy Performance Regulations: Impact of Proposed Regulations*, Report for the Sustainable Energy Authority and the Building Commission, Melbourne, www.seav.vic.gov.au/ftp/buildings/5starhousing/acgr.pdf (accessed 28 April 2005).

— 2003, *Funding Urban Infrastructure: Approaches Compared*, Report for the Property Council of Australia, Sydney.

— 2004, *A Benefit-Cost Analysis of Prospective Water Efficiency, Rainwater Tank and Solar Hot Water Heating Regulations*, Report to the Sustainable Energy Authority of Victoria. Melbourne.

— 2005, *Reducing Building Disputes in Victoria: Research Findings*, Final report to the Building Commission, Melbourne.

Allen, P. (Percy Allen & Associates Pty Ltd) 2002, *National Review of Home Builders Warranty Insurance and Consumer Protection*, Report prepared for the Ministerial Council on Consumer Affairs, Info Access, Canberra.

ANAO (Australian National Audits Office) 2000, *Better Practice Principles for Performance Information*, Canberra.

APIA (Australian Pipeline Industry Association) 2001, Productivity Commission Review of the National Access Regime — Position Paper: Submission by the Australian Pipeline Industry Association, DR70.

AQF (Australian Qualifications Framework) 2004, *AQF Website*, www.aqf.edu.au/about_aqf (accessed July 2004).

Architects Registration Board 2004, *Annual Report 2003-04*, Melbourne.

Ashby, K. and Routley, V. 1997, *Safe Home Design, Hazard*, Edition 32, Victorian Injury Surveillance System, Monash Accident Research Centre.

Atech Group 2003, *Health and Safety Risks in Buildings*, Report prepared for the Australian Building Codes Board, Canberra.

Auditor-General Victoria 2000, *Building Control in Victoria: Setting Sound Foundations*, Performance Audit Report No. 64, Melbourne.

Auditor General for Western Australia 2004, *Third Public Sector Performance Report 2004*, Perth.

BC (Building Commission) 1999, *Building Victoria 1998*, Melbourne.

— 2000, *Building Victoria 1999*, Melbourne.

— 2001, *Building Victoria 2000*, Melbourne.

— 2002a, *Annual Report 2001-02*, Melbourne.

— 2002b, *Building Victoria 2001*, Melbourne.

— 2002c, *Corporate Plan 2002-2007*, Melbourne.

- 2002d, *Regulatory Information Bulletin: Energy Efficiency Standards for New Residential Buildings*, Melbourne,
www.buildingcommission.com.au/asset/1/upload/RIB_final.pdf (accessed 7 February 2005).
- 2003a, *5 Star Standard – Frequently Asked Questions*,
www.buildingcommission.com.au/asset/1/upload/website_Q&As.pdf,
 (accessed 8 February 2005).
- 2003b, *Building Permits and Community Infrastructure Levies 2003-04*, Melbourne.
- 2003c, *Building Victoria 2002*, Melbourne.
- 2003d, *Regulatory Impact Statement Building (Further Amendment) Regulations 2003*, Melbourne.
- 2003e, *What You Need to Know about Occupancy Permits*, Melbourne.
- 2004a, *Annual Report 2003-04*, Melbourne.
- 2004b, *Background Papers for Victorian Competition and Efficiency Commission (VCEC)*, Melbourne.
- 2004c, *Building in Victoria: A Local Government Guide*, Melbourne.
- 2004d, *Pulse Building Intelligence 2003*, Melbourne.
- 2004e, *Research, Development and Education in the Building Industry: 2002-04 Report*, Melbourne.
- 2004f, *Residential Sustainability Measures*, Practice Note 2004-55,
www.buildingcommission.com.au/asset/1/upload/Residential_Sustainability_Measures_1_July_04.pdf (accessed 8 February).
- 2005a, *Building in Victoria: A Consumer's Guide*, Published in conjunction with the Victorian Municipal Building Surveyors group, Melbourne.
- 2005b, *Continuing Professional Development: How Can it Help You?*, Melbourne.
- 2005c, *Correspondence*, 11 May.
- 2005d, *Regulatory Impact Statement: Building (Owner-Builder) Regulations 2005*, Melbourne.
- 2005e, *5 Star—What to Do Now and For the Future*, Melbourne.
- undated A, *Building Commission's Pulse*, Melbourne.
- undated B, *Business Plan 03-04*, Melbourne.

— undated C, *Current Requirements*,
www.buildingcommission.com.au/www/default.asp?casid=2865 (accessed 16 May 2005).

— undated D, *Introduction*,
www.buildingcommission.com.au/www/default.asp?casid=2897 (accessed June 2005).

— undated E, *Requirements for Builders Warranty Insurance Providers*,
www.buildingcommission.com.au/asset/1/upload/BWI_New_requirements_April_04.pdf (accessed 16 May 2005).

— undated F, *What Type of Insurance is Required*,
www.buildingcommission.com.au/www/default.asp?casid=2863 (accessed 19 May 2005).

— and BAC (Building Advisory Council) 2003, *Review of the Categories and Classes of Building Practitioner Registration in Victoria*, Industry Discussion Paper, Melbourne.

BCC (Building Control Commission) 1995, *Regulatory Impact Statement Building (Amendment) Regulations 1995*, Building Control Commission, Melbourne.

— 1996a, *Regulatory Impact Statement Building (Qualification) Regulations 1996*, Building Control Commission, Melbourne.

— 1996b, *Regulatory Impact Statement Building (Amendment) Regulations 1996*, Building Control Commission, Melbourne.

— 1997, *Regulatory Impact Statement Building (Amendment) Regulations 1997 Building (Further Amendment) Regulations 1997*, Building Control Commission, Melbourne.

— 1999, *Regulatory Impact Statement Building (Amendment) Regulations 1999*, Building Control Commission, Melbourne.

— 2000, *Regulatory Impact Statement Building (Fees) Regulations 2000*, Building Control Commission, Melbourne.

— 2001a, *Regulatory Impact Statement Building (Cooling Tower Systems Register) Regulations 2001*, Building Control Commission, Melbourne.

— 2001b, *Regulatory Impact Statement Building (Single Dwelling) Regulations 2001*, Building Control Commission, Melbourne.

— 2001c, *Regulatory Impact Statement Building (Swimming Pool Fences) Regulations 2001*, Building Control Commission, Melbourne.

- Bickerdyke, I., Lattimore R. and Madge, A. 2000, *Business Failure and Change: An Australian Perspective*, Productivity Commission Staff Research Paper, AusInfo, Canberra.
- Blair, A. 2005, *Risk and the State*, Address to the Institute of Public Policy Research, 26 May.
- Brennan, G. and Hamlin, A. 1995, 'Economising on virtue', *Constitutional Political Economy*, vol. 6, pp. 35–56.
- Briscoe, S. 2005, 'The trouble with targets', *OECD Observer*, No. 246/247, December 2004-January 2005, pp. 33-34.
- Brown, C. and Jackson, P. 1990, *Public Sector Economics*, 4th Edition, Basil Blackwell, Oxford.
- Brumby, Hon. J. (Treasurer) 2005, *2005-06 Victorian Budget : Budget Paper No. 2—Strategy and Outlook*, Department of Treasury and Finance, Melbourne.
- Bunn, P. and Redwood, V. 2003, *Company Accounts Based Modelling of Business Failures and the Implications for Financial Stability*, Bank of England Working Paper no. 210.
- Burke, T. and Hayward, D. 2000, *Melbourne's Housing Past Housing Futures*, Institute for Social Research, Swinburne University of Technology, Melbourne, www.sisr.net/publications/0011burke.pdf (accessed 27 May 2005).
- Camerer, C., Issacharoff, S., Loewenstein, G., O'Donoghue, T. and Rabin, M. 2003, 'Regulation for conservatives: behavioural economics and the case for "asymmetric paternalism"', *University of Pennsylvania Law Review*, vol. 151.
- Chant Link and Associates 2005, *A Quantitative Report on Five Star Energy Efficiency and Environmentally Sustainable Building Practices*, Project 2711, Joint study for the Building Commission and the HIA.
- Commonwealth Government 2002, *Commonwealth Cost Recovery Guidelines for Regulatory Agencies*, Canberra.
- CAV (Consumer Affairs Victoria) 2004, *Building and Renovating: A Guide for Consumers*, Melbourne.
- Creffield, J. 2005, *Call for the Immediate Declaration of all Municipalities (Metropolitan Melbourne & Regional Victoria) as Regions Where Homes, Buildings, and Structures are Subject to Termite Infestation*, CSIRO, Melbourne.
- Davis Langdon Australia Pty Ltd 2005, *Regulatory Impact on Victorian Home Building Costs: Costing for a Typical Home*, Melbourne.

DCRSC (Development Contributions Review Steering Committee) 2000, *Review of Development Contributions in Victoria*, Report and Recommendations, Melbourne.

— 2001, *Review of the Development Contributions System, Funding Infrastructure Under the Planning and Environment Act*, Final Recommendations of the Development Contributions Review Steering Committee, Melbourne.

Delahunty Hon. M.E. (Minister for Planning) 2002a, 'New communities to have essential services sooner', *Media Release*, 4 November.

Delahunty Hon. M.E. (Minister for Planning) 2002b, Second Reading of Building and Construction Industry Security of Payment Bill, Legislative Assembly, *Hansard*, vols. 454 and 455, book 2, 21 March, p. 426–428.

Delahunty, Hon. M.E. (Minister for Planning) 2004, Second Reading of Building (Amendment) Bill, Legislative Assembly, *Hansard*, vols. 461 and 462, book 7, 3 June, p. 1849.

DoFA (Commonwealth Department of Finance and Administration) 2002, *Cost Recovery by Government Agencies*, Finance Circular No. 02/2002, Canberra.

DOI (Department of Infrastructure) 2002, *Melbourne 2030: Planning for Sustainable Growth*, Draft implementation plan 3—housing, Melbourne.

DPD (Department of Planning and Development) 1994, *Building Regulations 1994 Regulatory Impact Statement*, Department of Planning and Development, Melbourne.

DSE (Department of Sustainability and Environment) 2003a, *A New Development Contributions System for Victoria*, Department of Sustainability and Environment, Melbourne.

— 2003b, *Understanding Development Contributions*, Development Contributions Guidelines, Version 5.9, 16 June,
[www.dse.vic.gov.au/dse/nrenpl.nsf/646e9b4bba1afb2bca256c420053b5ce/5f0a65ab140a8edaca256f6300021a1a/\\$FILE/Understanding%20Development%20Contributions.pdf](http://www.dse.vic.gov.au/dse/nrenpl.nsf/646e9b4bba1afb2bca256c420053b5ce/5f0a65ab140a8edaca256f6300021a1a/$FILE/Understanding%20Development%20Contributions.pdf) (accessed 11 April 2005).

— 2003c, *Preparing a Full Cost Apportionment DCP*, Development Contributions Guidelines,
[www.dse.vic.gov.au/dse/nrenpl.nsf/646e9b4bba1afb2bca256c420053b5ce/5f0a65ab140a8edaca256f6300021a1a/\\$FILE/Preparing%20a%20Full%20Cost%20Apportionment%20DCP.pdf](http://www.dse.vic.gov.au/dse/nrenpl.nsf/646e9b4bba1afb2bca256c420053b5ce/5f0a65ab140a8edaca256f6300021a1a/$FILE/Preparing%20a%20Full%20Cost%20Apportionment%20DCP.pdf), (accessed 11 April 2005).

— 2003d, *Incorporating the DCP into the Planning Scheme*, Development Contributions Guidelines,
www.dse.vic.gov.au/dse/nrenpl.nsf/646e9b4bba1afb2bca256c420053b5ce/5f0a

65ab140a8edaca256f6300021a1a/\$FILE/Incorporating%20the%20DCP%20into%20the%20planning%20scheme.pdf, (accessed 11 April 2005).

—— 2004a, *A Guide to Property Values*, Melbourne.

—— 2004b, *Review of Development Contributions*, www.dse.vic.gov.au/dse/nrenpl.nsf/LinkView/487DCAF41EEF6B68CA256D480003CF32E58F59884C0F41A5CA256D190029AAB9, (accessed 1 June 2005).

DTF (Department of Treasury and Finance) 1999, *Output Specification and Performance Management Victoria*, Melbourne.

—— 2004, *Preparing for Victoria's Future, Challenges and Opportunities in an Ageing Population*, Melbourne.

—— 2005, *Guidelines for Setting Fees and User-Charges Imposed by Departments and General Government Agencies 2005-06*, Melbourne.

Energy and Water Ombudsman NSW 2004, *Submission to Productivity Commission Inquiry into the Economic and Environmental Potential Offered by Energy Efficiency*, Sydney, 23 November.

Energy Efficient Strategies 2002, *Comparative Cost Benefit Study of Energy Efficiency Measures for Class 1 Buildings and High-rise Apartments*, Project for the Sustainable Energy Authority of Victoria, www.buildingcommission.com.au/asset/1/upload/Energy_Efficient_Strategies_Report.pdf, (accessed 7 February 2005).

Exports and Infrastructure Taskforce 2005, *Australia's Export Infrastructure*, Report to the Prime Minister, Canberra.

Freehills Regulatory Group 1999, *NCP Review of Architects and Building Legislation*, Final Report.

Gann, D.M., Wang, Y. and Hawkins, R. 1998, 'Do regulations encourage innovation? The case of energy efficiency in housing', *Building Research and Information*, vol. 26, no. 5, pp. 280–96.

Gittins, R. 2002, 'Time to restump the housing industry', *The Age*, August 14.

Gordon, J. 2005, '13% slump forecast for Victorian house building', *The Age*, April 21.

Grellman, R. 2003, *NSW Home Warranty Insurance Inquiry*, Office of Fair Trading, Sydney, www.builderscollective.org.au/Grellman.pdf (accessed 18 May 2005).

Hampton, P. 2005, *Reducing Administrative Burdens: Effective Inspection and Enforcement*, HM Treasury, London.

Her Majesty's Treasury 2001, *Choosing the Right Fabric: A Framework for Performance Information*, London.

— 2003, *Setting Key Targets For Executive Agencies: A Guide*, London.

HIA (Housing Industry Association) 2003a, *Financing Infrastructure for Residential Development*, Report prepared for the HIA by Access Economics.

— 2003b, *HIA Submission to the Productivity Commission Inquiry into First Home Ownership*.

— 2004a, *HIA Housing 100: 2003-04*, Canberra.

— 2004b, *Submission to the Productivity Commission Inquiry into Energy Efficiency*.

— 2005, *Submission on the Competition Policy Provisions of the Trade Practices Act 1974*.

— and CBA 2004, *HIA-Commonwealth Bank Affordability Report, December Quarter 2004*.

Hill, M. 1999, *Adaptable Housing Study: A Cost Benefit Analysis of Adaptable Homes*, prepared for the NSW Department of Urban Affairs and Planning (Housing and Metropolitan Branch).

Hume City Council 2004, *Agenda*, Ordinary council meeting of the Hume City Council, Hume Global Learning Centre, Broadmeadows, 11 October.

ICAC (Independent Commission Against Corruption) 1999, *Strategies for Preventing Corruption in Government Regulatory Functions*, Sydney.

Industry Commission 1995, *Research and Development*, Inquiry Report, AusInfo, Canberra.

James Taylor Chair in Landscape & Liveable Environments 2001, 'The effects of developer cost charges on sustainable growth in the Greater Vancouver Regional District', *Technical Bulletin*, No. 10, May.

Knowles Hon. R.I. (Minister for Housing) 1993, Second Reading of Building Bill, Legislative Council, *Hansard*, 30 November, p. 1348.

Law Council 2001, *Part IIIA Position Paper*, DR108.

LexisNexis undated, *LexisNexis website*, www.lexisnexis.com.au (accessed June 2005).

Maclellan Hon. R. (Minister for Planning) 1993, Second Reading of Building Bill, Legislative Assembly, *Hansard*, 11 November, pp. 1689–1694.

- MAV (Municipal Association of Victoria) 2005, *Development Contributions*, www.mav.asn.au/CA256C2B000B597A/OrigDoc/~857DF8354BD743CFCA256FA2007D3F90?OpenDocument (accessed 31 March 2005).
- MBA (Master Builders Australia) 2004, *Submission to Productivity Commission Inquiry into Reform of Building Regulation*, May 2004, www.pc.gov.au/study/building/subs/sub024.pdf (accessed 17 March 2005).
- MBAV (Master Builders Association of Victoria) 2004, 'Local government in Victoria flouting State regulations by imposing charges on builders/developers', *Media Release*, 16 December.
- Mueller, D. 1989, *Public Choice II: A Revised Edition of Public Choice*, Cambridge University Press.
- National Plumbing Regulators Forum 2004, *Plumbing Code of Australia*, Melbourne.
- NCC (National Competition Council) 2003, *Assessment of Governments' Progress in Implementing the National Competition Policy and Related Reforms*, Melbourne, www.ncc.gov.au/pdf/ASTOV-003.pdf (accessed 28 April 2005).
- Neutz, M. 1997, *Funding Urban Services: Options for Physical Infrastructure*, Allen & Unwin, St Leonards.
- NECG (Network Economics Consulting Group) 2001, *Joint Industry Submission on the Productivity Commission's Review of the National Access Regime*.
- OCEI (Office of the Chief Electrical Inspector) 2004, *Annual Report 2003-04*, Melbourne.
- OECD (Organisation for Economic Co-operation and Development) 1997, *The OECD Report on Regulatory Reform: Synthesis*, Paris.
- 1998, *Best Practice Guidelines for User Charging for Government Services*, PUMA Policy Brief No. 3, Paris.
- 1999, *Regulatory Reform in Norway, Modernising Regulators and Supervisory Agencies*, Paris.
- 2003, *Relationship Between Regulators and Competition Authorities*, Paris.
- Office of Gas Safety 2004, *Annual Report 2003-04*, Melbourne.
- Office of Regulation Review 1998, *A Guide to Regulation* (second edition), Melbourne.
- Owen Hon. N, (Justice) 2003, *The Failure of HIH: Volume 1. A Corporate Collapse and its Lessons*, The HIH Royal Commission Final Report.

PC (Productivity Commission) 2001, *Cost Recovery by Government Agencies*, Report no. 15, Canberra.

— 2004a, *First Home Ownership*, Report No. 28, Melbourne.

— 2004b, *Inquiry into Energy Efficiency Issues Paper*, www.pc.gov.au/inquiry/energy/issuespaper/index.html (accessed 21 February 2004).

— 2004c, *Reform of Building Regulation*, Research Report, Melbourne.

— 2005, *Energy Efficiency*, Draft report, Melbourne.

PCA (Property Council of Australia) 2002, *Submission in Response to November 2001 Review of the Development Contributions System Final Recommendations Paper*, 30 January, www.propertyoz.com.au/ (accessed 12 April 2005).

PIC (Plumbing Industry Commission) 2002, *Corporate Plan 2002-05*, Melbourne.

— 2004a, *Annual Report 2003-04*, Melbourne.

— 2004b, *Regulatory Impact Statement, Plumbing (Water and Energy Savings) Regulations 2004*, Plumbing Industry Commission, Melbourne.

— 2004c, *The Registered Plumber*, Issue No 35, July, www.pic.vic.gov.au/pdf_file/PIC%20NL%20July%202004%20final.pdf, (accessed 9 February 2005).

— 2005, *How to Obtain a Registration or Licence*, www.pic.vic.gov.au/registration_licence.htm (accessed 29 June 2005).

RBA (Reserve Bank of Australia) 2005, *Statement on Monetary Policy*, February.

Rimmer and Wilson 1996, *Compliance Costs of Taxation in Australia*, Staff Research Paper, Australian Government Publishing Service.

Royal Statistical Society 2003, *Performance Indicators: Good, Bad and Ugly*, Report of a Working Party on Performance Monitoring in the Public Services, London, www.rss.org.uk/PDF/PerformanceMonitoring.pdf (accessed 24 June 2005).

SARC (Scrutiny of Acts and Regulations Committee) 2002, *Inquiry into the Subordinate Legislation Act 1994*, Parliament of Victoria, Melbourne.

— 2003, *Annual Review 2002: Regulations 2002*, Parliament of Victoria, Melbourne.

SEAV (Sustainable Energy Authority Victoria) 2004, *Become an Accredited Rater*, www.seav.vic.gov.au/buildings/firstrate/become_rater.asp (accessed 9 February 2005).

- Smith, F. and Ward, S. 2004, *Regulatory Architecture: Practitioners Perspectives, Paper Prepared for the National Consumer Congress Melbourne*.
- Spiller Gibbins Swan Pty Ltd 2001, *Development Contributions and Metropolitan Strategy*, Discussion Paper.
- State Government of Victoria 2004, *Productivity Commission Review of Building Regulation Reform, Victorian Government Submission*, Melbourne.
- 2005, *Victorian Guide to Regulation*, Department of Treasury and Finance, Melbourne.
- Surveyors Board of Victoria 2004, *Annual report 2003-04*, Melbourne.
- Treasury Board of Canada 2000, *User Charging in the Federal Government – A Background Document*, Ottawa.
- The Treasury (NZ) 2002, *Guidelines for Setting Charges in the Public Sector*, Wellington.
- Tyler, P.J. 2004, *A Review of the NSW Home Warranty Insurance Inquiry, 2003*, Peter J. Tyler Associates, Sydney.
- UK Better Regulation Taskforce 2003, *Independent Regulators*, London.
- VCEC (Victorian Competition and Efficiency Commission) 2004, *Regulation of the Housing Construction Sector and Related Issues*, Issues paper, Melbourne.
- 2005, *Regulation and Regional Victoria: Challenges and Opportunities*, Draft Report, Melbourne.
- Vero undated, *Myths and Facts About Home Warranty Insurance*, [www.vero.com.au/dirv/vero/vero.nsf/AttachmentsByTitle/Myths%2BFacts.pdf/\\$FILE/Myths%2BFacts.pdf](http://www.vero.com.au/dirv/vero/vero.nsf/AttachmentsByTitle/Myths%2BFacts.pdf/$FILE/Myths%2BFacts.pdf) (accessed 1 June 2005).
- Victorian Institute of Teaching 2005, *Frequently Asked Questions: What Does the Annual Registration Fee Pay For?*, www.vit.vic.edu.au/pdfs/iteach01_05.pdf (accessed 24 June 2005).
- VWA (Victorian WorkCover Authority) 2002, *Industry Standards for Electrical Installations on Construction Sites*, Industry Standard, Melbourne.
- Warrington Fire Research (Australia) & Pitt and Sherry 2004, *Improving the Efficiency and Effectiveness of the Building and Occupancy Permit Process Under the Building Act 1993*.
- Washington Research Council 2001, *Impact of Government Regulations and Fees on Housing Costs*, ePolicy Brief 01-18, May 24, Seattle.

Wong, C. 2002, 'State reforms fast-tracked in wake of continuing insurance crisis', *Law Society Journal* 35.

Wyndham City Council 2004, *Minutes of Ordinary Meeting of Wyndham City Council*, Werribee Civic Centre, 20 December.