

Lack of information on apartment defects leaves whole market on shaky footings

Written by Martin Loosemore, Professor of Construction Management, University of Technology Sydney

The litany of [defects, poor building standards](#) and [regulatory failures](#) has serious implications for apartment owners, occupiers and buyers alike. Fears of a [loss of confidence in the sector](#) have unfortunately come true. Our research suggests a lack of reliable information about building defects is a critical factor in the crisis.

Read more: [*Would you buy a new apartment? Building confidence depends on ending the blame game*](#)

About a year ago, we started a research project with [six industry partners](#) in New South Wales entitled [Cracks in the Compact City: Tackling Defects in Multi-Unit Strata Housing](#). The context is compact city planning policies and a rapid shift towards apartment living in Australian cities.

The urban development strategies of NSW and other states rely on higher-density cities with many more multi-unit strata title dwellings. The [human](#) and [economic](#) impacts of the building defects crisis could undermine these strategies.

Even with our resources, obtaining data on the extent and nature of defects in NSW apartment buildings has been a challenge. Individual buyers and owners must face even greater obstacles.

This lack of access to information poses a clear challenge to the principle of “buyer beware” that underpins property sales. The imbalance it creates between buyers and sellers is a prime example of what economists call “[information asymmetry](#)”.

Why does this matter for the whole apartment market?

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Nobel laureate George Akerlof [explained](#) how the price and quality of goods traded in a market affected by information asymmetries tend to gradually reduce to the point where only lowest-cost “lemons” remain. When buyers can’t tell the difference between products of good and bad quality, they typically prefer the cheapest available. This forces higher-quality products out of the market.

Sellers can also exploit this situation to hide poor-quality products from consumers. They might even charge the same as competitors selling higher-quality products.

While some unscrupulous sellers might profit in the short term, overall profits fall for everyone as confidence and links between price and quality are undermined. Ultimately, the entire market can collapse.

Read more: [It's not just the building cracks or cladding – sometimes uncertainty does even more harm](#)

The risks are highest in markets with these two features:

- sellers are not rewarded for delivering information to buyers or cannot disclose it effectively
- buyers cannot discriminate between the quality of different products, as is often the case in apartment developments.

These problems are more likely when buyers cannot easily inspect products at the time of sale – as with apartment units bought off the plan.

When a vendor sells a product to multiple buyers, again typical in apartment developments, that can multiply the impact of information asymmetries.

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The buyer of a standalone house might be able to make the sale conditional on an independent inspection of the entire building. But such clauses are very difficult to negotiate in off-the-plan sales for apartments in multi-unit buildings.

It would also be too costly for each buyer to commission such an inspection. Buyers are unable to organise a joint inspection of the building until after they have settled, which greatly increases their risk. While NSW's new [defects bond scheme](#) does require an inspection, it happens after ownership is transferred.

The negative impacts for buyers have spill-over effects as information asymmetries mean risks are perceived to increase across the entire apartment housing sector. [Negative publicity](#), such as the [flammable cladding](#) and [defects](#) scandals, can cause values to fall market-wide, regardless of the quality of individual developments. At the same time, [finance and insurance costs increase](#).

Read more: [***The big lesson from Opal Tower is that badly built apartments aren't only an issue for residents***](#)

The issue persists for subsequent buyers too. Information about defects is often unavailable due to [poor record-keeping](#) or [confidentiality agreements](#). Ironically, this adds to the information asymmetries that contributed to the problem in the first place.

What can we do about the problem?

To reduce information asymmetries, sellers and buyers tend to engage in two main types of behaviour: [signalling and screening](#).

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Signalling involves sellers flagging the higher quality of their products to buyers indirectly. For example, a reputable developer may use warranties and brands or quality marks, certificates and awards as a sign of their high-quality work. Buyers may well be prepared to pay more for higher-quality products that won't cost more in the longer term.

Crucially, signalling only works if the signal is credible. At present, there are no construction-specific quality certifications and warranties, only [generic standards such as the international ISO 9001: 2015](#)

And the administrative burden and costs of independent third-party certification make it unviable for many small companies. So instruments like ISO 9001 are likely of very limited value for effective signalling in the apartment sector.

The NSW Building Commissioner is supporting an industry rating system that will enable better signalling. Data mining will be used to identify risky players and [phoenix operators](#). It should take effect in the apartment sector by 2021.

Screening involves buyers investing time and resources to uncover the likelihood of defects. This includes examining available records and the behaviours of sellers and their representatives. But this adds to buyers' costs, which disadvantages them in the marketplace.

Stakeholders in the building development process should be compelled to release this information. NSW's [new law](#) on off-the-plan contract sales will increase sellers' disclosure obligations and provide stronger protections for buyers. Importantly, sellers will have to identify material changes made during the development process at least 21 days before settlement.

A similar requirement involving an independent expert building inspection would help buyers better understand the risk of defects before they finalise their purchase.

Read more: [**Housing with buyer protection and no serious faults – is that too much to ask of builders and regulators?**](#)

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Another positive move is the requirement in the new [Design and Building Practitioners Bill](#) for declared designs and as-built drawings to be lodged with the government. The Building Commissioner has said these will be made available on an easy-to-access platform.

This would enable buyers to check information as the development progresses, before the crucial building handover. It's a step towards creating a “[digital twin](#)” for everyone licensed to perform construction work, making it easier for the public to check their record.

While the devil is likely to be in the detail, the NSW government is on the right track in tackling the information asymmetry problem. However, the various information gatekeepers will still have to be persuaded – or required – to release information they have long withheld in their own interests.

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