SUBMISSION BY THE

Housing Industry Association

to the

Senate Economics References Committee

on the

Inquiry into Insolvency in the Construction Industry

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HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 43,000 builders, contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.

1 Executive Summary

1.1 The Housing Industry Association Limited (HIA) welcomes the opportunity to comment on the Senate's Inquiry into Insolvency in the Construction Industry (Inquiry).

About HIA

1.2 HIA is the voice of the residential building sector of the Australian economy, and represents some 40,000 members throughout Australia. The residential building industry includes both cottage construction and multi-unit apartment buildings. HIA's membership includes builders, trade contractors, design professionals, kitchen and bathroom specialists, manufacturers and suppliers.

The terms of reference

1.3 The terms of reference broadly references the scale and incidence of insolvency in the Australian construction industry, including the incidence of "phoenix companies", the amount of monies lost by secured and unsecured creditors and the causes of insolvency.

1.4 HIA acknowledges that many of these issues provoke considerable discussion and debate. They have been covered at both a state and Commonwealth level over the past 2 decades, including comprehensive coverage by the Cole Royal Commission in 2002 and more recently the 2012 Collins Inquiry into Insolvency in the Construction Industry in NSW.

General comments

1.5 Financial failure for some firms will be an unavoidable consequence of the competitive forces of Australia's market economy.

1.6 ASIC data indicates that the number of insolvencies in the construction industry for the period of 2013-2014 was 1802. This makes it the largest single category behind the composite category 'Other (business & personal) services'.

1.7 Whilst it is important to recognise that the construction sector had the most businesses operating in Australia in June 2014[1], higher rates of insolvency are a bad thing for productivity in any industry.

1.8 By its very nature, insolvency means that some financiers of activity in the industry are left out of pocket upon the liquidation of the insolvent entity. This has unfavourable impacts on the financing costs for all businesses in the same sector, regardless of how strong their own solvency is. The higher costs of financing therefore may have a flow on impact adverse effects on the productivity position of all firms in the industry. In terms of economic signalling, insolvency is the system's way of saying that the resources consumed in creating the firm's output exceeds the benefit of that output. This means that as long as insolvent companies remain trading, they are diverting resources and productivity away from other areas of the economy. A firm's customers and suppliers are often materially impacted by an insolvency, and in some cases this could damage the reputation of other firms in the same industry and cause its customers, suppliers and other stakeholders to engage with them in a more cautious and less favourable manner.

1.9 An effective and efficient statutory framework is required to help business and creditors deal with the impact of insolvency but at the same time not be too obtuse as to impose

[1] See http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/8165.0Main%20Features1Jun%202010%20to%20Jun%202014?opendocument&tabname=Summary&prodno=8165.0&issue=Jun%202010%20to%20Jun%202014&num=&view=

unnecessary regulation that makes it even more difficult for firms to enter the market, grow, and hopefully prosper.

1.10 The ASIC data does not disaggregate between large public infrastructure projects nor the civil, commercial and residential sectors.

1.11 HIA's submissions to the Inquiry are based on the premise that the residential construction industry represents a distinct and unique component of the construction industry.

1.12 HIA's submissions are also premised on the fact that the residential construction industry is highly input costed, highly taxed and heavily regulated sector and these elements can and do play a role in the departure of firms from the industry.

1.13 The competitive nature of the industry, the cycles of building activity, restrictive consumer protection provisions together with the costs of complying with complex overlapping state, local and Commonwealth laws and regulations have a considerable impact on business operations, profitability and viability.

1.14 Introducing even further regulation to "manage" business to business arrangements, to "protect" one business at the expense of another or mandate levels of business risk or control are counterproductive and will aggravate the difficulties faced by business.

1.15 HIA contribution to the Inquiry will focus on the following:

- The impact of red tape and regulation on firms in the residential construction industry;
- The difference between commercial and residential construction;
- The availability of security of payment protections to subcontractors;
- Causes of business failure and insolvency in the residential construction industry;
- The current law and regulatory framework;
- The incidence of phoenix companies; and
- Trust funds.

2 The Business of Residential Construction

The residential building industry, red tape and regulation

2.1 The residential building industry, including the home improvements and alterations market, is a key component of the Australian economy. The residential construction industry is also the dominant sector in the building construction industry.

2.2 ABS figures show that during the full 2014 calendar year, dwelling construction – new home building as well alterations and additions – was worth $75.2 billion, equivalent to 4.9 per cent of GDP. Since the downturn in mining investment activity, residential construction has become a central driver of domestic demand growth. Within the housing industry, expenditure on new dwelling construction in 2014 was worth $46.5 billion, with renovations valued at $28.7 billion.

2.3 Unlike the commercial and civil construction sectors, the residential industry is principally comprised of small businesses and self-employed independent contractors.

2.4 HIA estimates that more than 90% of the residential building industry is comprised of small businesses and sole traders.

2.5 With such a high number of small businesses, this sector is particularly vulnerable to the negative impact of additional red tape and government regulation.

2.6 Independent research by the Centre for International Economics has confirmed that new housing is one of the most heavily and inefficiently taxed sectors of the Australian

economy. Typically the taxation on a new home constitutes around 40% of the purchase price. [2]

2.7 Similarly there is a large red tape and regulation burden imposed on the industry.

2.8 The average small business builder/principal contractor spends significant hours each week attending to paperwork and compliance obligations arising from regulatory requirements including business, income and payroll tax compliance, training regulations that apply to apprentice employees, workplace health and safety management, occupational licensing and state-based home building laws and requirements.

2.9 Regulations impose cost, barriers and administrative burdens on firms that distract them from their principal objective of growing and running a profitable business.

2.10 The overwhelming burden of excessive red tape and regulation is often cited by HIA members as the number one reason they leave the industry.

2.11 As the OECD has stated:

> *" in general the adverse impact of regulations on SMEs can be particularly harmful. This is because SMEs are less equipped to deal with problems arising from regulations since they have less capacity than larger firms to navigate through the complexities of regulatory and bureaucratic networks. SMEs are more likely to be hampered by regulations because their strength stems from their flexibility…*
>
> *Furthermore, due to its "fixed cost" nature, the cost burden of regulation is larger for small firms than for larger firms: i.e. administrative costs entailed in compliance have a disproportionate effect on small firms. In many cases compliance is based on an initial fixed, standard cost for all firms, irrespective of size, followed by a sliding scale, related to increasing size. This means that average compliance costs per employee are much higher for small firms."*

Residential Construction vs Commercial construction

2.12 The practice and paradigm in the residential construction industry differs significantly from those businesses operating in commercial construction.

2.13 The terms and conditions for commercial builders and those engaging in government contracts are significantly different from the conditions a builder faces when working on a residential job.

2.14 Commercial projects and government works are generally characterised by:

- a tendering process;
- the use of retentions;
- longer payments terms (up to 45 days compared to 21 days in residential);
- limitations on a builder's ability to select subcontractors;
- contract administration by a superintendent/ architect;
- significant amounts for liquidated damages; and
- longer defects liability periods.

2.15 Such elements are not present in the residential market, which faces equally as challenging, yet different factors such as:

- the homeowner, whose significant emotional and financial investment places additional pressures on the builder and trade contractors;

[2] Centre for Independent Economics, "Taxation of the Housing Sector", Canberra 2011 available at http://hia.com.au/~/media/HIA%20Website/Files/Media%20Centre/policy%20developments/CIE%20Tax%20Report.ashx.

- complex and extensive statutory consumer protection requirements;
- quasi regulation of payment terms through the involvement of financial institutions;
- ineffective and time consuming mandatory dispute resolution methods;
- demanding terms of trade from suppliers;
- significant exposure to uncontrollable events such as inclement weather; and the fluctuation in supplies of building materials and price of subcontract labour.

Home Warranty Insurance

2.16 One defining feature of the residential construction industry is the mandatory regime of builder's indemnity or Home Warranty Insurance (HWI) which operates in every jurisdiction except for Tasmania.

2.17 Since 2001 these schemes have been one of "last resort". This means that a consumer can access the benefit of the policy of insurance when the builder dies, disappears or is insolvent.

2.18 In New South Wales, there is also a fourth trigger that enables a consumer to claim on the policy of warranty insurance when a builder fails to comply with a monetary order issued by the Court or Tribunal.

2.19 The operation of mandatory HWI under which the insurer provides a completion guarantee to a home owner in the event of a builders' insolvency means that a builder's financial position is consistently monitored by their insurer.

2.20 In Victoria for instance, under the *Domestic Building Contracts Act 1995*, each time a builder enters a domestic building contract over $12 000 with a customer, they must take out a domestic building insurance (DBI) project certificate specific to the works covered by the contract.

2.21 Before granting eligibility, an insurer reviews a builder's business history and finances to assess their risk. Insurers impose an annual turnover limit on builders based on their assessment of the value of works that a builder can prudently undertake given their financial position. In some circumstances insurers require a financial security or indemnity of some form before granting eligibility.

2.22 Similarly under *New South Wales' Home Building Act 1989* any residential construction project over $20,000 must obtain HWI prior to the receipt of money or the commencement of work.

2.23 In order to obtain HWI a builder must be deemed 'eligible' by SICorp. In determining eligibility SICorp examines a range of financial and non-financial information provided by the business in order to assess the risk of potential threats to solvency.

2.24 The New South Wales Government has also introduced the Building Contract Review Program (BCRP) which reviews the competence of the builder to price and manage a project as a condition of eligibility to new entrants to the building industry, as well as existing small to medium builders without demonstrated experience for proposed larger projects.

3 The Subcontract System

3.1 A key element of this Inquiry is directed to the amount of monies lost and the effects of insolvency on certain industry participants including subcontractors and suppliers.

3.2 The residential construction industry, in particular the detached housing and renovation markets, relies on the use of subcontractors.

3.3 In commercial construction, whilst there is a large number of subcontracting firms, the overwhelming majority of those working in building and construction are actually employed by these subcontracting firms. Further subcontracting occurs only in specialist areas. Many employees are union members or employed under EBAs that are negotiated with unions.

3.4 By contrast, in the housing industry, subcontracting predominates down to the lowest levels, so that there are significantly fewer employees on a low or medium density housing site.

3.5 The flexibility of the subcontract system and the highly competitive nature of the home building industry have interacted to secure a high degree of efficiency and productivity.

3.6 As with any commercial relationship, there are risks for both builders and trade contractors in managing the subcontractor relationship.

3.7 For builders and principal contractors there are ongoing challenges ensuring the trade work is done to an adequate standard and will perform its designed life, particularly during statutory and contractual defects liability periods.

3.8 Many trade contractors, in turn, often do not want to give 6 or 12 months defect warranty. They also face challenges in securing payment, although as noted below there are significant statutory protections available to them.

Security of payments protections for subcontractors

3.9 Since 1999, security of payment (SOP) legislation for the construction industry has been progressively introduced into all Australian jurisdictions.

3.10 The common objective of this legislation has been to improve cashflow down the contractual chain. It effectively establishes a default entitlement to payment.

3.11 Under these laws:

- the subcontractor has a statutory right to a progress payment;
- the builder/principal is liable for claimed amounts irrespective of what the contract provides;
- the subcontractor may suspend work or supply without liability, and, if the principal removes any part of the work or supply from the contract as a result of the suspension, the principal is liable for any loss or expense the contractor suffers;
- the subcontractor can exercise a lien in relation to the unpaid amount over any unfixed plant or materials supplied;
- there is an expedited dispute resolution procedure (adjudication) by which disputes concerning payment are resolved, usually by way of written submission, within a very short period of time;
- if a principal becomes liable for an amount under the Act, then, in addition to recovering the amount as a debt due to the contractor, the adjudication determination may be enforced as if it were a court judgment; and
- there are very limited appeal rights or rights of judicial review in respect of an adjudication decision materials supplied by the contractor for use in connection with carrying out construction work.

3.12 Clauses in building contracts that offend the security of payment legislation are void – contracting out is prohibited.

3.13 Timeframes favour claimants and hearings are restricted allowing for little probity of an adjudicator's decision making process.

3.14 The remedy of rapid adjudication is also not available for a domestic builder in dispute with a client[3] and is not available to a principal contractor or builder for disputes with contractors for contractual back charges or defective work claims.

3.15 Some commentators have remarked that whilst security of payment legislation establishes a default entitlement to payment (particularly under the East Coast model), as it is biased on ensuring cash flow to contractors/subcontractors, there is little determination of a dispute on its merits or in a fair manner. The principle has been succinctly stated as "pay now and argue later".

3.16 Additionally the introduction of security of payment legislation makes certain 'unfair' provisions void. There are time limits for payments to subcontractors and a principal contractor/builder cannot require that payment to a subcontractor be withheld or delayed due to payment from the client not yet being received. This has codified the common law position that 'pay when paid' and 'pay if paid' clauses are void in respect of contracts for construction works performed or related goods and services supplied in Australia[4].

3.17 In HIA's experience the SOP has provided an effective mechanism for payment for those subcontractors who have availed themselves of the laws. When used appropriately they can minimse the financial impact of a builder's collapse or insolvency on a subcontractor to current works in progress.

3.18 However and notwithstanding the existence of SOP some subcontractors continue to work for builders and principals when they have not been paid for a number of outstanding progress claims. This choice to continue to work even when substantial sums are already outstanding and when there is therefore an increased exposure to greater losses in the event of insolvency, is often based on a balanced assessment of risk and essentially is a commercial decision of these firms.

3.19 There also are a number of building firms who continue to undertake work for a consumer or home owner notwithstanding a failure to pay current or previous progress claims. Unlike subcontractors they do not have access to SOP or rapid adjudication to remedy cashflow issues (discussed in further detail below).

3.20 Below is a table setting out the security of payment protections:

State	Legislation	Maximum time period for payment of progress claims	Paid when paid clauses
ACT	*Building and Construction Industry (Security of Payment) Act 2009 (ACT)*	*10 days after a payment claim*	Void
NSW	*Building and Construction Industry Security of Payment Act 1999 (NSW)*	*30 days to a subcontractor, 15 days by a principal to a head contractor.*	Void
SA	*Building and Construction Industry Security of Payment Act 2009 (SA)*	*15 days after a payment claim*	Void
NT	*Construction Contracts (Security of Payments) Act 2004 (NT)*	*28 days*	Void
Qld	*Building and Construction Industry Payments Act 2004 (Qld)*	*25 business days after submission of a payment claim for construction management trade contract or subcontracts.* *For commercial building contracts, 15 business days after submission of a payment claim.*	Void
Tas	*Building and Construction Industry*	*10 days*	Void

[3] Except in Tasmania

[4] See eg *Ward v Eltherington* [1982] QdR 561; *Sabemo (WA) Pty Limited v O'Donnell Griffin Pty Limited* (1983) (unreported, Court of Western Australia); *Crestlite Glass & Aluminium Pty Ltd. v. White Industries (QLD) Pty Ltd* (Unreported, Federal Court of Australia).

	Security of Payment Act 2009 (Tas)		
Vic	*Building and Construction Industry Security of Payment Act 2002 (Vic)*	*20 days*	Void
WA	*Constructions Contracts Act 2004*	*50 days*	Void

3.21 HIA notes that in NSW under the *Contractors Debts Act 1997* subcontractors (or supplier of building materials) who have not been paid by a contractor can sometimes obtain payment directly from the principal.

3.22 The rights under this legislation are expansive.

3.23 For instance the subcontractor is able to freeze monies in the hands of the principal (client) so that the principal does not pay the money to the contractor (builder) until the subcontractor has had the opportunity to obtain judgment of the amount owed by the contractor to the subcontractor.

3.24 Recent amendments also enable subcontractors to earmark money which may become payable by the principal contractor to the subcontractor through rapid adjudication under the security of payment legislation.

3.25 Queensland also has the *Subcontractors Charges Act* which enables subcontractors to secure a statutory charge over money owed (or allegedly owed) to them by their contractor. The monies charged will be available irrespective of the solvency of the contractor.

4 Causes of business failure and insolvency in the residential construction industry

4.1 Australian Bureau of Statistics Data directly states that 60% of new businesses disappear within 3 years.

4.2 Construction industry businesses have a 71% survival rate.

4.3 Not all of them become insolvent or bankrupt. Many close down after meeting all their outstanding obligations.

4.4 When business failure occurs, it is usually the precursor of an event of insolvency. A formal insolvency appointment/process is a response to an event of insolvency. The law enables the process of insolvency to be initiated by the directors, the secured creditors or the unsecured creditors.

4.5 The construction industry is admittedly largely represented in the overall number of insolvencies. This to some extent, is a natural reflection of the size and number of construction industry firms operating in the economy. The residential construction sector is particularly characterised by a large number of small firms and a small number of very large firms.

4.6 No matter how stringent the regulation nor how effective a business is managed, some corporate business failures may be an inevitable consequence of the competition, entrepreneurship and risk taking inherent in Australia's free market economy.

4.7 Government policies should be directed to promoting and preserving these cornerstone values.

4.8 The residential construction industry is a high cost, highly regulated industry and the nature of firms in the industry means that they are especially susceptible to economic cycles and adverse government policies and regulation.

4.9 During rapid upward phase of the economic cycle, inflated prices and rising labor costs and reduced competition can lead to a fall in production whilst the downward phase leads to competitive cost-cutting and reduced margins and pressures on quality.

4.10 The failure of a business in this environment can occur from a number of causes including cashflow problems, poor management; external shocks; actions taken by third parties; competitive forces; changes in government policy and regulation and fraud.

4.11 A consistent challenge for builders is determining their price and profit margins by their actual overheads and the financial needs of the business and not by market pressures.

4.12 Builders in the industry ordinarily fund their works by way of overdrafts and trade credits and are paid in arrears by clients. Yet, their undertaken activities are subject to a high level of risk.

4.13 There are inherent uncertainties in contract prices which arise from the fact that prices are usually required to be fixed many months before construction commences and will be based on technical, financial and workforce assumptions.

4.14 The builder's reliance on cashflow to manage growth and cyclical conditions exposes them to an even greater extent in the event of non-payment by client.

4.15 In HIA's experience, many failed builders may also have encountered one or more of the following situations:

- Lack of accurate aged creditors and job costing information so individual jobs do not pay for themself and hence do not contribute to a positive cash flow.
- Relying on progress payments received from clients or principals to fund growth.
- Balance sheet assets overstated in respect to work in progress and realisable debtors.
- Financial records not current enough or only prepared for taxation requirements.
- Investments in non-core business activity using cash flow rather than earned profits.
- Lost production due to boom trading or adverse weather.
- Estimating errors and lack of accurate budgets for jobs.
- Major contractual disputes with clients locking up progress claims
- Time delays.
- Progress payments not paid on time.
- Cost Variations.

Cash flow and Working Capital

4.16 In the residential construction industry, statutory limits on deposits and progress payment claims means that the builder essentially 'finances' a job.

4.17 Progress payments are due on the achievement of scheduled milestones, but these milestones do not always correlate with the way expenses are incurred.

4.18 It is generally the case that progress payments are at least one construction stage behind (for example, the frame stage is well under way by the time the builder receives payment for completion of the slab). Clients are not generally charged interest for late payments, although builders have the right to do so.

4.19 Large volume builders undertake a significant number of projects at one time – sometimes hundreds of jobs – so the aggregate impact may be very significant. This places a heavy reliance and large amount of pressure on working capital.

4.20 As an example, outlined at Annexure 1, over the life of a 16 month detached house construction job with a contract value of $260,000, the builder is carrying a negative cash flow for 12 out of those 16 months. At a peak, this negative cash flow for a month reaches $26,000, which is over 60 per cent of the net cash flow (excluding GST) of the entire project.

4.21 The second example at Annexure 2, for a smaller company that focuses on customised new homes and large structural renovation work, demonstrates that projects do not become cash flow positive until the final payment. In other words the builder in this instance is 'carrying' the entire job. This example demonstrates that for a seven month, $300,000 project, the builder finances the project until the completion stage when a final claim is made (in month eight). In this example the negative cash flow position in a given month is as high as $53,500. The same model applies proportionally to a $500,000 or $1,000,000 project.

4.22 Where a negative cash flow situation applies, a builder must find other sources of working capital to make regular sub-contractor and supplier payments. These payments have to come from borrowed funds or resources from previous jobs.

4.23 Delays in the approvals of claims by client's banks and valuers aggravate the pressure on builders' working capital and on the negative cash flow model.

5 Legislative framework

5.1 There are a number of Commonwealth laws in place to address and regulate corporate insolvencies.

5.2 Under the *Corporations Act 2001*, directors have a direct and positive duty to prevent their company from trading if it is insolvent. A company is insolvent if it is unable to pay all its debts when they are due. Directors must prevent their company from incurring debts where the company is insolvent, or becomes insolvent by incurring the debt(s) and at that time, there are reasonable grounds for suspecting the company is insolvent, or would become insolvent.

5.3 There are various penalties and consequences of insolvent trading, including civil penalties, compensation proceedings, criminal charges and/or disqualification from managing a corporation.

5.4 A company must also keep financial records to correctly record and explain transactions and the company's financial position and performance. A failure of a director to take all reasonable steps to ensure a company fulfils this requirement contravenes the legislation.

5.5 Directors' also have fiduciary duties which include the duties to act in good faith in the best interests of the company, to act for proper corporate purposes and to avoid conflicts of interest. It has been held that the duty of directors to act in good faith and in the best interests of the company includes consideration of the interests of creditors upon insolvency.

5.6 Under taxation laws, directors' personal liability may arise where the Commissioner of Taxation issues a Director Liability Notice ("DLN") under Section 222AOE of the ITAA to the directors at a time when the company has failed to remit tax. The objectives of these provisions are to ensure that a company satisfies particular income tax obligations or is promptly placed into voluntary administration or liquidation.

5.7 Liquidators and external administrators have obligations to investigate causes of failure and identify and report breaches of law to ASIC. This is aimed at ensuring inappropriate director/corporate behaviour is identified and addressed by the party capable of taking disciplinary action, generally the corporate regulator.

5.8 Liquidators also have powers to investigate and void certain transactions such as unfair preference payments.

5.9 ASIC, in turn, has a number of powers to take action against such reported breaches.

5.10 To enforce the deterrent intent of the current laws are being met it is important that ASIC take effective action against reported breaches.

5.11 The above laws provide a solid and sound regulatory framework for regulating insolvencies. Calls by various parties for further laws or regulatory powers are usually made in circumstances where existing powers have not been effectively used.

5.12 Both the level of enforcement funding provided to the regulators and operational matters such as the existence and attainment of Key Performance Indicators are pivotal in ensuring the effect of the legislation is being met and achieved.

6 "Phoenix companies"

6.1 In responding to the issue of phoenix companies in the construction industry, HIA notes that there is no current statutory definition of what is a "phoenix company" although as noted above there are a range of corporations and taxation laws targeted towards fraud, directors duties, insolvent trading and unpaid tax liabilities.

6.2 The unique nature of the residential building industry, including its mandatory licensing of builders and home owners warranty insurance system (discussed earlier) reduces the ability of directors to utilise phoenix arrangements.

6.3 In order to be licensed most builders (as well as many trade contractors) are subject to strict financial and personal probity requirements. Directors who have controlled an insolvent company may alternatively be automatically excluded from consideration or will typically fail the "fit and proper" person requirements.

6.4 In Queensland, Section 56AC of the *QBCC Act* currently applies to "excluded" individuals and companies.

6.5 Under section 56AE, the Commission must not grant a person a licence if the person is an excluded individual for a relevant event, or an excluded company.

6.6 Section 56AC provides:

- that individuals that become bankrupt, will be excluded for 5 years from the date of bankruptcy;
- that companies that are put into liquidation, administration or are wound up, will be excluded for 5 years from the date of the events mentioned above;
- Company directors or secretary or an influential person, who were in that position for a period of 1 year immediately before the above events occur will also be excluded for 5 years:
    - An influential person means 'an individual, other than a director or secretary of the company, who is in a position to control or substantially influence the conduct of the company's affairs, including, for example a shareholder with a significant shareholding, a financier or senior employee.'

6.7 In South Australia, section 9 of the *Building Work Contractors Act* provides that an applicant for a building license cannot be insolvent or subject to a deed or scheme of arrangement with or for the benefit of creditors over the last 2 years, or over the last 5 years has not been a director of a company that was wound up for the benefit of creditors.

6.8 The *Home Building Act* in NSW similarly provides that a license must be cancelled if the holder of the licence becomes bankrupt or insolvent or is a deregistered company (see section 22).

6.9 In addition, section 20 provides that a license application must be refused if:

- the applicant is disqualified by this Act or the regulations from holding a contractor licence, or
- the Chief Executive considers that a close associate of the applicant who would not be a fit and proper person to hold an authority exercises a significant influence over the applicant or the operation and management of the applicant's business.

6.10 Under the Act a person is disqualified from holding an authority (other than an owner-builder permit) if the person:

- is in partnership with a person who is, or is a director of a body corporate that is, disqualified from holding an authority under this Act, or
- is in breach of any provision of this Act or the regulations that is prescribed by the regulations as a disqualifying breach.

6.11 There are also grounds to refuse an application if the applicant is not a "fit and proper person to hold a licence.

6.12 In Western Australia while there is no automatic ban or exclusion for directors/officers of an insolvent company from holding a building practitioner registration in their own individual capacity and/or seeking to obtain registration for themselves or a new company as a building services contractor, this issue is a relevant consideration when it comes to applying for or renewing registration.

6.13 Under sections 17 and 18 in assessing fitness and probity, consideration would be given to the financial background of the applicant, including whether they were ever a director of an insolvent company or have been bankrupt.

6.14 Similarly, in Victoria the Building Practitioners Board (BPB) may refuse to register an applicant if a number 'good character' requirements are not met (s170(c)) and instances of insolvency under administration is a relevant factor.

7 Trust Funds

7.1 Over the years, including during the recent Collins Inquiry into Insolvency in the Construction Industry in NSW, some industry participants have proposed mandatory trust fund or project bank account arrangements to protect subcontractor payments.

7.2 Under a deemed trust arrangement, a contractor receives progress payment upon trust to pay workers, subcontractors and suppliers. Only after these parties have been paid does the balance go to the builder.

7.3 For the benefit of this Inquiry, HIA reiterates that it strongly opposes the introduction of any form of trust scheme in the residential building industry. They are an unreasonable legislative interference in commercial transactions, adding costs and uncertainty to the industry.

7.4 As a legal concept, there are practical difficulties and shortcomings in determining which parties in the supply chain are worthy of legislative protection.

7.5 Further, the imposition of trust arrangements discriminate against the party that wears the bulk of the risk on the construction project – the builders and principal contractors. As set out earlier in these submissions, builders in the residential construction industry face unique cash flow challenges. Trust funds would further restrict the ability of a builder to use money received from progress payments in a flexible manner, further depriving them of working capital and forcing them to incur additional financing costs.

Annexure A

Table 1: Project House with contract cost (excl. GST) of $260,000				
Total House Costs		$	205,426	
GST	10%	$	20,543	
CMA	3%	$	6,163	
ETO	3%	$	6,163	
Total Cost		$	238,294	
Total Cost excl GST		$	217,752	
House Contract (Excl GST)		$	260,000	Month
Initial Deposit		$	3,000	1
Contract Deposit	5%	$	10,000	3
Slab	20%	$	52,000	12
Frame	25%	$	65,000	13
Bricks	20%	$	52,000	14
Lockup	20%	$	52,000	15
Final	10%	$	26,000	16
	100%	$	260,000	
Net Cash Flow (excl GST)		$	42,248	

	Net Cash Flow (excl GST)	Cumulative Net Cash Flow (excl GST)
M1	-$ 7,086	-$ 7,086
M2	-$ 1,988	-$ 9,073
M3	$ 8,013	-$ 1,061
M4	-$ 1,988	-$ 3,048
M5	-$ 1,988	-$ 5,036
M6	-$ 1,988	-$ 7,023
M7	-$ 1,988	-$ 9,011
M8	-$ 1,988	-$ 10,998
M9	-$ 1,988	-$ 12,986
M10	-$ 1,988	-$ 14,973
M11	-$ 11,114	-$ 26,088
M12	$ 11,297	-$ 14,790
M13	$ 26,450	$ 11,660
M14	$ 19,351	$ 31,011
M15	$ 9,477	$ 40,488
M16	$ 1,760	$ 42,248

Note: CMA – Cost Movement Analysis

ETO – Extra's to Order.

Annexure 2

Estimated Job Cost $300,000 with a profit margin of 10% (Duration - 7 months)									
Expenditure	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8 Final Claim	End of Job
Deposit received	$15,000								
Opening Cash following month		-$19,000	-$31,729	-$33,548	-$47,184	-$53,548	-$37,184		
Assumed stage of Works	Site set up, insurances, excavation, tipping, labour - all paid for up front (shown in mthly exp)	In ground works Begin structure	Structure and closing in	Roof & Lock Up	Ruff in services	Linings	Fit off & Finish		
Monthly expenditure claimable	**-$34,000**	**-$31,729**	**-$33,548**	**-$47,184**	**-$53,548**	**-$37,184**	**-$32,807**		-$270,000
Less Deposit	$15,000								
Progress Claims based on previous monthly expenditure		$19,000	$31,729	$33,548	$47,184	$53,548	$37,184	$36,898	$274,091
Add OverHead for Claim		$1,900	$3,173	$3,355	$4,718	$5,355	$3,718	$3,690	$25,909
Progress Claims Paid		**PC 1 $20,900**	**PC 2 $34,902**	**PC 3 $36,902**	**PC 4 $51,902**	**PC 5 $58,902**	**PC 6 $40,902**	**PC 7 $40,588**	$300,000
Balance for project at end of the month	-$19,000	-$31,729	-$33,548	-$47,184	-$53,548	-$37,184	-$32,807		
The above graph illustrates how a builder finances the project to completion stage. The above numbers are assumed on a typical S graph scale which is applicable to 90% of residential construction work. It does not take into account any retention amounts which would only add the financial burden of the contractor.									