NEITHER FISH NOR FOWL—BREACHES OF STATUTORY WARRANTIES UNDER THE *HOME BUILDING ACT 1989* (NSW) AND A MORTGAGEE IN POSSESSION'S RIGHTS, OBLIGATIONS AND RISKS

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IN BRIEF

Mortgagee in possession not entitled to claim home owners warranty insurance nor liable as 'developer' to successors in title.

INTRODUCTION

A recent decision of the Supreme Court of New South Wales in *Gardez Nominees Pty Ltd v NSW Self Insurance Corporation* [2016] NSWSC 532 has found that a mortgagee in possession of an unfinished and defectively constructed strata residential development could not claim the benefit of home owners warranty insurance under the *Home Building Act 1989* (NSW) to complete and rectify residential building work carried out on behalf of a developer, despite the insolvency of the builder engaged to carry out the works.

Additionally, the court found that the mortgagee in possession in the circumstances of this case did not become a 'developer' for the purposes of the Act merely by exercising 'step–in rights' under a side deed to the building contract and consequently would not be held liable, merely on that basis, to successors in title of the original owner, for breaches of statutory warranties under the Act.

MORTGAGEE TAKES POSSESSION OF UNFINISHED AND DEFECTIVE DEVELOPMENT UPON DEFAULT OF THE MORTGAGE

Railway Land Holdings Pty Ltd, the registered proprietor of land near Wollongong, engaged Lifestyle Property Development to build a residential strata development upon the land. The plaintiff, Gardez Nominees Pty Ltd, financed Railway in exchange for a mortgage over the land.

A policy of insurance required for the development by Part 6 of the Act was obtained for the project through the defendant, NSW Self Insurance Corporation.

Additionally, as is common practice between parties and the financiers of construction work, Railway, Gardez and Lifestyle entered into a side deed, pursuant to which (amongst other things):

- Lifestyle undertook to Gardez to observe and perform all of the builder's obligations under the building contract; and
- Gardez obtained the right, in the event of Railway's default under the building contract or mortgage, to exercise step–in rights to exercise the rights and perform the obligations of Railway under the building contract.

Partway through construction, Railway defaulted on the terms of the mortgage and Gardez took possession of the land and exercised its step–in rights under the building contract. Subsequently, Lifestyle became insolvent, following which Gardez terminated the building contract and sought to make a claim on the policy of insurance issued by Self Insurance for the costs to complete the building works and rectify defects in works already undertaken.

GARDEZ BRINGS PROCEEDINGS AGAINST INSURER WHO DENIES HOME OWNERS WARRANTY INSURANCE

Gardez claimed that as a consequence of taking possession, it was entitled to claim directly against Self Insurance under the policy because of its inability to recover the cost of completing and rectifying Lifestyle's work from the insolvent builder.

Self Insurance denied liability. The proceedings were an appeal from that decision.

In order to be entitled to claim the benefit of home owners warranty insurance, Gardez (which was not a party to the building contract), was required to demonstrate that it was either a successor in title to the developer (being Railway) (see sections 18D (1) and 99 (1)(b) of the Act), or a 'non–contracting owner' of the land (see Schedule 1, 18D (1A) and 99 (2A) of the Act).

GARDEZ FOUND TO BE NEITHER A SUCCESSOR IN TITLE NOR A NON–CONTRACTING OWNER

The court found that Gardez, as mortgagee in possession, should not be regarded as a successor in title for the purposes of the Act, because although section 57(1) of the *Real Property Act 1900* (NSW) recognises the effect of a mortgage as a security interest and the entitlement of a mortgagee to possession is granted by section 60 of that Act, no actual transfer of any interest in land took place; Railway remained registered proprietor both in equity and at law.

As an alternative proposition, Gardez sought to argue that it was entitled to the benefit of the policy insurance as a non–contracting owner of the land. Schedule 1 of the *Home Building Act* defines a 'non–contracting owner' as an owner of land that is not a party to the contract for residential building work, including any successor in title to the owner.

In also finding against Gardez on this count, the court emphasised that the Act contains no provision by which a person who is not an owner of land at the time the relevant building contract was entered into can become an 'owner' for the purposes of the Act—other than by reason of it becoming a successor in title to an owner. On this basis, Gardez could not be characterised as a non–contracting owner of the property and did not obtain the benefit of the statutory warranties.

GARDEZ NOT A DEVELOPER FOR THE PURPOSES OF THE HOME BUILDING ACT AND NOT HELD LIABLE FOR BREACHES OF STATUTORY WARRANTIES

Under the scheme of the Act, a developer assumes the same level of responsibility to successors in title for breaches of statutory warranties as the builder.

Self Insurance separately asserted in the proceedings that Gardez in fact became a developer, either as a consequence of exercising step–in rights to the building contract under the side deed or because it fell within the definition of non–contracting owner under the Act, which included a person who would, if the land were let to a tenant, be entitled to receive rents and profits of the land as a mortgagee in possession.

The court found that Gardez was not a developer for the purposes of the Act because, relevantly:

- the exercise of the step–in rights entitled it to act 'as though it were a party to the building contract' but did not make it a party—there had been no novation of the building contract to Gardez, and
- the court found no legislative intention that a person would become a 'developer' and be liable in that capacity because at some stage after the building contract was executed and work performed, it exercised rights that gave it an entitlement to rent and profits in respect of the land.

CONSTRUCTION PROJECT FINANCIERS SHOULD CONSIDER RISK OF LIABILITY AS DEVELOPERS TO SUCCESSORS IN TITLE FOR BUILDERS' STATUTORY WARRANTY BREACHES

This case will be of particular interest to financiers of construction projects because not only does it clarify some of the more ambiguous definitional concepts of the Act, but it also highlights a particular risk that financiers or their nominees could run if tempted to exercise a right conferred by a side deed to novate the building contract to themselves (or a nominee) for the purpose of completing the works—namely the risk that the financier or its nominee thereby becomes a 'person on whose behalf the residential building work' was done and therefore a deemed 'developer' for the purposes of the Act.

That would make the financier (or its nominee) liable in turn to successors in title to the owner at the time the building contract was entered into for breaches of statutory warranties by the builder. Care should always be taken to consider the implications of the Act on the exercise of any rights conferred by instruments of construction finance.

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