

# Title Insurance: A Risk Management Tool for CPCs

## Part 1 - Illegal Building Works

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### Introduction

Risk management is an integral part of modern conveyancing practice. Much has been written in the AICNSW 'New South Wales Conveyancer' about the need for CPCs to develop a strong culture of risk management. An effective risk management program serves the dual objectives of ensuring client satisfaction and reducing the incidence of professional indemnity claims.

One aspect of effective risk management is title insurance. Title insurance is a specialised type of insurance which can be obtained by purchaser clients during the course of a conveyancing transaction which is designed to deliver protection to purchasers against risks which are inherent in modern conveyancing practice that might otherwise leave a purchaser exposed to loss and damage.

One such risk is the problem of illegal/unapproved building works.

In Part 1 of this article series on title insurance as a risk management tool, we look at the issue of illegal building works and discuss how the Stewart Title "Residential Purchaser Policy" may be utilised by CPCs as a means of effectively managing this risk.

### What is Title Insurance?

Title insurance may be described as a contract of *indemnity* whereby the title insurer indemnifies the insured (being the owner of a legal right in real property) against actual loss incurred by the insured as a result of any unknown title defect or other risk covered in the policy as at the policy date (the date of settlement)<sup>2</sup>. Some of these covered risks include loss caused by:

- Illegal/unapproved building work;
- encroachments;

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<sup>2</sup> See for example definitions of title insurance in O'Connor, P "Double Indemnity – Title Insurance and the Torrens System" *QUT Law & Justice Journal* Vol 3 No 1 2003.

- zoning non compliance;
- unsatisfied conditions of a development consent;
- non compliance with the terms of a positive and/or restrictive covenant or easement;
- unregistered rights of way and easements or non compliance with registered rights of way and easements;
- post settlement dealing registrations by a third party;
- fraud and forgery;
- unpaid rates and taxes resulting in a charge on the land.

In addition to indemnifying the insured from actual loss arising from a risk covered in the policy, Stewart Title will also defend the insured's title as represented in the policy and to cover the costs incurred in that defence, such as legal costs and expenses<sup>3</sup>. These costs would be in addition to any liability the insurer may have in respect of the indemnity amount contained in the policy.

The policy amount will normally be the purchase price of the property which will automatically increase in line with the market value of the land up to a maximum of 200% of the policy amount.

### **Why Title insurance?**

Whilst the Torrens Title system, under which most land dealings in New South Wales are registered, is designed to protect a purchaser against any defect in the registration system, it will not protect a purchaser against many of the practical risks inherent in property transactions which fall well outside of the safety of the Torrens System.

Stewart Title's 'Residential Purchaser Policy' allows a purchaser to transfer conveyancing risks which might otherwise leave your purchaser client exposed to loss and damage to Stewart Title. It is this re-allocation of risk that makes title insurance such an effective risk management tool.

The following is a summary of the 'illegal building work' coverage offered by a Stewart Title Residential Purchaser Policy. For complete coverage, terms and conditions you should refer to the Policy or contact Stewart Title's Underwriting Department on (02) 9081 6200.

### **Title insurance coverage for illegal building work**

Risks associated with illegal building work clearly fall outside of the Torrens Assurance fund provisions of the *Real Property Act* 1900. Yet recent national

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<sup>3</sup> See clause 1.2 of the Stewart Title Policy.

statistics published by Archicentre, the building advisory service of the Royal Australian Institute of Architects, reveal that 18% of all homes inspected by Archicentre in New South Wales showed some form of illegal building activity, with Botany (38%), Pittwater (38%), Marrickville (33%), and South Sydney (32%) Councils being the most affected.

Some of the illegal building work identified included the removal of interior load bearing walls, illegal drainage, the addition of rooms in roof space, the construction of unapproved balconies and decks, and illegal wiring<sup>4</sup>.

Despite the introduction of vendor warranty legislation in New South Wales following the decision of the NSW Court of Appeal in *Carpenter v McGrath*<sup>5</sup>, the existence of illegal building work remains a serious issue for purchasers and their lawyers.

In particular, where there is no building certificate issued in respect of a building the subject of a contract for sale, the purchaser cannot be sure whether the improvements erected on the land have been constructed and completed in accordance with Council approved plans or will require future rectification or demolition to comply with relevant development standards and consents. Where illegal building work is discovered after completion, the purchaser will have no financial recourse to the vendor.

### **Limitations of Vendor warranty legislation**

In the context of conveyancing transactions, although Schedule 3 Part 1 (d) of the *Conveyancing (Sale of Land) Regulations 2005* provides a warranty by the vendor that there is no matter in relation to any building or structure on the land (being a building or structure that is included in the sale of the land) that would justify the making of any “upgrading or demolition order”<sup>6</sup>, the issue of whether to advise a

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<sup>4</sup> Archicentre New Release “One in Four Home Buyers caught in Illegal Building Trap” 3 November 2005: URL:<http://www.medialaunch.com.au/446/>, “NSW Home Buyers Risk Doubles” 14 September 2005: URL:<http://www.archicentre.com.au/media/ACSEPT142005NSWCostsDouble.htm>; “Weatherboard Homes Top Illegal Building in Archicentre Survey” 15 December 2005: URL:<http://www.medialaunch.com.au/463/>

<sup>5</sup> (1996) NSW ConvR 55-788 – In that case the Court of Appeal held that an illegal structure which could attract the council’s power of demolition did not constitute a defect in the vendor’s title.

<sup>6</sup> Schedule 3 Part 2(d) defines “upgrading or demolition order” to mean any of the following: (i) order No 2 in the Table to section 121B of the *Environmental Planning and Assessment Act 1979*, being an order made in the circumstances referred to in paragraph (a) or (d) relating to that order, (ii) order No 12, 13 or 14 in the Table to section 121B of the *Environmental Planning and Assessment Act 1979*, (iii) order No 1 in the Table to section 124 of the *Local Government Act 1993*, being an order made in the circumstances referred to in paragraph (d) relating to that order, (iv) order No 3 in the Table to section 124 of the *Local Government Act 1993*, being an order made in the circumstances referred to in paragraph (c) relating to that order.

client to apply for a building certificate in order to 'test' the vendor's warranty following exchange of contracts is potentially problematic<sup>7</sup>.

One of the problems associated with applying for a building certificate following exchange of contracts lies with clause 11 of the 2005 edition contract for sale (and earlier editions), which provides that a vendor must by completion comply with any work order issued on or before the date of exchange but the purchaser must comply with any work order issued after exchange<sup>8</sup>. A "work order" is defined in clause 1 of the contract to mean "a valid direction, notice or order that requires work to be done or money to be spent on or in relation to the property or any adjoining footpath or road".

If a building certificate does not issue because of the prospect of an upgrading or demolition order, then the vendor will be in breach of the prescribed warranty and a purchaser will have a right of rescission. However, as the right to rescind only applies to "upgrading or demolition" orders, clause 11 renders the purchaser liable for the costs of complying with any other 'work order' issued by the council arising from the building certificate application inspection.

This risk may often deter a purchaser from applying for a building certificate following an exchange of contracts, particularly where the purchaser intends to carry out renovation works in the future and is not inclined to outlay additional rectification costs prior to completion. Of course, after settlement, if any subsequent application for a building certificate gives rise to an upgrading or demolition order the owner will have no remedy whatsoever and may face penalties for non compliance<sup>9</sup>.

### **What does the Stewart Title policy cover?**

The Stewart Title policy provides an indemnity in respect of "actual loss"<sup>10</sup> suffered by the insured in circumstances where a property has been purchased without a building certificate, and following settlement the insured is ordered to demolish or rectify all or part of an existing structure due to non-compliance with or the absence of relevant building/or development consents required by law<sup>11</sup>.

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<sup>7</sup> Skapinker, D: *Purchasers bear the risk of illegal buildings: Carpenter v McGrath* (1996) 34 (11) NSW Law Society Journal 50 and Khan, Izaz: *Illegal Structures after Carpenter v McGrath*: Law Society Journal, September 1999, page 53 (1999) 37 (8) LSJ 53.

<sup>8</sup> Clause 11 states: "normally, the vendor must by completion comply with a work order made on or before the contract date and if this contract is completed the purchaser must comply with any other work order."

<sup>9</sup> See for example s678 of the *Local Government Act 1993* and section.121ZJ of the *Environmental Planning & Assessment Act 1979*.

<sup>10</sup> Actual loss is referred to in clause 1.1 of the Stewart Title Policy.

<sup>11</sup> That is, a failure to obtain any development consent as required under the *Environmental Planning & Assessment Act 1979* and any relevant LEP.

## Example

*You act for a purchaser. The contract for sale issued by the vendor does not contain a current building certificate. You are instructed not to obtain a building certificate after exchange of contracts. After settlement, your client applies for a building certificate from Council.*

*Following a Council inspection, Council informs the new owners that the rear deck and car port, which was built by the previous owner, was never approved by Council and must be upgraded or demolished.*

*Council issues an order requiring your client to demolish or upgrade the rear deck and car port.*

## What is the “Actual Loss”?

In relation to the above example, Stewart Title would be obligated to indemnify the insured for any “actual loss” arising from the upgrading and demolition order. Such loss might include:

- The costs of upgrading or correcting or **replacing** the rear deck and car port so that they comply with relevant building standards and Council approval;
- If the illegal structure may not be upgraded, corrected, or replaced then the loss in the market value of the property for the deprivation of the use of the rear deck and car port;
- In circumstances where the insured has entered into a contract to sell the property and prior to completion the purchaser elects to rescind the contract because of the issue of an upgrading or demolition order, then the actual loss would include (for example) the interest payments on any bridging loan secured by the insured to purchase a new home, any subsequent shortfall in the contract price if a subsequent purchaser is found (the marketability coverage).

## Exclusions: Infestation and dilapidation orders excluded

In the context of illegal building work, the Stewart Title policy excludes certain matters from cover<sup>12</sup>. For example, in relation to the illegal building work coverage, the policy does not cover ‘work orders’ which are issued by Council **solely** due to the infestation, dilapidation, or disrepair of the home, including approved structures which have not been built in accordance with applicable building codes<sup>13</sup>. The order, whether it be to demolish or repair a building, such as for example an Order issued in

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<sup>12</sup> See for example Clause 3 “Exclusions” of the Stewart Title policy.

<sup>13</sup> Clause 3.2 (c) of the Stewart Title policy.

accordance with Order No 12 or 13 in the Table to section 121B of the *Environmental Planning and Assessment Act 1979*, must relate to the *unlawful erection* of the building, that is, the absence of or non compliance with, relevant development consent which was required pursuant to the relevant LEP but was not obtained or complied with.

However, where the *unapproved* building work *also* does not comply with the Building Code of Australia (BCA) then any work required by the relevant consent authority to bring into compliance with the BCA any building or part of a building which has been unlawfully erected will also be covered by the Stewart Title policy. This coverage is important as structures which have been erected *without* Council approval and final certification will most likely also not comply with the BCA.

Accordingly, as structures which have been built in accordance with council approval but have been built negligently or have subsequently fallen into disrepair or have become infested will be excluded, then CPCs should continue to recommend that purchasers obtain a pest and building report prior to exchange of contracts, since the insured will be liable for the cost of repairing those dilapidated or infested structures.

### **The Benefits of Title Insurance**

The benefit for purchasers is that following settlement, Stewart Title, rather than the purchaser, will assume the risk of the existence of any unknown illegal building works, and will accordingly indemnify the purchaser against actual loss caused by a subsequent demolition or upgrading order following any post settlement application for a building certificate by the purchaser. In the event of a claim there is no excess payable by the insured.

The benefit for the CPC is that in the event of a loss incurred by the purchaser as a result of illegal building works, the purchaser can make a claim on the title insurance policy on a “no fault” basis rather than commence proceedings against the CPCs professional indemnity insurance. As long as the insured has suffered “actual loss” as a result of a matter covered under the Stewart Title policy and the insured is able to provide proof of loss then Stewart Title is obligated to pay the claim. Stewart Title will also waive its rights of subrogation against solicitors and CPCs<sup>14</sup>. In addition to the waiver of subrogation, Stewart Title provides a standard wholesale indemnity for solicitors and CPCs in the event that the purchaser is insured under a title insurance policy but nonetheless elects to pursue the solicitor or CPC thereby triggering a claim under the solicitor or CPC’s relevant professional indemnity insurance policy.

For more information please email us at [paul.watkins@stewart.com](mailto:paul.watkins@stewart.com) or contact Stewart Title’s Underwriting Department on **1800 300 440**.

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<sup>14</sup> Except in circumstances where the solicitor or CPC has been grossly negligent or criminal.