Real Estate Markets Quarterly

SUMMER 2022

Hamilton Locke

Foreword

Welcome to the Summer edition of Real Estate Markets Quarterly 2022:

It has certainly been a challenging year for the Australian real estate market and we're sure everyone is looking forward to a well-earned break over the festive season.

As this is our last edition for the year, we thought we would share some of the market insights from the Core Property 2022 Annual Property Funds Industry Forum, which we recently attended.

Some of the key insights were:

1. Transactions volumes for 2022 are well below 2021, with much of the capital "fence sitting" for now.
2. The marginal cost of debt is the highest it has been since the GFC (2012), but there are limited signs of distress as most property funds have low levels of gearing and relatively long dated debt.
3. There is still a significant amount of overseas capital investing in the Australian real estate market, with the US and Singapore still the main sources of overseas capital (representing approximately 60% of the total overseas capital).
4. Return growth was slowing in all sectors of the Australian real estate market, apart from retail.
5. In the office sector, there is a flight to quality assets in a tenant's market.
6. The A-REIT market has underperformed in 2022 (mainly driven by interest rates), with many of the A-REITs trading at large discounts to NTA. However, funds under management continues to grow for most groups.
7. Demand for "alternative" real asset classes continues to grow, particularly in areas such as cold storage, healthcare, data centres, senior housing, student housing and real estate debt.

On the regulatory front, ASIC have been very active in targeting property fund operators for failures to comply with Design and Distribution Obligations and in particular the adequacy of Target Market Determinations. In addition, ASIC has been targeting managed fund advertising and in particular "greenwashing". ASIC has stated they will continue to focus their enforcement priorities on those areas in 2023.

From that overview, it's clear that 2022 has been a difficult year for the Australian real estate market. But hopefully inflation and interest rates begin to moderate in 2023 and that provides the capital markets with more certainty and increased confidence to invest.

In this edition we feature:

1. An industry spotlight on Georgia Liu, who is an Executive Director in Property and Construction at the CBA.
2. An insurance market update from Ryan Neary, Head of Professional and Financial Lines, at GSA Insurance Brokers.
3. Information and guidance on ASIC's crackdown on Design and Distribution Obligations and Target Market Determinations.
4. A review of a recent NSW Supreme Court decision which is a reminder of the issues with calling on a bank guarantee from construction companies facing financial troubles.
5. An update on recent developments in Building Duty of Care and Insurance for construction work in NSW.
6. A review of the considerations for private lenders when lodging caveats.

We hope you find this Summer edition of Real Estate Markets Quarterly informative and useful.

Finally, from all the team at Hamilton Locke, thank you for your support in 2022 and we wish you a safe and happy festive season and all the best for 2023.

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Something Different

It's certainly been a wet and cold spring. As summer approaches I'm sure we're all hoping for a little less rain and some warm weather. The days will be longer and our trips to the beach and engagement in water activities will increase.

To help keep us safe, we've attached a short video reminding us of the dangers of rips and how to spot them.

Industry Spotlight - Georgia Liu

Georgia Liu

Corporate Banking Executive/Director - Property & Construction

Please provide an overview of your career to date.

- 16+ years experience in Banking & Finance across two local major Banks having worked in both Business and Corporate Banking sectors and held a range of roles from senior analysts to Relationship Executives/Directors to relieving leadership roles.
- Highly experienced and skilled in mid-market/small cap ASX listed, PE backed businesses operating in diversified industries, with capital and banking needs for cash flow, working capital, expansion, growth and M&A.
- I have experience in Property and Real Estate Finance including Development Finance, Investment Finance for High Net Worth (HNW) Individuals, private borrowers and domestic and offshore fund managers with institutional capital.
- I have also had a short stint working at a private company to assist it with capital management, finance, strategy framework and AFSL license application and served as a non-executive director for a small-cap ASX-listed mining company during the same period.
- Outside work, I've been active in the community and the not-for-profit space having served as a Treasurer for a local independent school's parents association for 6 years and participated in Vinnies CEO Sleepout for 3 consecutive years. Currently, I am a member of the Australian Institute of Company Directors (AICD) and Women in Banking and Finance (WiBF).
- In 2015, I also had the privilege of undertaking the Leadership Immersion Program in partnership with McKinsey Group and The Hunger Project in rural India. Change Leaders were chosen based on their leadership skills and commitment to living the vision of CBA.

Please tell us a little bit about your current role with CBA.

- Currently, I am the Relationship Executive/Director of CBA VIC Property Team focusing on $30m+ property investments and development finance (including residential, commercial, industrial, mixed-use, hotel/serviced apartment, emerging assets i.e. BTR and other specialised assets).
- I specialise in structured property finance and advisory services (senior debt, mezzanine debt, Bilateral & Syndicated Loans) for private mid-market company borrowers and established property fund managers backed by private equity and/or institutional capital.
- A regular presenter at industry events on topics such as Sustainability Finance, Capital Market and Property Market updates.
- I also provide ongoing coaching and mentoring to team members/new starters and have been heavily involved in talent and graduate recruitment for our business divisions.

What do you like most about working in the property/construction financing sector?

- Achieving the unachievable, surprising and delighting my clients, and being able to add value to all my client engagements provide me with the greatest satisfaction and sense of achievement.
- The ability to work with clients and their advisors to support them with the right debt-sized facilities and well-structured capital to help navigate difficult periods is always highly appreciated by clients. My care, commitment and courage are what set me and my team apart from our competitors who may be just doing enough or BAU (business as usual).

How and why did you decide to work in the property/construction financing sector?

- Property Finance has always been a part of what I provide my clients ever since I started my banking career in 2016.
- Properties and Real Estates exist everywhere and are a core part of individual and business' landscapes whether as a landlord, tenant/occupier, operator or tenant customers (ie employees of tenants).
- Capitals have been and are still constantly and strategically looking for real estate/property opportunities as a core sector for allocation to deploy and invest their capital. It has historically proven to be an inflation-hedging investment obviously with current rising rates and inflation challenges, if your investments can participate in the inflationary environments (ie resetting prices, passing on costs, being a price-maker, not a price-taker), the risk-adjusted returns will still remain attractive.

What are you most proud of in your career to date?

- Apart from having successfully completed some landmark transactions (in size, complexity, anti-cyclical situations and/or competitive tender processes) with a total exceeding $1.5bn in asset values, I take great pride in representing a diversity of Women in Banking, Finance and Property and being a dedicated, hard-working, resilient professional.
- I am driven by visionary, inclusive and inspirational leadership and continuous personal development. I believe in innovation, empowerment and workplace diversity, and I enjoy the challenges of leading, influencing and driving change.

What are the biggest challenges you have experienced in your career to date?

- The GFC from 2008-09, COVID-19 in 2020 as well as some structural changes facing certain industries have created some of the biggest challenges which required exceptional professionalism and capabilities of banking and finance professionals.
- Having said that, crises and difficult situations provided the greatest and most enriching learning experiences. 'Never waste a crisis' is what I always say to myself and my clients as opportunities await amidst challenges and volatilities for those who are prepared.

What are your tips for young professionals aspiring to pursue a career in the property/ construction financing sector?

- Follow your passion, give it a go, and embrace the opportunities and challenges any roles present to you.
- Be inquisitive, Be courageous, Be diligent, Be Resilient and set higher targets.
- It's also important to have a support team around you (mentor, peers, family & friends) who will challenge you to work on your weaknesses and overplay your strengths, lift you higher and support you unconditionally.

> *"Be inquisitive, Be courageous, Be diligent, Be Resilient and set higher targets"*

If applicable, what other industry roles do you currently hold? What led to these positions?

- As mentioned earlier, I'm currently a member of AICD, WiBF (Women in Banking & Finance) and an active participant in the PFA (Property Funds Association of Australia) and PCA (Property Council of Australia) events and educational classes.
- I love self-investment, learnings, challenges and opportunities that exposure to other organisations and professional network platforms provides hence I have been thoroughly enjoying various positions and participation outside CBA.

Please provide insight into the current state of the property/construction financing sector. What do you think are potential issues and opportunities prevalent in the sector over the next 12 months?

- Rising interest rates, inflationary environments, skilled labour shortages, dislocation and volatilities in the markets have been some of the greatest challenges globally and Australia is not immune to these challenging economical backdrops.
- That being said, Australian financial institutions/Banks are very well capitalised/ positioned to support businesses and households with their banking and financing needs and requirements
- As per our 2022 Annual Report, CBA's Common Equity Tier 1 (CET1) capital ratio of 11.5% (Level 2, APRA), is well in excess of regulatory minimum capital requirements
- I've been having regular dialogues with clients (some operating globally) and advisors to share insights and our observations and updating them by inviting them to regular and timely CBA economic/ market updates. Personally, I remain cautiously optimistic and believe paths can be found to navigate through these economic conditions, and investment opportunities can be found by businesses who are adaptive, well-capitalised, moderately leveraged, well-resourced (people/equity and debt capitals) and remain disciplined.

What are your top reading/listening/watching recommendations? (Feel free to provide an answer for one or all three)

- Country Music (believe it or not) and various business/capital market Podcasts as well as Oprah Winfrey's Super Soul are always some of my favourites when exercising and driving to/from work/appointments. Been listening for many many years and am up-to-date with all Episodes
- Currently reading ' The Happiness Advantage' by Harvard lecturer Shawn Achor which is about positive psychology, and emphasises instilling resiliency and positive attitudes to maximise potential at work and maintain a more positive mindset in every aspect of one's life.

Missing the Target: Design and Distribution Obligations Enforcement Action Against Property Funds

Recent enforcement action by ASIC against property fund managers that failed to meet the design and distribution obligations (**DDOs**) has shone light on ASIC's expectations for the regime.

The actions show that ASIC are taking aim at the adequacy of target market determinations (**TMDs**), and have pulled products from the market through the issue of interim stop orders. ASIC's Corporate Plan for 2022-2026 has identified driving compliance with the DDO as an enforcement priority.

What are the design and distribution obligations?

The DDOs require issuers and distributors of financial products to ensure that investors obtain products that are likely to be consistent with their objectives, financial situation and needs. As part of this, responsible entities must identify the types of investors who are suitable for their products through the preparation, release and review of a target market determination (**TMD**).

Broadly, the TMD for a registered property scheme must meet certain content requirements by including a description of:

- the class of investors who are within the issuer's target market;
- conditions for how the financial product is distributed;
- the events and conditions that will trigger the TMD to be reviewed;
- when the TMD will have its first review and when subsequent reviews will occur; and
- what information distributors of the financial product will need to report to the issuer and when they are required to provide that report.

A TMD must also meet appropriateness requirements. This means that the TMD must accurately identify investors whose objectives, financial situation and needs can be met by investing in the fund, and explain why the distribution conditions will make it likely that the consumers who acquire the product are in the target market.

There are additional obligations relating to record keeping, reporting and review.

Recent enforcement actions

ASIC's recent spate of enforcement actions all resulted in the issuing of an interim stop order to the responsible entities of each fund. An interim stop order is a temporary order to stop offering or distributing a product. In each enforcement action, the responsible entity was prohibited from issuing interest in the funds, giving retail clients a product disclosure statement (**PDS**) or providing general advice or otherwise recommending investment in the funds for a period of no more than 21 days.

The table on the following page outlines the relevant features of the funds and aspects of the TMDs that ASIC took issue with:

	Fund 1	Fund 2	Fund 3	Fund 4	Fund 5	Fund 6
Product Features	Sole investment was a loan to a related company for the development of a sandstone quarry.	Portfolio of Australian residential property assets. Supported by borrowing. Engages in property development. Low liquidity.	Concentrated portfolio of commercial property assets. Borrows money to support investment. Cannot withdraw in the first 7 years	Fund was invested in two shopping centres and was raising money to purchase a third shopping centre. Investment supported by borrowing. Investors cannot withdraw until April 2029. Returns not guaranteed and distribution forecasts based on assumptions, where actual result may differ.	Fund invested in individual crypto-assets such as bitcoin, ether and filecoin. Assets in the funds could face a total loss of value.	Portfolio of secured and unsecured loans, credit leases and other high-risk fixed interest assets. Fund is invested in five property development loans in NSW.
Target Market	Intending to use the investment as a core component of their investment portfolio. With an objective of high capital growth or a mixture of capital growth and income.	With a capital preservation investment objective. Intending to use the product as a core (25-75%) or standalone component (75-100%) of their portfolio. With a medium or low risk and return profile. With a need to withdraw their money from the Fund on an annual basis.	With a capital preservation or potentially a capital guaranteed investment objective. Intending to use the product as a core (25-75%) or standalone component (75-100%) of their portfolio. With a low risk and return profile. With a medium and potentially short investment timeframe. With a need to withdraw their money from the fund annually or longer.	Looking to invest in commercial properties with the prospect of capital growth and a secure income stream. Investors who are 'cash rich' entities or retirees looking for a long-term capital investment along with a monthly return. With a 'buy and hold' strategy and do not require immediate access to capital. With a need for capital preservation that accrues capital gains/losses.	With a potentially medium, high or very high risk and return profile. Intending to use the fund as a satellite component (up to 25%) of their investment portfolio. Intending to use the fund as a solution/standalone component (75-100%) of their investment portfolio.	With a tolerance for a moderate level of risk with respect to their investment. Needing liquidity or needing to make withdrawals during the investment term. Seeking to have their capital invested for a minimum period of two years. Seeking regular monthly income distributions.
DDO Breach	The product was not suited to all investors in the target market.	The product was not suited to all investors in the target market. The TMD failed to meet the appropriateness requirements as the distribution conditions didn't adequately ensure that it only reached investors in the target market.	The product was not suited to all of the investors in the target market. The TMD did not adequately describe the class of retail clients in the intended market or specify review periods. The TMD failed to meet the appropriateness requirements as the distribution conditions didn't adequately ensure that it only reached investors in the target market.	Not suited to investors in the target market. The TMD did not meet the information requirements. The TMD did not meet the appropriateness requirements as the distribution conditions were inadequate – they relied solely on a self certification by the investor.	Not suited to the wide target market defined in the TMD.	The product was not suited to all of the investors in the target market. The TMD did not meet the appropriateness requirements. The distribution conditions in the TMD were not specific enough to ensure the product was distributed to consumers in the target market.
More info	22-194MR	22-252MR		22-266MR	22-278MR	22-284MR

In each case, the responsible entity failed to accurately describe the risk profile of their product, which lead to an incorrect TMD. High risk products are not suitable for investors with capital preservation objectives or to be a large component of an investment portfolio. Some TMDs involved clear contradictions, such as conflicting statements about the product's intended investment portfolio percentage or identifying consumers who required to withdraw their funds during the time period that the product did not enable withdrawals.

Avoiding Non-Compliance

Each fund faced interim stop orders that prevented them from offering or selling their financial product, and one fund withdrew their offer. ASIC is also considering whether to undertake further regulatory action. These enforcement actions can have a significant impact on the viability of a fund.

Compliance with the DDO requires fund issuers to consider the value of the product from an investor centric perspective. Fund managers can reduce their risk of non-compliance by taking the following steps:

1. Have your TMD reviewed

The simplest way to avoid non-compliance is to engage a legal advisor to assist with the preparation and review of your TMD. Many funds failed to include mandatory information in their TMD, such as required information or distribution conditions. Hamilton Locke can assist you to ensure that your TMD meets the content requirements and provide advice on compliance with the broader DDO regime.

2. Establish an accurate risk profile

Fund managers must accurately consider the risk profile of their product within their TMD. The TMD should not act as marketing material. Features such as concentrated or single asset class investment, use of borrowing, inability to withdraw and inability to guarantee returns are likely to contribute to the product being considered high risk. The mischaracterisation of risk profile by the funds was cited by ASIC in the enforcement actions. Funds that consider their product as low risk should prepare adequate reasoning and proof.

3. Review the features of the product

Considering the features of a fund product can help identify the common objectives, financial situations and needs of a consumer who acquires the product. A fund that provides concentrated investment into commercial property would be more suitable as a minor component of a portfolio rather than a core or single product in an investment portfolio. Similarly, a fund that does not allow withdrawals for several years would be more suitable to an investor that does not need to access their investment. All funds failed to accurately match the features of their products with the objectives, financial situations and needs of their target market.

Conclusion

The introduction of the DDO requires product issuers to consider how their product will benefit a particular class of consumers. Funds must take care to accurately assess their products within the wider context of financial products. A fund that is relatively low risk in comparison to other funds may not be considered a low-risk financial product. Funds should engage expert legal advisors to help them comply with their DDO and avoid ASIC enforcement action.

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Bank Guarantees: Pay Now, Argue Later?

In the past 12 months, we have seen the collapse of several high-profile Australian construction companies; and many others are in financial difficulties. In Australia, the construction industry records more insolvencies than any other, with recent victims including Probuild, Condev Construction, Pivotal Homes and Waterford Homes. There are many contributing factors to the issues facing the industry, including increased cost of materials, supply chain issues, the COVID-19 pandemic, inflation, lower margins, skilled labour shortages, moves by the Australian taxation office to recover tax arrears deferred during the pandemic and general misallocation of risk.

The recent decision of the NSW Supreme Court in *Daewoo v INPEX [2022] NSWSC 1125 (Daewoo)* is a timely reminder of the principles which will govern a principal's ability to call on a bank guarantee when its contractor is facing financial troubles and/or potential insolvency and an illustration of the courts' general reluctance to intervene to prevent claims being made under a bank guarantee except in exceptional circumstances.

What is the nature of a bank guarantee?

First, a brief refresher on the nature of a bank guarantee.

A bank guarantee is an unconditional bond to pay money on demand up to a stated maximum amount, unqualified by the terms of the underlying contract between the party at whose request the bank guarantee has been issued and the party entitled to claim on it. A bank guarantee comprises an independent and primary undertaking by a particular bank or financial institution to pay on demand by the person in whose favour it has been issued. Whilst the parties to the underlying contract may have negotiated a regime which governs the circumstances in which a claim may be made under the bank guarantee, for the issuer, the bank guarantee is a direct, standalone unconditional undertaking to pay the stated maximum amount on demand which is independent of the terms of the underlying contract.

A bank guarantee has been described as a contract of "suretyship" or "as good as cash". Bank guarantees are regarded as the gold standard of security for their unconditional "cash-like" quality. From the issuing bank's perspective, the grounds for non-payment are minimal. In *Simic Simic v NSW Land and Housing Corporation* (2016) 260 CLR 85; [2016] HCA, the Court observed that "such securities 'create a type of currency' and are … essential to international commerce and, in the absence of fraud, should be allowed to be honoured free from interference by the courts".

There are two primary contexts in which a bank guarantee may be issued in a commercial transaction:

- *As **security for non-payment** – in this context, the bank guarantee provides security to the beneficiary of the bank guarantee that it can recover some money in the event of non-payment its counterparty; and*
- *As a **risk allocation device in the event of dispute** – in this context, the bank guarantee enables the beneficiary to make a claim so as to not be "out of pocket" pending the resolution of the dispute (often referred to as "pay now, argue later").*

Whether a bank guarantee is intended as security or a risk allocation device will turn on the terms of the underlying contract, and normal contractual principles of interpretation will apply.

When will a court intervene to prevent a claim under a bank guarantee?

Courts are generally reluctant to intervene to prevent claims being made under bank guarantees on the basis that the form of security is by its nature unconditional and intended to be the equivalent of cash. There are certain very limited exceptions being:

- Fraud on the part of the beneficiary;
- Unconscionable conduct on the part of the beneficiary; or
- An "underlying contract exception" where the making of the claim is contrary to the terms of the underlying contract. In such a case, whether the underlying contract qualifies for the right to call on the bank guarantee will be determined in light of the terms of the contract and the bank guarantee (the primary focus being on the terms of the contract).

Importantly, courts will generally not intervene to restrain the issuer of the bank guarantee from making payment (and honouring the terms of the bank guarantee) but may intervene to injunct a party making a claim under a bank guarantee in the limited circumstances noted above.

Daewoo Shipbuilding Marine Engineering

The recent decision in Daewoo is an illustration of the general reluctance by the courts to intervene to prevent claims being made under a bank guarantee, even when the contractor is facing financial troubles and/or potential insolvency.

The key facts of the case are:

- The parties to the case were:
  - Daewoo (a Korean shipbuilding company); and
  - INPEX (an Australian subsidiary of a Japanese company that operates the Ichthys Gas Field Development Project (the **Project**), in Northwest Australia).
- The Project is one of the world's most complex LNG projects, with deep offshore production facilities, two floating production units, a gas pipeline and a liquefaction plant, and a whopping valuation of US$45 billion (AU$62.6 billion).
- The parties had entered into an Engineering, Procurement, Supply, Construction and Commissioning Contract (the **Contract**) for Daewoo to build a floating production storage and offloading facility in respect of the Project. Under the Contract, Daewoo was obliged to provide an irrevocable bank guarantee to INPEX of US$328,510,832 (around AU$467 million) (the **Bank Guarantee**).
- Daewoo sought to extend an interim injunction restraining INPEX from calling on the Bank Guarantee, pending the outcome of an arbitral determination tribunal regarding a dispute under the Contract.
- Daewoo was experiencing financial troubles due to sanctions on Russia following the invasion of Ukraine and the pandemic. Daewoo submitted that its financial troubles might have adverse consequences for INPEX's ability to enforce the outcome of the arbitral determination against it (and so should be a factor which the Court should take into consideration in extending the injunction preventing a claim being made under the Bank Guarantee).

The Court declined to provide the injunctive relief sought by Daewoo, notwithstanding the considerable financial difficulties faced by Daewoo. Observations made by the Court included:

- That the Bank Guarantee was intended as a "risk allocation" mechanism and to restrain recourse to the Bank Guarantee in the circumstances would defeat the commercial purpose of the Bank Guarantee which was provided in the context of a "pay now, argue later" contractual regime.
- That whilst Daewoo's financial troubles might have adverse consequences for INPEX's ability to enforce a judgement in Korea, that will not (of itself) be grounds to injunct INPEX from calling on a bank guarantee (and indeed could make it less likely that INPEX would be restrained).
- Courts ordinarily need to be satisfied that there is a strong prima facie case justifying the court's interference in restraining a claim being made under a bank guarantee. Here, the Court was not satisfied that Daewoo had a strong prima facie case to justify continuing to injunct INPEX from calling on the bank guarantee and the application was dismissed.

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Recent Developments in NSW – Building Duty of Care and Insurance

Duty of care

In New South Wales, under section 37 of the *Design and Building Practitioners Act 2020* (NSW) (**DBP Act**), any person who carries out construction work (as defined) must exercise reasonable care to avoid economic loss caused by defects in or related to a building for which the work is done and arising from the construction work. This duty of care is owed to the owner of the land in relation to which the construction work is carried out and to each subsequent owner of the land. A claim for breach of the duty must be brought within 6 years from when the economic loss first became apparent, subject to a further limitation for defective building work of being brought within 10 years from completion of the work.

This duty commenced on 10 June 2020 and also applies retrospectively to construction work carried out in the 10 years prior to that date if the economic loss first became apparent in that 10 year period (potentially subject to the standard limitation periods for making a claim described above). In addition to carrying out building work, construction work is defined to also include design and manufacturing work relating to building work along with supervising, coordinating, project managing or otherwise having substantive control over the carrying out of each of those types of work.

Until recently it had generally been understood that the duty of care only applied to buildings to which the DBP Act has applied since 1 July 2021, being class 2 buildings or buildings containing a class 2 part, and residential building work. The recent judgment of the NSW Supreme Court in *Goodwin Street Developments Pty Ltd atf Jesmond Unit Trust v DSD Builders Pty Ltd (in liq)* [2022] NSWSC 624 has greatly extended the types of buildings that the duty of care will apply to. While the judgment concerns boarding houses, which are excluded from being residential building work under the *Home Building Act 1989* (NSW), the effect of the judgment is to apply the duty of care in relation to all buildings in NSW, whether residential in nature or otherwise. We note that the Court of Appeal has reserved its judgment in the appeal brought by the individual who project managed and supervised the building work, who was held to have breached the duty of care.

In addition to this significant extension of the application of the duty of care, the courts have also decided that a developer can be caught by the duty of care if, as matter of fact, it exercised substantive control over the carrying out of the construction work. This was decided by the NSW Supreme Court in *The Owners – Strata Plan No 84674 v Pafburn Pty Ltd* [2022] NSWSC 659, which cited the developer being the sole owner of the builder as a potential example of such control (although in this case the builder was the sole owner of the developer). The court in this case also decided that a developer would not owe the duty to itself if it was the owner of the land at the time the relevant work was carried out.

In October the NSW Supreme Court delivered another judgment on the extent of the duty of care (*Boulus Constructions Pty Ltd v Warrumbungle Shire Council* [2022] NSWSC 1368). The court decided, in relation to adding defendants to the proceedings, that the duty of care is owed by individuals who carry out construction work, whether for an incorporated entity, such as a company, or in their personal capacity.

Insurance

Builders carrying out residential building work in NSW are required to take out home building compensation cover (often still called home warranty insurance) before commencing work (subject to exceptions). The most widely understood exception is that such cover is not required where the builder is constructing a multi-storey building (having a rise in storeys of more than three, along with some further technical considerations in that regard).

Where the cover is required, it can only be claimed by an owner if the builder has died, cannot be found or is insolvent. The cover applies in relation to a claim against a builder for breach of the statutory warranties in the *Home Building Act 1989* (NSW) that apply to residential building work. There are monetary limitations on the amount of cover.

A developer must not enter into a contract for the sale of land on which residential building work has been done, or is to be done, on the developer's behalf unless a certificate of insurance evidencing the home building compensation cover (if it is required) is attached to the contract of sale (if the land is sold up to 6 years after completion of the work). The contract for sale is voidable at the option of the purchaser if the certificate is not attached, although, as long as the cover was in place when the contract was entered into, the failure can be cured by providing the certificate before completion. Additionally, if the work has not commenced when the contract is entered into, the certificate can be provided within 14 days after the cover is taken out (which is done by requiring provisions to this effect to be included in the contract including a provision giving the purchaser the right to rescind the contract if they are not complied with).

The effect of the multi-storey exemption from home building compensation cover was ameliorated in 2018 by the introduction of a requirement that a developer provide a bond for 2% of the building contract value to the Commissioner for Fair Trading before the occupation certificate is obtained (if the building was built on the basis that it would be strata titled). In summary, the bond is able to be accessed by the owners corporation to rectify defects following completion of the building work (after required inspections, with the balance of the bond being returned to the developer approximately 2 years after completion).

The NSW Parliament has recently amended the legislation governing the 2% bond to provide developers with an alternative to providing the 2% bond, being the developer taking out decennial insurance before the building work commences. Such insurance will insure the owners corporation against defects in a building element (as defined in the DBP Act, being an element of the common property) for not less than 10 years from completion of the work, on a strict liability basis. The intention is that having such cover in place will enable an owners corporation to have defects rectified without needing to enforce the statutory warranties. We understand there to be a single product offering such cover at the time of writing. The amending legislation providing for this alternative hasn't removed the inspection regime that accompanies the 2% bond from applying if decennial insurance is taken out.

Effect of these developments

While the option of decennial insurance cover may be welcomed as providing improved protection for owners corporations and, by extension, apartment owners, time will tell whether that product is commercially attractive to developers given it will need to be price competitive with the costs incurred by a developer in procuring the 2% bond (noting also that the insurance must be taken out significantly earlier than provision of the bond).

More concerning is the extension of the duty of care to all buildings in NSW, particularly given its retrospective effect, and the application of the duty to individuals. Given the current state of the professional indemnity insurance market and the concern over whether such insurance extends to cover liability arising from breach of statutory duties, there are potentially many claims that will be uninsured.

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Caveatable Interests – Not a 'Bargaining Chip': Considerations for Private Lenders and Practitioners

Key takeaways:

- Lodging a caveat over land notifies the Registrar General of the caveator's interest in land, and can prevent any further dealings without, at least, the caveator's consent.
- Accordingly, caveats can be used by private lenders as a form of security to protect their interests.
- However, lodging a caveat without a proper basis carries serious consequences for both the caveator, and the practitioner who prepares and facilitates the lodgement of the caveat.

The legal maxim that a caveat cannot be used as a 'commercial bargaining chip'[1] cautions against the practice of lodging a caveat where no actual interest in the land exists and for an 'ulterior or collateral purpose', such as protecting a lender's position in a transaction.

This article sets out the various considerations, for practitioners who lodge caveats and the caveator's themselves when determining whether caveatable interests exist, and the serious consequences that may arise from a failure to do so.

What is a caveat:

The term 'caveat' comes from the Latin term 'let him beware'. The effect of which is to act as a warning registered on a land title to third parties that the caveator (i.e., the lodging party) has an interest in land.

Caveats title and can either be absolute or permissive:

- a *permissive caveat* allows further dealings with the property, subject to the permission of the caveator; and
- an *absolute caveat* prohibits the registration of any further dealings with the property until the caveat has been removed.

Grounds for lodging a caveat

In New South Wales, caveats are governed by the *Real Property Act 1900* (NSW) (the **Act**) and the Common Law. A caveat cannot be lodged without a reasonable cause, meaning the lodging party must have a proper interest, either legal or equitable, in the land.[2]

Consequences of improperly lodged caveats:

Considerations for lenders

Section 74P of the Act provides that a caveator who lodges a caveat without reasonable cause is liable to pay compensation to any person who sustains pecuniary loss attributable to the lodging of the caveat.

Further, the landowner can apply for a lapsing notice when caveats are lodged without a valid reason.[3] The lapsing notice requires the caveator to obtain a Supreme Court order extending the operation of their caveat within 21 days of service of the lapsing notice.

The New South Wales' Court of Appeal (**NSWCA**) decision in *Ta Lee Investment Pty Ltd v Antonios considered whether a Deed of Loan (the* ***Deed****) and Guarantee executed between* MV Developments (Lane Cove) Pty Ltd (the **Borrower**) and Ta Lee Investment Pty Ltd (the **Lender**) for a $1.5 million loan to develop land into an apartment block gave rise to a cavetable interest where such an interest was not expressly stated.

In *Ta Le*, the Borrower claimed the Deed contained an 'implied right to charge the land' and accordingly, in an event of default, they had the right to lodge a caveat over the land.

The NSWSCA rejected that any implication could be drawn, finding that a caveatable interest is subject to a proper construction of the Deed as a whole. The NSWSCA found the Deed failed to reference a "security", "secured interest", "charge", "caveatable interest, or use "an other language which would point to the lender having an equitable interest" , further, it was noted that given the Deed was a professionally drafted business document, had the parties intended for the Lender to have a secured interest, provisions would have been included to that effect.[6] Accordingly, the Lender's caveats were withdrawn.

Considerations for practitioners

A solicitor or conveyancer who prepares and facilitates the lodgement of an erroneous and defective caveat may face serious allegations of professional misconduct.

In *Victorian Legal Services Commissioner v Souki*,[7] the Legal Services Commissioner bought charges against a legal practitioner who had facilitated the lodging of a caveat for her client when she knew and had advised that no caveatable interest existed. The Commissioner alleged, and the practitioner admitted, her conduct involved a substantial failure to reach or maintain a reasonable standard of competence and diligence which amounts to professional misconduct.

Guirgis v JEA Developments Pty Ltd[8] provides another cautionary tale for practitioners as to the importance of taking reasonable steps to inform themselves of the proper basis on which a caveat is to be lodged. In this case, a conveyancer was found to have failed to make any enquiries or obtain any supporting documentation from their client to confirm a caveatable interest actually existed before lodging the caveat.

The conveyancer's failure was heavily scrutinised by the Kunc J who noted, "no reasonably competent conveyancer who had bothered to take proper instructions from [the client] would have co-operated in the lodgement of the Caveat." The caveat was inevitably removed and the caveator was ordered to pay the landowner's costs.

As New South Wales' conveyancing moves to a completely electronic platform, wherein ordinary members of the public are no longer able to lodge caveats, the Court highlighted that "the role of conveyancers, solicitors as persons qualified to prepare and lodge caveats becomes all the more important".[9]

At the outset of Kunc J's judgment in *Guirgis*, it is noted that 'lodging a caveat is not a trivial act to be undertaken lightly.' The judicial scrutiny surrounding the lodging of erroneous caveats should act as a warning to lenders and practitioners alike to ensure they have a proper basis before lodging a caveat.

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[1] See for example, *Pascoe and Robinson (in their capacity as trustees for sale of land known as 124 Tennyson Road Gladesville) v James* (2013) 17 BPR 32, 743, [12]; *Kuipers v Harrington (No 2)* [2019] VSC 190, [33(c)] and *Hermiz v Yousif [2019] VSC 160*, [52(h)].

[2] Section 74F(5), Real Property Act 1990 (NSW).

[3] Section 74J, the Real Property Act 1990 (NSW).

[4] [2019] NSWCA 24 (***'Ta Le'***).

[5] Ibid [104].

[6] Ibid.

[7] [2022] VCAT 663 (***'Souki'***).

[8] [2019] NSWSC 164 (***'Gurgis'***).

[9] Ibid at [39].

[10] Ibid at [1].

Professional Indemnity and D&O Update

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In recent months both the Professional Indemnity (PI) and D&O markets have begun to trend downwards, Insurers are more focused on new business and growing their portfolios, this is a result of improved loss ratios. These improvements are a direct result of the material remediation that Insurers have taken on their portfolios over the past five years. In addition to this, we are now experiencing increased competition in both the PI and D&O markets, this increased competition is coming from both local and overseas Insurers who are keen to gain market share in these policy classes.

We have witnessed a deceleration of PI and D&O rate increases due to new market entrants and corrective portfolio measures, with rates now close to flat for Primary Insurers and reducing for excess layer Insurers, who are attaching above the primary layers. The largest reductions we are experiencing are on the excess layer placement, in the hard market we have just come through, Insurers were pricing for capacity and not for risk on the upper layers and this is now being corrected.

Insurers with growth targets are viewing well-priced placements as new business opportunities. This very much applies to the more challenging risks which are now paying significant monetary premiums as well as retaining much more of the risk themselves. In turn, this is creating an opportunity for these clients to reassess their programme structures, limits and remove any overpriced capacity from the market, we are seeing significant improvement to value or cost within the D&O sector in the market. Line size restrictions are showing signs of lifting this again shows again the movement within the D&O marketplace. As rates begin to fall, insurers are looking to put out more capacity to balance the loss of premium they see on the larger towers.

There has been movement in the Australian market over the previous 12 months with side A Directors and Officers cover being one of the most important parts of a D&O policy. In our experience, many insureds are either dropping or reducing their Side C coverage due to cost and lack of capacity. Some Directors are also opting to remove Side B cover and only maintaining Side A, to solely protect Directors and Officers where they are not indemnified by the company. We understand that of their ASX listed clients, about 20% decided to remove Side C in their last renewal cycle. It was also reported recently by an industry body that 29% of ASX 100 clients had made the decision to remove Side C.

Having said the above, what about the actual risk environment? There are issues that concern the market. Whilst the ability to navigate Covid-induced supply chain issues and the move to more flexible working arrangements are now taken as a given, ESG is moving to centre stage. ESG reporting is thought by many commentators to be an area that will drive litigation as we move through 2022. Over-optimistic ESG commitments and reporting, or active 'greenwashing', are expected to become areas of focus. Equally, companies with good ESG scores will be able to differentiate themselves in the market.

More broadly, there is concern that insolvencies and corporate restructures could spike, with most government support schemes at an end or in the process of being phased out. Over the last two years we have also seen considerable activity in mergers/acquisitions, private equity investment in entities and products which will see an increased focus on representations made and decisions taken. Additionally of course, uncertainty remains around the overall macroeconomic outlook. Growing inflationary forces generated by rebounding economies, shortages in both materials and labour and more recently, the conflict in the Ukraine may all impact on companies' financial stability and create a flow of claims into the D&O and PI markets.

Whilst there are some macro factors that may affect the market moving forward (noted above), we still feel that the increased competition and remediation that has occurred over the past five years by Insurers will continue to drive the PI and D&O market downwards and we will see premiums continue to reduce.

Cyber Liability

We have recently seen the most distressed cyber market we have experienced. Ransomware has been, and continues to be, the area affecting organisations the most. From the claims trends we have seen, it affects all industry sectors and organisations of all sizes. Insurers continue to develop a further understanding of the threats an organisation faces, and the optimal way to minimise or eliminate these. The most recent examples of these situations are both Optus and Medibank becoming compromised and having sensitive information/data taken.

Whilst Ransomware will remain the main focus for Insurers moving forward, the threat of other exposures or business vulnerabilities are evident with a number of large data breaches taking the place in the past 2 years.

Insurers are placing a heavier focus on mitigating their exposure in the following ways:

1. Top-line growth: premium increases, in some instances up to 150%, have been a major focus for Insurers.
2. Underwriting Review Process: Insurers are investing more time and resources into the Underwriting review process. There is an expectation that the Insured will implement and follow certain Cyber Security measures to mitigate possible threats.
3. Capacity Management: majority of Insurers have reduced their maximum capacity to $5,000,000.
4. Coverage Restrictions: in addition to reduced maximum capacity, Insurers are looking to increase Deductibles and Waiting Periods. Furthermore, a major focus for Insurers is limiting the Ransomware exposure through aggressive sub-limits or requiring a Co-insurance agreement between the Insurer and the Insured.
5. Reducing Insurer Participation: in certain circumstances, we are seeing Insurers withdraw from the Cyber market or alter their Underwriting appetite to a level where they are unable to offer a renewal option.

Moving forward, we anticipate there will be further market movement in the short to medium term. It is anticipated that the reinsurance market will also harden in response to current claims trends which will further impact cyber insurance terms and conditions.

Controls will remain a critical element of not only reducing premium spend on Cyber Insurance but will also impact accessibility and availability of these policies. 2022 saw a rapid change to Underwriting appetite and reducing Insurer's exposure to unsustainable losses. It is now becoming clear that the focus has now shifted to consolidating these changes and further developing the data collection process through adequate submissions and engaging with the key stakeholders in an organisation to understand these.

Property/General Insurance

The trends that we have experienced over the past 12 months are due to continue into 2023, with local and global conditions posing substantial problems to the insurers. 2022 was yet another challenging year for insurers with the following key factors all impacting the overall market;

- Natural disasters and catastrophic weather events
- Claims inflation
- Insurer's profitability and ongoing remediation
- Environmental, Social and Governance (ESG)

Natural disasters and catastrophic weather events have been the main area of focus in the market where there is an exposure we are seeing, sub-limiting of cover, application of higher deductibles and location driven pricing based on the exposure. This unfortunately, is leaving many insureds with significantly higher premiums and reduced coverage, with some cases resulting in the need for additional policies to buy down deductibles or purchasing of excess coverage to provide adequate limits, all at an additional cost.

Another area of major focus is on values with insurers seeking current valuations and adequate costs escalation/indexation on the sum insured to ensure the values are reflective of the current increased rebuilding and replacement costs. We are however starting to experience a steady, gradual softening in premium rate increases. That does not mean, however, that premiums will be reducing, merely that the increases seen over the past 24 months are starting to stabilise. The insurance market place remains subjective, where conditions/ rates are more favourable for well managed risks and tougher for less attractive risks.

How can I get the Best Outcome for my Business

Whilst the Insurance market goes through cycles, there are some important steps that Businesses can take to ensure they secure the optimum outcome available in the current market. We have provided some of these below:

- Start the Renewal Process Early (4 months out)
- Make your underwriting submission stand out (focus on Risk management, corporate governance, cyber security)
- Ensure key stakeholders within the business are involved to ensure the best information is collated (i.e. CIO in relation to Cyber Security questions)
- Engagement with Insurers, meet with your Insurers and allow them to become familiar with your business
- Partner with a Broker that knows the sector/ Industry

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