THE LAW SOCIETY
OF NEW SOUTH WALES

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Residential Energy Efficiency Team
Buildings Government Energy Efficiency Branch
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Dear Sir / Madam,

Mandatory disclosure of residential building energy, greenhouse and water performance – Consultation Regulatory Impact Statement

The Law Society's Property Law Committee (Committee) appreciates the opportunity to participate in the consultation to assess a proposal to introduce mandatory disclosure of building energy, greenhouse and water performance at the point of sale or lease for residential property as set out in the Consultation Regulatory Impact Statement (RIS).

The Committee has responsibility to consider and deal with any matters relating to property law and to advise the Council of the Law Society of NSW on all issues relevant to that area of practice.

The members of the Committee are senior property law practitioners and experts. Committee members regularly act for both vendors and purchasers in relation to contracts for the sale of residential land. The Committee also periodically reviews the terms of the standard contract for sale of land used in NSW, the 'Contract for Sale of Land- 2005 edition" which is published under the joint copyright of the Law Society of NSW and Real Institute of NSW.

The Committee participates in consultations and reviews of legislation relating to residential lease transactions.

Purpose of the review

The purpose of the review is to examine regulatory and policy measures driving disclosure of information pertaining to energy, greenhouse and water performance during residential property transactions. The RIS process considers different options to achieve the government objectives stated below.

Objectives of government action

The RIS notes that the objective of intervention "is to improve community wellbeing and environmental sustainability, and reducing potential greenhouse gas emissions in particular, by countering information shortfalls and the uneven distribution of information (or information asymmetries) in the residential housing market that prevent efficient investment in energy and water efficiency"[1].

The RIS later notes that the information provided by the options "is expected to encourage investments in known technologies aimed at improving the energy efficiency, greenhouse and water performance of existing building stock"[2].

Disclosure on sale of property in New South Wales

Current regulation

There is no current requirement for a vendor to supply at the point of sale any information in relation to the energy, greenhouse and water performance of the residential property that is being sold.

Rationale for the vendor disclosure regime

The underlying rationale for a vendor disclosure regime is that there are a number of topics which are of such fundamental importance to all (or most) prospective purchasers that they should be addressed in a document attached to (or notice forming part of) the proposed contract for sale of land. The issue can then be squarely placed before the proposed purchasers prior to their signing and binding themselves contractually.

The current regime prescribes vendor disclosure documents for contracts for sale of all land whether vacant, residential, strata or otherwise. If a vendor fails to attach one of the prescribed documents to a contract for sale of land, the purchaser may rescind the contract within 14 days after the making of the contract (clauses 16 and 17 of the *Conveyancing (Sale of Land) Regulation 2010*.

The documents that currently form part of the vendor disclosure regime in NSW have the following characteristics:

- They are issued by monopoly providers, (e.g. LPI, local councils, sewerage authorities);
- They are authoritative rather than qualitative or subjective;
- They are relatively inexpensive (around $200 per transaction).

The Committee believes the existing regulatory regime has worked well over a period in excess of 20 years, is well-understood by stakeholders in conveyancing, provides an appropriate balance between the competing interests of vendor and purchaser and has generated relatively little litigation.

Debate in NSW on vendor disclosure

There is regular debate in NSW on the appropriate level of vendor disclosure and in particular whether additional documents should be mandatory vendor disclosure documents. The debate includes the public consultation process undertaken as a result of the 5 yearly reviews carried out upon the staged repeal of statutory rules under section 10 of the

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[1] RIS page 20
[2] RIS page 21

Subordinate Legislation Act 1989. Such a review of the *Conveyancing (Sale of Land) Regulation 2005* was undertaken in 2010. Committee members participated in a working party, together with members of the Legal Division of LPI, a division of the former Department of Land with responsibility for the legislation.

There was an additional public inquiry held in 2010 namely the "Review of Vendor Disclosure for Residential Property Sales in NSW" by Member of Parliament Matt Brown. The discussion paper issued for that review stated that it proposed to investigate the practical and legislative aspects of stipulating that pre-purchase reports (including building inspection and pest inspection reports) must be provided by vendors to potential purchasers prior to sale of real property in NSW. One issue raised in the Discussion Paper was a comparison of the information required to be provided to purchasers of real property in NSW with other jurisdictions and in particular the ACT.

ACT- style regime

The vendor disclosure provisions in the ACT are contained in the *Civil Law (Sale of Residential Property) Act 2003*. Part 3 deals with energy efficiency ratings. The advertising of residential premises without stating the energy efficiency rating of the habitable part of the premises (or misstating the correct details in a material particular) is an offence (section 20)). Section 23 provides that the vendor must give an energy efficiency rating statement (EERS) to the prospective buyer (for example, by attaching it to the contract) and receive written confirmation from the purchaser that he or she has received it (for example, by an acknowledgment in the contract). If the vendor fails to comply, the seller must pay 0.5% of the price to the purchaser (section 23(3)).

If a person knowingly or recklessly makes a statement or omission in a EERS, a building and compliance inspection report or a pest inspection report which makes the report materially false or misleading , they commit an offence with a maximum penalty of $50,000 - $10,000 if not a corporation (section 37). Giving a false or misleading document to someone else is likewise an offence (section 38).

In its submission to the Matt Brown review, the Committee voiced concerns about the adoption of a similar regime in NSW. There is an existing and tested vendor disclosure scheme operating in NSW. That regime applies penalties for failure to have the prescribed documents available to prospective purchasers where the property is "residential property" and more generally provides a remedy where the prescribed documents are not attached to the contract prior to signature by the purchaser. While it is an offence under the ACT legislation not to supply the documents, a purchaser has no rights in relation to the contract arising from the failure to attach the documents to the contract (except a limited remedy for the lack of an EERS). It would be necessary, if an "ACT style regime" was to be adopted, to have two parallel vendor disclosure regimes operating. This would lead to confusion and would not assist purchasers.

Point of disclosure

It is suggested at Table 4.1 of the RIS in relation to options 1 to 3 described in the paper that the certificate should be provided to a prospective buyer or tenant (or an agent for a prospective buyer/tenant) at all reasonable times when an offer to buy/lease the property may be made to the seller/lessor and or available for download. "If the certificate is not made available it is not considered a breach of contract, but a penalty may be applied and/ or orders applied to rectify it.[3]" Although it is not entirely clear how it is proposed that the certificate will be made available, for the reasons outlined above, the Committee strongly opposes making such a certificate a prescribed vendor disclosure document . It does not have the characteristics that are common to all current certificates that are subject to the NSW vendor disclosure regime. The Committee is also opposed to the adoption of an "ACT-

[3] RIS Page 23

style" regime of requiring the certificate to be annexed to the contract without contractual consequences if it is not annexed.

Disclosure on leasing of residential property in New South Wales

Regulation of residential leasing reflects a different policy approach based on the perceived disparity in bargaining power between landlord and tenant, a disparity that is not perceived to exist between vendors and purchasers of residential land. This more stringent regulation is underpinned by the following:

a. Prescribed form of residential tenancy agreement

b. Prescribed form of condition report

The *Residential Tenancies Act 2010* requires the landlord to pay rates, taxes and certain utility charges as specified in section 40 to prevent landlords attempting to pass on certain outgoings such as council rates and like charges to tenants. The tenant will generally bear heating and power charges and certain other specified utility charges under section 38. There is limited opportunity for a landlord to pass on water usage charges (one threshold requirement since 31 January 2011 is to have prescribed water efficiency measures in place – *Residential Tenancies Regulation* 2010 clause 11).

Information asymmetry or information inertia?

Section 2.1 of the RIS examines the nature of the information problems in the market for residential buildings. The RIS identifies these as primarily being 'information asymmetries' and 'missing information'. It is noted that while "pervasive evidence exists regarding missing and asymmetric information from everyday experience of the operation of the current market....little is known about the extent to which potential buyers/tenants would use this information were it available.[4]"

The Committee agrees there is a lack of information about energy efficiency of residential buildings. The Committee does not view the problem as one of asymmetry in that typically neither vendors nor purchasers/tenants are aware of the energy efficiency status of residential buildings. Nor does it appear to the Committee that the energy efficient status of residential buildings is a factor given any weight by purchasers or tenants in making decisions about which building to purchase or lease. It is acknowledged in the RIS that there is only limited empirical evidence that suggests that there is adverse selection in the residential housing market[5].

The Committee questions whether the parties to conveyancing transactions would view themselves as truly benefitting from any system which mandated energy efficiency disclosure. It is recognized that one possible reason why prospective buyers/tenants may not actively seek information about residential energy, greenhouse and water performance is because they consider the issue one of lower priority than other property attributes, such as location, size, amenity and price. They may judge that obtaining information about building performance is not worth the investment of time or money especially compared with attempts to obtain information about attributes that are seen to be of greater importance[6].

Many vendors, purchasers and tenants would, in the Committee's view, consider that the primary beneficiaries of such a system would be those who were in the business of inspecting properties with a view to assessing energy efficiency, together with the

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[4] RIS page 9
[5] RIS page 18
[6] Box 2.3 on page 8, RIS

statisticians and other bureaucrats who had the role of gathering, collating and analysing the data obtained.

For this reason, the Committee would prefer a minimalist approach to regulation in relation to mandatory energy efficiency in residential properties unless and until there was a demonstrable market demand for the provision of those categories of information. The Committee notes the existence of disclosure requirements in relation to larger commercial buildings, but considers the market dynamics in that class of transaction are markedly different (in part because costs relating to energy and water use are typically, and transparently, passed on to commercial tenants in the form of a contribution to outgoings over and above rental, and also because many major tenants (including but not limited to Government agencies) have adopted "green building" policies, thereby providing an incentive to landlords to actively implement energy efficiency measures in buildings to be leased).

The Committee considers that given the absence of market awareness in the residential property sector of energy efficiency measures, it is premature to mandate any form of disclosure in the contract preparation and formation process. A preferable approach and one more likely to heighten awareness of these issues is to mandate whatever level of disclosure is ultimately considered appropriate at the **marketing** (rather than the conveyancing or contract) stage of the transaction.

The identified options

Given the "objective of government action" identified in the RIS, the Committee is of the view that option 5 (the non-regulatory option) is unlikely to be adopted.

Option 1 involves a negative total net benefit on the figures at Table ES 1.2, and this being the case, the Committee considers that option ought to be rejected.

The Committee believes, based on the probability that a self-assessment process would produce information of limited quality and low accuracy, that option 3 and option 4 should also be rejected.

Option 2 is presented as involving the highest net benefit to society and would therefore appear to be the option most likely to be adopted.

Opting out of mandatory disclosure

Option 6 addresses the possibility of combining one of Options 1 to 4 with an ability to "opt out" of the disclosure obligation. The Committee notes that for some types of property transactions, the disclosure of energy efficiency information would be of no utility (to take one example, the sale of a residential property which the purchaser intends to demolish, or substantially renovate, in order to redevelop the site). In other circumstances, mandatory disclosure could create enormous practical difficulties (for instance, if option 1 or option 2 were adopted, a property in a remote region). The RIS asks for comment on the likely take-up rate of disclosure if there were an ability to opt out.

The Committee notes there are a number of documents available in the existing conduct of a conveyancing transaction which, while not compulsory, are, to varying degrees, frequently useful and desirable. To take three examples:

- A certificate under section 149(2) of the *Environmental, Planning and Assessment Act* 1979 is a mandatory disclosure document. For an additional fee, an applicant for that certificate can purchase additional information provided by the council pursuant to section 149(5). As there is currently no prescribed content which must be provided under

the latter subsection, the quality of information varies dramatically from council to council, Nevertheless, on many occasions the purchaser is interested in that additional information. If the vendor obtains the "full" certificate and attaches it to the contract for sale, doing so should better inform the prospective purchaser (and arguably shorten the time between the prospective purchaser finding the property and the time of exchange of contracts) and also preclude objection by the purchaser to matters disclosed in the full certificate.

- A vendor who attaches an identification survey to the contract for sale will preclude the purchaser objecting (and potentially rescinding) in relation to encroachments by or upon the property.

- Another optional certificate is a building certificate, issued by the local council under sections 149A to 149E of the *Environmental, Planning and Assessment Act* 1979. The certificate indicates that Council will take no action in relation to any non-compliance with building legislation (for example, unauthorised improvements).

The 149(5) information, the survey and the building certificate are not mandatory documents. Anecdotal evidence suggests most vendors are not prepared to pay the cost of obtaining those certificates. In the case of the 149(5) information, the additional cost over and above the mandatory certificate is $80; a survey of a residential dwelling is typically of the order of $600; a building certificate attracts a minimum fee of $250, but the local council will require an identification survey to accompany the application. Furthermore, a substantial proportion (in the Committee's experience, a majority) of purchasers are unwilling to pay for an identification survey or building certificate unless there is an indication of a likely problem from other sources or the certificate is required by a mortgagee.

Based on the market evidence of limited take-up of these arguably, more useful certificates, the Committee suggests that there is unlikely to be a significant "opting-in" if option 6 is adopted.

Energy efficiency assessment of apartments

Table ES 1.1 Note (a) states an assumption that the likely cost of an energy assessment of a home unit is assumed to cost less than an energy assessment for a house. The Committee considers that it is more likely that a home unit energy assessment will cost more for these reasons:

- If the unit is held under strata title as is commonly the case in New South Wales, a number of the matters relevant to an energy efficiency assessment will relate to common property, with any available details held by the owners corporation. Arranging to gather that information (from a second source apart from an owner) is likely to add to costs of information gathering and the reporting process. Indeed, given that an owners corporation will typically obtain little, if any, direct benefit from the provision of the information it would be surprising if owners corporations and their representatives did not seek to charge a fee for provision of the required information and co-operation.

- It is very common for a single lot in a strata scheme to comprise two or more discontiguous areas (for example, a flat and a separate garage). It is not clear from the RIS whether the garage region of the flat would be excluded from the report (and in relation to residential properties generally, whether any analysis would be restricted to living areas or would extend to detached outbuildings).

Conclusion

The Committee does not consider that a cost / benefit analysis justifies altering the existing vendor disclosure regime to require vendors to supply certificates in the forms discussed in options 1 to 4 of the RIS. If however, the government proposes implementing this system for data gathering or other purposes (unrelated to addressing information asymmetry) then for the reasons advanced above, the Committee takes the view that disclosure should be made at the point of marketing the property for sale or lease, rather than at the point of exchange of contracts.

Thank you, once again for the opportunity to comment on the proposals set out in the RIS. If you have any questions, please contact Ms Liza Booth, Policy Lawyer, Property Law Committee on 9920 0202 or via email at liza.booth@lawsociety.com.au

Yours faithfully

Stuart Westgarth
President