Unfair treatment of standard industry construction contracts by banks

Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

August 2018

SUBMISSION BY

ARCHITEAM

Association of Consulting Architects
The Business of Architecture

PURPOSE

This submission is made by the Australian Institute of Architects (the Institute), ArchiTeam Cooperative (ArchiTeam) and the Association of Consulting Architects Australia (the ACA) to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. It provides comments on the unfair treatment of industry standard construction contracts by banks.

At the time of this submission the National President of the Institute is Clare Cousins, the Directors of ArchiTeam involved in the preparation of the submission are Barbara Moje and Warwick Mihaly, and the National President of ACA is Kieran Wong.

INFORMATION

The Institute is the peak body for the architectural profession in Australia, representing around 11,000 members. The Institute works to improve our built environment by promoting quality, responsible and sustainable design. Through its members, the Institute plays a major role in shaping the future of Australian cities, and the physical environment in which people live.

ArchiTeam is a national membership association and the leading representative of small, medium and emerging architects and architecture practices in Australia. Founded in 1991 with a growing membership of 650, ArchiTeam exists to provide benefits of cooperation, professional learning and a heightened public profile to its members.

The ACA is the national peak body representing architectural employers, with a membership of more than 500 practices, representing over 4000 architects and technical professionals. The ACA is a non-profit, member driven association that leads the conversation on business matters in architecture across Australia, helping architecture practices navigate the changing world of business leadership.

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1. INTRODUCTION

The Institute, ArchiTeam and the ACA have, over a number of years, received an ever-increasing number of complaints from their members that many banks are refusing to approve their clients' construction loans. This occurs primarily in the housing sector and where architect-administered construction contracts are used. We are strongly of the view that in prejudicing specific forms of building contracts, the banks are displaying anti-competitive behaviour and lessening competition in the construction industry.

Specifically, banks are refusing to lend to consumers where:

- Contracts specify an architect as the contract administrator
- Contracts contain provisions for monthly progress payments
- Progress is assessed by the architect rather than a bank appointed quantity surveyor
- Contracts contain provisions for variations

The refusal of these contracts has many detrimental effects on consumers and small architectural practices, as well as builders and building subcontractors. These effects will be explored in detail later in this submission.

The refusal of these contracts also has a negative impact on the Australian economy. The financial value of building work in the housing sector in 2017 was $71b[1], of which it is generally accepted the architecture profession contributed between 5 – 10%.

The Institute made an approach to the Australian Banking Association in 2014 but were redirected to the Association's members. The Institute also approached the Commonwealth Bank of Australia (CBA), who were initially unwilling to consider changes to their practices or policies. After significant advocacy efforts, CBA advised they had made amendments to their construction loans policy in favour of architect-administered contracts.[2] However, reports from our members suggest that this policy was not applied in practice.

2. HOW ARCHITECTS PROTECT CONSUMERS

In order to undertake a construction project, the consumer and builder enter into a building contract that establishes the rights and responsibilities of each party. Often, the consumer engages an architect to administer the contract and project manage the construction process. This is achieved via the selection of one of three industry standard building contracts with a defined role on site for an architect:

- Australian Building Industry Contract (ABIC) suite
- Australian Standard contract AS2124
- Australian Standard contract AS4000

The architect is specifically trained and has the expertise to carry out the role of contract administrator for these contracts. The architect is obliged by their professional conduct regulations to prioritise their client's needs above their own.[3] Their role on site reduces the many risks inherent in construction on behalf of the consumer and improves the quality of building outcomes.

An architect must successfully complete a minimum of five years' full-time study in an accredited university program to attain a Master of Architecture, must then undergo a minimum of two years mandatory practical experience, and must pass a registration exam conducted by the respective state and territory government registration board.

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[1] *8752.0 Building Activity, Australia*; Australia Bureau of Statistics; March, June, September and December 2017 releases.
[2] Mark Lim, Executive Manager of Valuation Risk and Secured Losses; Secured Credit Risk Management Department, Commonwealth Bank, email received 15th July 2015.
[3] *Working with an architect*; Architects Registration Board of Victoria; accessed August 2018.

The practicing architect is regulated by the Architects Act of that state or territory and legislation requires that they hold professional indemnity insurance, and in some jurisdictions, undertake mandatory continuing professional development.

The architect's role during construction is to continuously monitor progress on site, manage payment claims and assess quality. As construction proceeds, the architect visits the building site to make sure the builder follows the design, adheres to the schedule, uses the specified materials and meets work quality standards. The architect's role on site facilitates a smooth building process and improves the contractual relationship between consumer and builder.

3. IMPACTS OF BANK DISCRIMINATION

3.1. Effects of refusal of architect-administered contracts on architects

The Institute, ArchiTeam and the ACA are concerned that banks unfairly discriminate against architect-administered contracts. Their policies discourage the professional engagement of architects and exclude them from engaging in a task for which they are specifically trained. This unfair exertion of market power results in a negative financial impact on architects, and jeopardises a substantial portion of their overall project fees.

For instance, the CBA Credit Policy on Building / Construction Loans states construction loans are not to be provided for contracts under $1m where:

- The contract is for simple works.
- There is no progress payment schedule.
- Progress payments are to be paid on a monthly basis.
- An architect is overseeing the project.[4]

In addition to singling out key characteristics of architect-administered contracts as unacceptable loan conditions, CBA requires a bank-approved quantity surveyor to assess each progress payment, a condition that compromises the role of the architect and contravenes the conditions of the building contracts.

Other major banks have similar policies: the Bank of Melbourne's Consumer Mortgage Lending Policy stipulates staged progress payment claims. ANZ's policy insists on a quantity surveyor to assess payments and places a twelve-month limit on construction. Macquarie Bank requires a quantity surveyor and staged payments. NAB demands staged payments, predefined variations and will not loan against simple works contracts.

Collectively, these policies reveal a poor understanding of architect-administered contracts and systematic interference with an essential facet of the architecture profession's service provision. The policies prevent architects from receiving professional fees for a service for which they are qualified and trained, often as much as 30% of their overall project fees.

3.2. Effects of refusal of architect-administered contracts on consumers

We are also concerned that the banks' policies have a negative impact on consumers who are often forced to:

- Bear additional legal and certification costs as a consequence of the banks' requirement for consumers to hire bank-approved quantity surveyors to assess progress payments.
- Face time delays leading to higher project costs.
- Experience increased stress and uncertainty, and strained relationships with their architects and builders.

[4] See appendix for a copy of the Credit Policy on Building / Construction Loans issued by the Commonwealth Bank of Australia.

- Be a party to a building contract where their rights and interests are not being protected by a professional with a clear, contractual role.

Banks are attempting to protect their own interests at the direct, avoidable and additional cost to the consumer. Their policies increase costs and risks for the consumer, and contribute to substantial delays at the commencement and during construction projects.

3.3. Effects of refusal of architect-administered contracts on builders and subcontractors

In building contracts without an architect to assess monthly payments, set payments are made on the completion of key stages of construction. Typically:

- 5% deposit
- 10% footings
- 15% framing
- 35% lock up
- 25% fixing
- 10% completion

While staged payments may be suitable for standard project homes, where construction takes around twelve weeks to complete, it is highly unsuited to custom architect-designed projects that can typically take twelve months or longer to complete. The effects of sporadic payments on the cash flow of builders and subcontractors is substantial, with the banks dictating payments that do not reflect the process or value of work completed. This not only puts builders and subcontractors under financial pressure but can also lead to disputes between builder and consumer.

The banks' policies cause further negative impacts on builders and subcontractors with respect to:

- Delayed progress payments throughout the project, forcing builders and subcontractors to risk financial insolvency while waiting for infrequent staged payments. Builders in effect become "de facto financier[s] for medium term debt."[5]
- Strained relationships with consumers and architects.
- Exclusion of variations, a functionally necessary mechanism within building contracts.[6]

4. JOINT SURVEY

To collect evidence for this submission, the Institute, ArchiTeam and the ACA called on their respective members to provide testimonies of projects which have been impacted by the banks' unfair treatment of architect-administered building contracts.

The data was gathered over a two-week period from 21st June – 2nd July 2018.

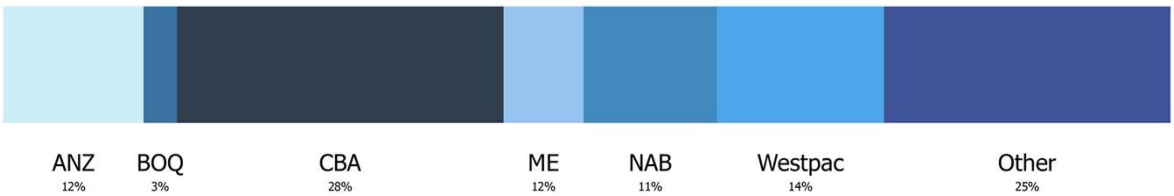
We received responses from 157 architecture practices covering 175 projects. This was a strong response, spanning every state and territory except for the Northern Territory, and reflective of the widespread impacts of the banks' behaviour.

[5] Michael Smith; *Home builders at high risk of bankruptcy under new staged payment scheme*; Domain; 16th August 2018.

[6] *Fixed price* and *Lump sum* are contract descriptions that are often incorrectly used interchangeably. Minter Ellison defines a fixed price contract as one "which contains no provision to compensate the [builder] for increases in labour or material costs," and a lump sum contract as one where "the remuneration for the [builder] is… subject to variations." In both instances, the contract price is agreed prior to commencement. In contrast, a cost plus contract is used "when the total amount payable to the [builder] cannot be determined at the time of entering into the contract… and the [consumer] takes the risk of that cost." Sourced from *Construction Law Made Easy*; Minter Ellison; accessed August 2018.

4.1. Identification of banks

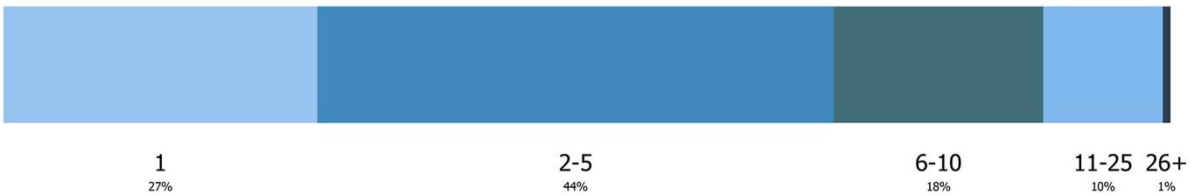
All four of the big banks are identified, together appearing in 65% of reported cases. A large number of smaller banks and credit unions are also identified:



Other institutions identified include Macquarie Bank, Bendigo Bank, AMP, Suncorp, Bankwest, Bank of Melbourne, Credit Union Australia, Adelaide Bank, Bank First, St. George Bank, HSBC, Citibank and Police Credit Union.

4.2. Impact by practice size, project type and budget

Survey responses clearly indicate that this is an issue predominantly affecting small businesses, with 71% of impacted architecture practices employing five people or less:



Affected projects belong primarily to the housing sector, split closely between new dwellings and alterations and additions. Issues are also identified for multi-residential and mixed-use projects:

Reported project budgets are most commonly at the smaller end of the construction industry, with 66% of budgets under $1m and 85% under $1.5m. The average project budget is around $870k[7]:

These findings confirm that the bank problem is primarily affecting small residential projects, and the small architecture practices that work on them. They also confirm that the projects are almost entirely single, private houses. Though the architecture practices and projects are small, their contribution to the economy is not:

- The aggregate budget of the surveyed projects is around $152,000,000[8].

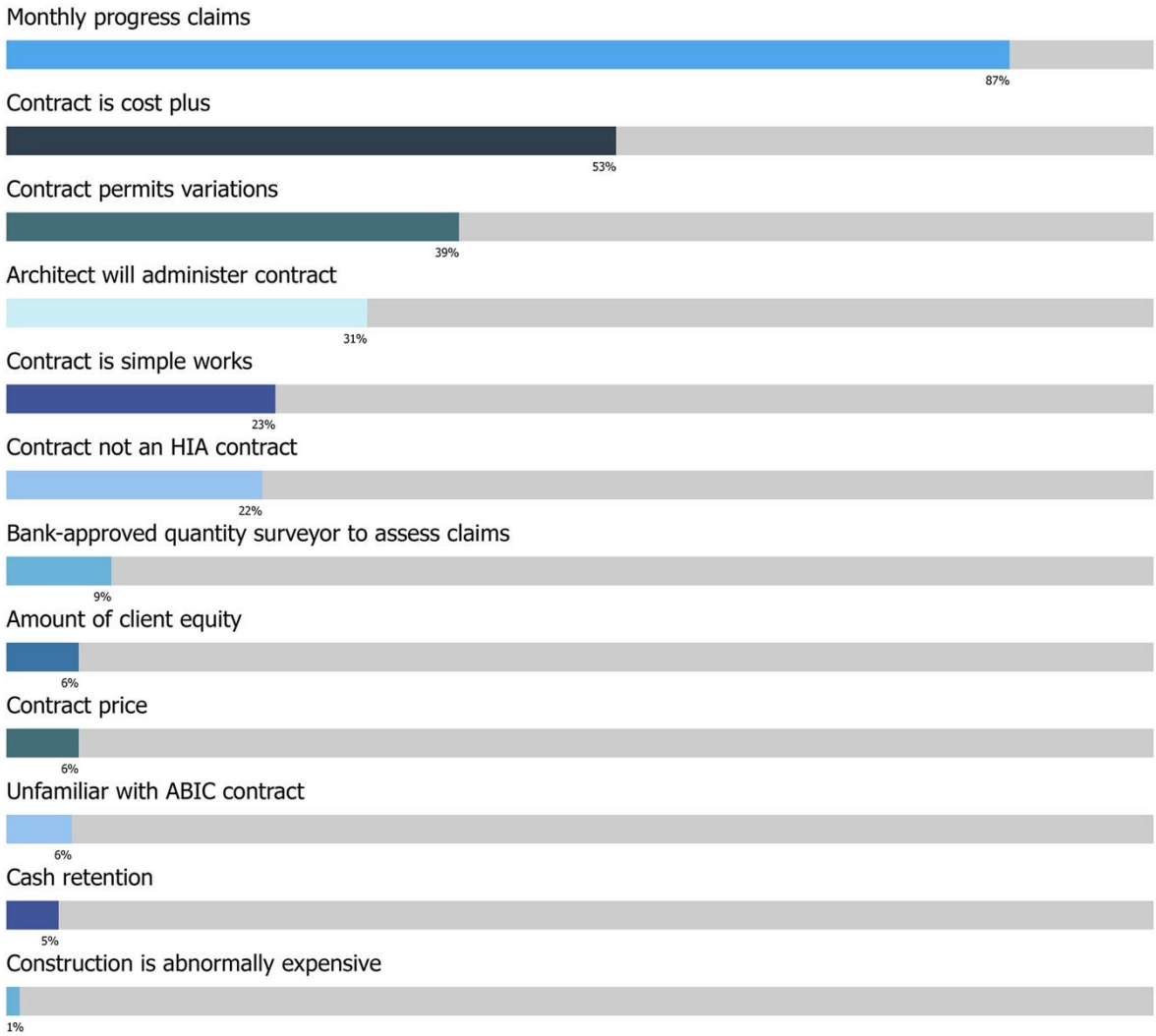
[7] The average budget of surveyed projects is an approximate figure based on the mid-point of budget ranges provided by survey respondents

[8] The aggregate value of surveyed projects is an approximate figure based on the mid-point of budget ranges provided by survey respondents

4.3. Affected **contracts and bank issues**

Respondents identify Australian Building Industry Contracts (ABIC) as the most commonly affected building contracts, cited in 93% of cases. The ABIC contract suite is published by the Institute in partnership with the Master Builders Association (MBA). They have been in regular use since 2008:

A wide range of issues with architect-administered contracts are identified by the banks:



These bank issues confirm that there is a widespread lack of understanding of architect-administered contracts and how they operate. For example, the ABIC SW-H is a lump sum contract, but has been identified by banks as a cost-plus contract in 53% of cases.”

Some issues indicate a misunderstanding of building contracts in general. For example, all fixed price contracts may be varied as a result of "variations to the work, extra costs as a result of certain delays… or latent ground conditions."[9] This includes Housing Industry Association (HIA) and MBA contracts, which the banks expressly prefer. Yet the banks identify variations as a problem in architect-administered contracts 39% of the time.

Overwhelmingly, the most widespread single issue is monthly progress payments, cited in 87% of cases. This is at odds with the architecture profession's general position that they are fairer than staged payments for architect-designed projects, relate directly to the value of work completed, and mitigate against the risk of builders going bankrupt.

Further insight is provided by the following comments from survey respondents:

> *"There was a general lack of understanding of the contract and unwillingness to review or understand its details."*
> - Brunswick East, VIC

> *"No real issues were identified by any of the banks approached by our client. There was simply a blanket refusal to allow the ABIC contract to be used."*
> - East Brisbane, QLD

> *"The bank believed the involvement of an architect would result in variations, and so considered the contract to be cost plus. The bank also said the ABIC contract was not industry standard."*
> - Perth, WA

> *"The bank refused to accept any contract except an HIA contract."*
> - Sydney, NSW

> *"The bank required a schedule of anticipated claims at the commencement of the project and would not allow variation from those despite a legitimate claim from the builder."*
> - Hobart, TAS

> "*The bank advised the progress payment schedule must be within industry standards i.e. deposit 5%, base 10%, frame 15%, lock up 35%, fixing 25% and completion 10%. The builder and I were not happy with this schedule as it did not necessarily reflect the progress of the project."*
> - Brunswick, VIC

> *"The bank didn't accept certification of payments by the architect, and insisted on using a quantity surveyor to check the works."*
> - Mount Beauty, VIC

> *"The bank checked each progress claim with a quantity surveyor. This was heavy handed and expensive for our client, plus funds were only released 30 days after the builder issued his invoice. This was bad for the builder's cashflow and the ongoing financial stability of the project*."
> - Cremorne, VIC

[9] Allowable adjustments to fixed price contracts defined in: *Credit Policy on Building / Construction Loans*; Commonwealth Bank; page 2.

4.4. Resolving bank issues

Attempts to resolve bank demands result in a number of adverse outcomes for architects, consumers and builders. Most commonly, construction loans are approved at the cost of consumers accepting bank mandated conditions not necessarily in their interest. This occurs in 73% of cases:

(i) Loan granted with alternate contract (ii) Loan granted with alternate bank
(iii) Loan granted under a personal loan (iv) Loan refused

Conditions placed on construction loans typically include some or all of the following:

- An alternate building contract, often excluding a contract administration role for the architect.
- Staged progress payments.
- A bank approved quantity surveyor to approve payments.
- No cash retention.
- No variations.

Survey respondents indicate that the banks' loan conditions regularly result in unnecessary difficulty during and following construction:

> *"Our client resorted to obtaining a personal loan for the construction period, then had to transfer this back into a construction loan after completion."*
> - Melbourne, VIC

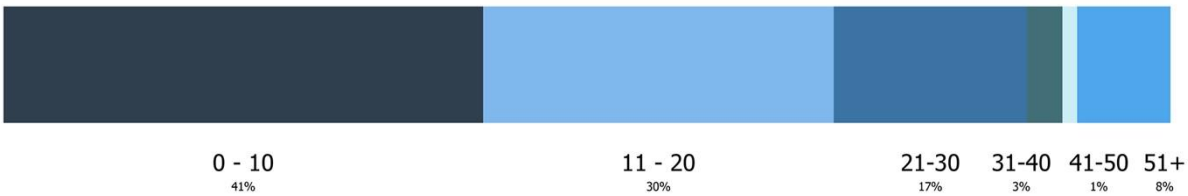
> *"The builder had to carry a $10,000 underpayment for one month."*
> - Hobart, TAS

> *"The bank delayed certified payments to the builder, insisting on getting their own assessor on site."*
> - North Melbourne, VIC

> *"Our client had to pay the first claim from their own funds so as not to delay the project. They also had to pay for all variations themselves."*
> - Turner, ACT

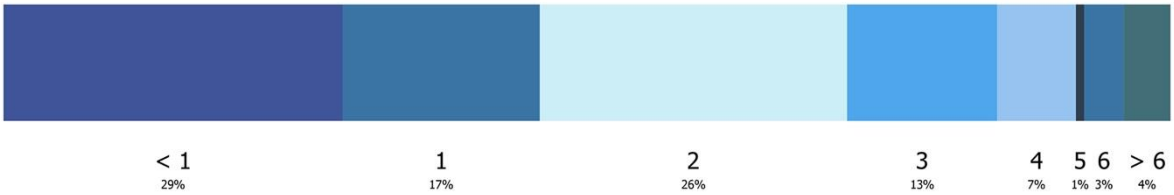
> *"The loan was approved, but during construction payments stopped. We had to deal with bank staff who had never worked on a construction site before and did not want to comprehend the issues faced by our clients and the builder. We resolved the issue by doing the work of the quantity surveyor that had been stipulated by the bank, time we were never reimbursed for."*
> - Orange, NSW

Survey respondents confirm that substantial time is spent by architects in negotiation with the banks. 59% of architecture practices spend ten hours or more attempting to resolve issues with the banks on behalf of their clients, and on average sixteen hours. 12% of architecture practices spend more than a week, or forty hours:



The vast majority of this time is not reimbursed. 84% of survey respondents are not reimbursed at all, and 93% are either not reimbursed or only partially reimbursed:

In addition, projects are often substantially delayed by bank interference at project commencement. 71% of projects are delayed by one month or more. The average delay is two months, and a small percentage of projects are delayed by a very large period, twelve months or more (2%):

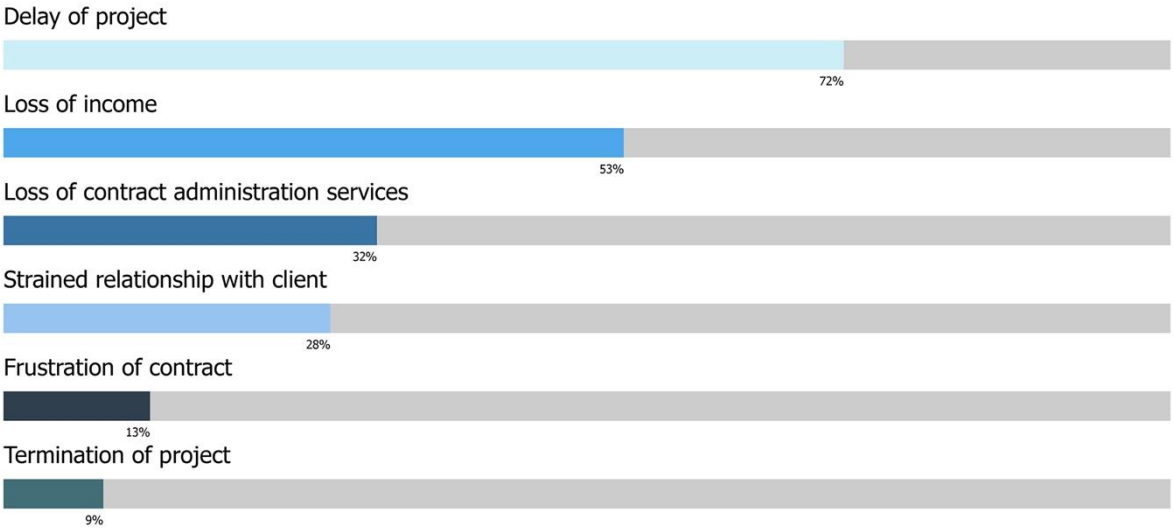


These results clearly show that the banks' behaviour is delaying projects, and costing architecture practices considerable time and money. Aggregating the banks' impact on the 175 projects included in the survey data, it is possible to conclude the following:

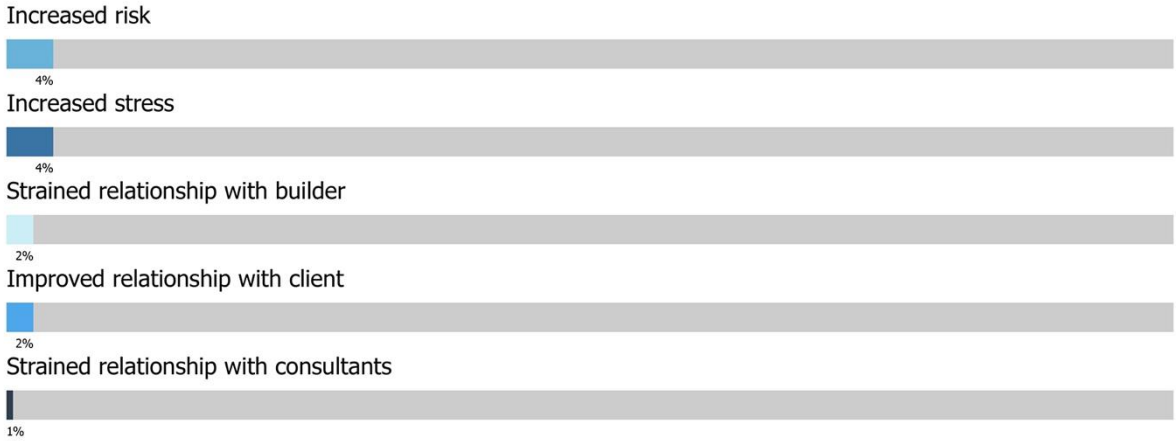
- The surveyed projects are delayed by an aggregate total of 324 months.
- The surveyed architecture practices spend a total of 2,714 hours addressing the banks' issues on their clients' behalf.
- Of the hours spent, 2,280 are unpaid and a further 244 only partially paid.

4.5. Impacts on architects, consumers and builders

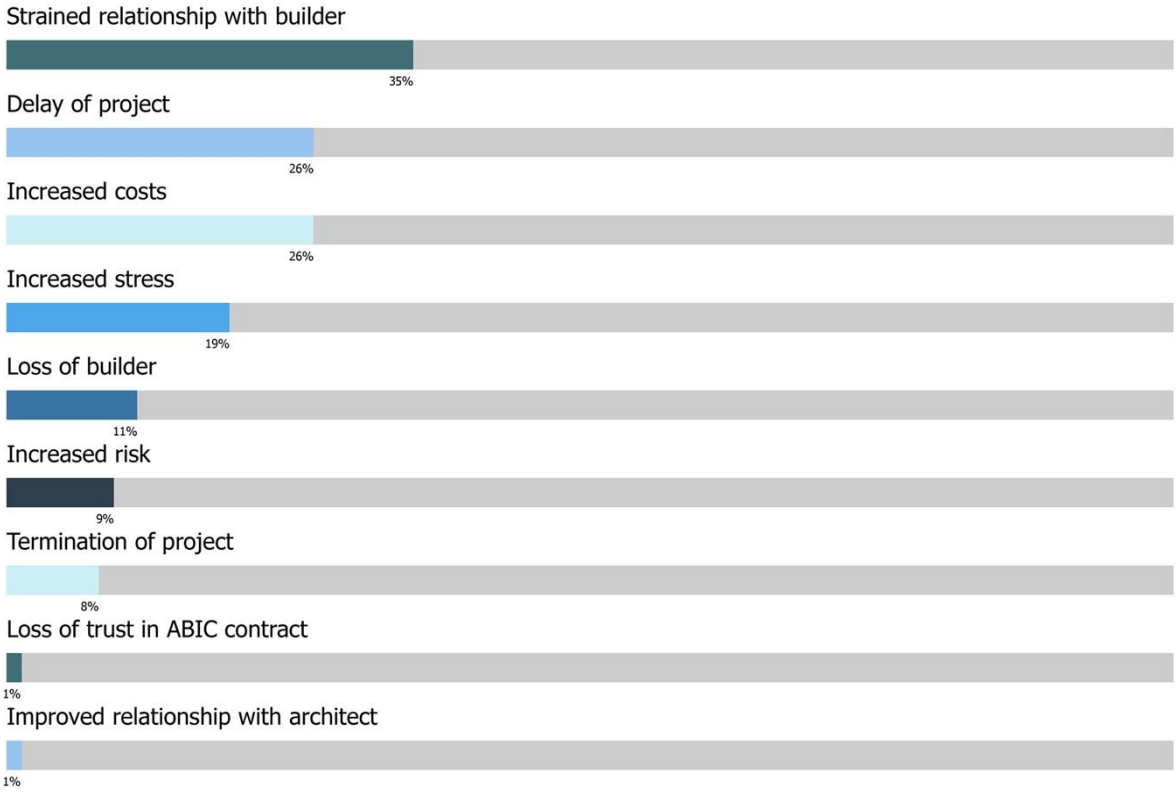
Bank discrimination results in further negative impacts on architects, consumers and builders. Reported effects on architecture practices are as follows:



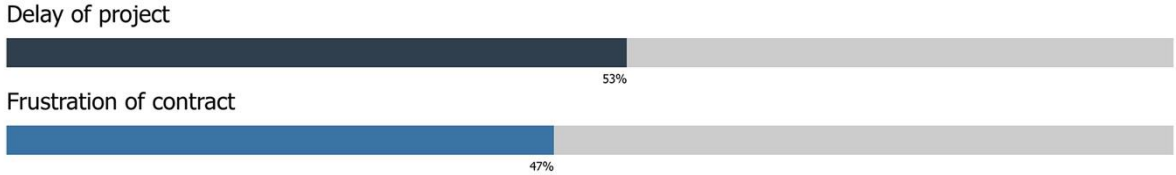
Effects on architecture practices *continued*:



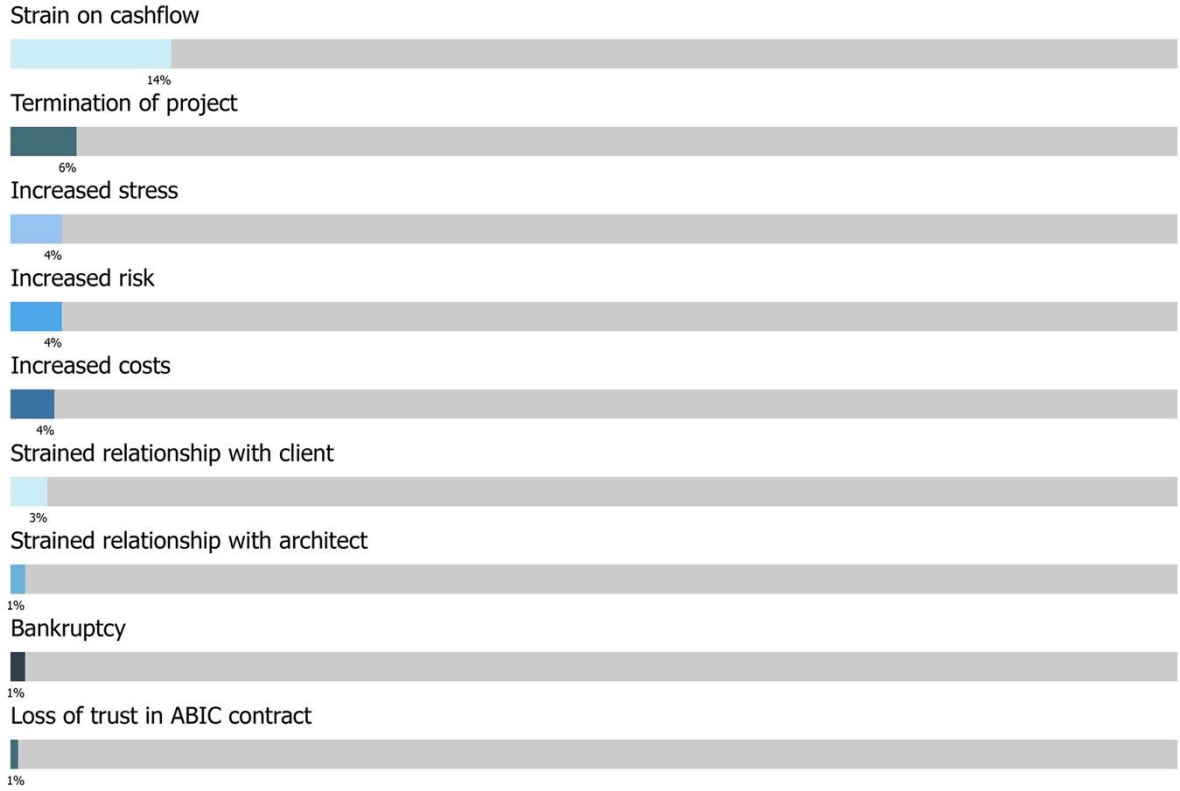
Reported effects on consumers include:



And reported effects on builders include:



Effects on builders *continued*:



Amongst all three groups, project delays are cited most commonly (72% for architects, 35% for consumers and 53% for builders).

There are numerous financial implications for all three groups, including loss of income for architects (53%), increased project costs for consumers (26%) and strain in cashflow for builders (14%). Additional costs to consumers include higher financing costs, fees for bank-approved quantity surveyors to check progress payments, the requirement to self-fund variations, and variations due to increased paperwork required from the builder.

Strains on the relationships between the architect, consumers, builder and specialist consultants are widespread (for 31% of architects, 35% of consumers and 4% of builders).

Respondents note frustration of the contract is a problem for architects a small percentage of the time (13%) and a substantial percentage of the time for builders (47%). This indicates that while it is the consumer who introduces the bank into the construction project, it is the builder and to a lesser extent the architect who bear the brunt of the banks' interference.

In a small number of cases, projects are affected catastrophically. 9% of architects lose the project entirely, 11% of consumers lose the builder and 1% of builders go bankrupt.

The following comments further highlight the banks' impact on architects, consumers and builders:

> *"We worried that at times the payments mandated by the bank's set stages were well in excess of works actually completed and the client would be financially impacted if the builder failed."*
> - North Melbourne, VIC

> *"The bank delayed payments to the builder as they sent someone out to check on progress claims even though that was my responsibility under the contract."*
> - Canberra, ACT

"I had to spend a huge amount of time negotiating with all parties to modify the contract to suit the bank. For the entire build, I had to certify progress claims that were not necessarily an accurate reflection of the amount of work completed."
- Hobart, TAS

"The bank's mistrust of the both the architect and the contract made monthly certifications more complex and, from the builder's point of view, unacceptably delayed."
- North Fremantle, WA

"The bank required extra paperwork from the builder at every progress claim, causing increased costs to our client for the builder's time."
- East Sydney, NSW

"*The bank insisted on a quantity surveyor's cost estimate even though the project had already been out to tender and three market prices received. The additional cost to our client was approximately $2,500 for the cost estimate plus a further $800 for the quantity surveyor to review each of eight claims = a total cost of $8,900."*
- Melbourne, VIC

"The builder stopped work twice because of slow payment of his invoices."
- Hobart, TAS

"The project program was delayed due to the bank's inappropriate progress payment model which impacted the builder's cashflow. Ultimately the builder went into liquidation prior to completion with unpaid bills, forcing our client to pay approximately $200k over the original contract price."
- Abbotsford, VIC

"Our clients lost faith in the project, and almost abandoned building their family home."
- Brunswick, VIC

"Our clients had to pay additional fees for independent inspections, additional banking fees for variations to the contract, and additional costs in rental accommodation as project period was longer due to builder's cashflow issues."
- Fremantle, WA

"The bank placed unwarranted financial burden on the builder. With staged payments the builder was unable to vary a claim, so if something out of his control ran late, he still wasn't paid."
- Fitzroy, VIC

"The bank caused a three-month delay in starting, and the builder was then forced to carry out in-ground works in the wet season."
- East Brisbane, QLD

4.6. Further comments

Survey respondents provide more general comments on the impacts of bank discrimination, a small selection of which is as follows:

"*The banks show a fundamental lack of understanding of how architecturally designed homes are procured. Unless these issues are resolved, the banks will make construction more expensive and riskier for clients, and fundamentally disrupt the business model for bespoke builders. Anything that dissuades clients from accessing design expertise during the construction phase also has a detrimental impact on the quality and value of the finished built product."*
- Fitzroy, VIC

"All recent experiences involving project financing through a bank have resulted in project termination."
- Brunswick, VIC

"*Monthly progress payments are preferred by both builders and clients. Architects have the skill set to determine percentages of work complete and process claims accordingly. Risk is reduced as a result of monthly claims as payments are a true reflection of work complete. Staged payments never truly reflect the works complete, particularly when banks require them set at typical percentages*."
- Yarralumla, ACT

"The staged progress payments imposed by the bank create financial strain on builders which are reflected in their tenders. Many builders are not able to tender with these financial restrictions. The role and function of the architect under the contract is not understood or allowed to function."
- Alphington, VIC

"I am surprised that banks generally haven't heard of the ABIC contract, especially given that the architect's high level of scrutiny of progress payments can only be of greater security to them and their customers."
- Eltham, VIC

"I am furious that a bank has so much influence as to almost stop a project coming to fruition because of the choice of contract. Especially when the original contact is legal, binding and correct for purpose – the renovation of a house."
- Sydney, NSW

"*Banks cause major delays in builders' cashflow, at times paying claims 1-2 months late, yet builders are obliged to pay subcontractors on time, which cannot happen if the monthly claim is late. Small businesses suffer major stress waiting for payments that banks seem to have no obligation to make in a timely manner.*
- Newstead, QLD

The survey conducted by the Institute, ArchiTeam and the ACA reveals a poor understanding of architect-administered construction contracts and systematic discrimination against architects, consumers and builders.

A brief summary of its findings is as follows:

175	surveyed projects with an aggregate budget of
$152m	delayed by
324 months	on which
2,714 hours	were spent by architects.

5. CONCLUSION

The Institute, ArchiTeam and the ACA appreciate that banks provide construction loans for buildings that do not yet exist, and that they seek to reassure themselves that the completed buildings align with their valuation of the underlying security assets approved. The banks will claim that through their lending policies they manage their risk through familiar building contracts and processes. We acknowledge that the banks, like any other business, are entitled to manage and reduce risk.

However, in our view the banks' discriminatory behaviour towards architects and architect-administered contracts increase risk to architects, consumers, builders and the banks themselves. They impose unfair lending conditions that:

- Remove choice for consumers.
- Add costs that fall on the consumer.
- Unfairly exclude architects from practicing their profession.

We are concerned that the lending practices and policies of banks discriminate against industry-standard construction contracts and have a significant negative impact on consumers and small business. We request that the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry examine this issue with a view to making recommendations that:

- Improve the attitude of the banks towards architect-administered construction contracts.
- Cease the practice of forcing architects, consumers and builders to use construction contracts that create more risk to them and add to the overall project cost.

We advocate the importance of industry-standard construction contracts that provide a clear and contractual role for the architect to administer the project and provide considerable protections for the consumer. This is in the common interest of architects, consumers and builders, as well as the risk profile of the banks.

CommonwealthBank

Search

Credit Policy

Building/Construction Loan

Back to Satisfactory Security

Conditions For all Building/Construction Loans

- Construction must be completed under a fixed price building contract unless the value of the building contract is equal to or greater than $1 million, in which case Cost Plus contract may be considered.
- Dwellings are to be retained for personal investment or residential purposes and NOT built for the purpose of immediate sale.
- Construction loans must not be on an owner builder basis where:
  - borrowers are the directors of the company (or a party to the firm or partnership) issuing the building contract. or;
  - company/trust borrowers issuing the building contract on their own behalf
- Construction is restricted to a maximum of 2 dwellings on the same title. Construction of more than 2 dwellings should be considered on a commercial basis.
- For progressively drawn loans, a formal building tender, formal building plans (non council approved) and specifications plus quotes for any 'Out of Contract' items must be provided by the broker on submission of the application
- An 'as if complete' valuation is required for all construction loans.
- For building contracts between $250,000 and $1,000,000 a progress payment inspection will be completed by a Bank valuer prior to making the first loan drawing when the building has commenced construction.
- For constructions costing > $1,000,000 a progress payment inspection will be completed by a Bank valuer for every progress payment request.
- Construction loans will be progressively drawn according to the progress payment schedule.
- Customers should be made aware that they must use all of their own equity (e.g. personal savings or First Home Owners Grant, if applicable) before any progressive payments are made from their loan towards the construction.
- Construction must commence within 6 months from the disclosure date on the Consumer Credit Contract Schedule and be completed within 24 months of that date. If not, approval of the loan or any undrawn portion of the loan may be withdrawn at the Bank's discretion

Notes:

For personal borrowers only:

- It is acceptable to receive electronically executed building contracts including progressive payment schedules, contract variations and council stamped plans.
- Customers applying for any of the **First Home Owners Grant Schemes (FHOGS)**. Refer below for states accepting electronically executed Contract of Sale or Building Contract along with FHOG application.

States	Executed documents (Contract of Sale or Building Contract) for the First Home Owners Grant Schemes (FHOGS)
Australian Capital Territory (ACT) New South Wales (NSW) South Australia (SA) Victoria (VIC) Western Australia (WA)	Acceptable to receive electronically executed Contract of Sale or Building Contract OR Must physically sign the original document (Wet Signature)
Queensland (QLD) Tasmania(TAS) Northern Territories (NT)	Must physically sign the original document (Wet Signature)

- It is **not** acceptable to receive electronically executed progressive payment invoices.

For companies and trusts, it is not acceptable to receive electronically executed building contracts including progressive payment schedules and council stamped plans.

Out of Contract Items

- "Out of Contract" construction items are additional improvements or renovations being completed in conjunction with the construction of a dwelling that do not form part of the scope of fixed price building contracts with a primary builder. They are restricted to non-structural works, such as kitchen and bathroom prime cost items, and floor coverings etc. They may also incorporate ancillary improvements, such as swimming pools, pergolas and landscaping etc. The Bank will accept up to 10 "Out of Contract" items per application so long as their total does not exceed of 20% of the Primary Building Contract amount.
- All additional work must be formally quoted for both supply and installation. These quotes must be provided to the Bank's Valuer completing the valuation at origination, to ensure they are included in the "as if complete" value of the property.
- CBA Mortgage Services will reconcile the total costs of the Construction project, (inclusive of "out of contract" items), to ensure all costs can be met by both loan funds and client's equity, prior to unconditional approval.

Prior to releasing loan funds for "out of contract" items, CBA Mortgage Services will ensure the following requirements are met:

- A formal Invoice from the Contractor confirming work is completed, has been received together with a letter signed by the client(s) confirming completion of work.
- Where any individual "out of contract" item is $30,000 or more, a progress inspection from the Bank's Valuer will be obtained to confirm completion of work.

Where there are variations or where "out of contract" items are not completed / required, resulting in undrawn loan funds, these undrawn funds will be withdrawn by the Bank. Where incomplete "out of contract" items do not pertain to the "fit out" (e.g. pergolas, driveways, pools etc.), an "occupation certificate" (or State equivalent), must be obtained prior to the completion of the construction loan.

Progress Payment Schedule

The customer must provide a progress payment schedule as part of the building contract. It must be confirmed that no more than 50% of the funds are used for slab plus frame stages (stage 1 and stage 2).

Below are two examples of what a Progress Payment Schedule may look like:

Example 1:

Payment is required in five stages and these five progress payments total 100%:

1. Slab including deposit – 15%
2. Frame – 15%
3. Lock up – 35%
4. Fix – 25%
5. Completion – 10%

Example 2:

Payment is required in five stages and these five progress payments total 100%:

1. Slab including deposit - 15%
2. Frame - 15%
3. Enclosed - 35%
4. Fixing - 20%
5. Practical completion 15%

Construction of multiple dwellings

- Servicing cannot be reliant on the sale of one or more of the constructed dwellings

Note: Where the proposal is to construct more than one dwelling on the same title, potential subdivision cannot take place until the construction is complete. Therefore, the proposal should be considered on an "in one line basis", with the subdivision ignored for the purposes of the construction and the valuation. (ie we cannot consider the dwellings to be on separate titles and we cannot consider the potential security value once and if the dwellings are subdivided)

Construction Loans in a Company/Trust (or Firm or Partnership)

- Servicing must be demonstrated using independent and ongoing income (ie Where the applicant derives their income from regular salary/employment or business
- Proposed rental income can be considered for servicing purposes but should be supplementary to main income source

Note: Where the applicant derives their income from property development, the purchase and sale of property and/or they need to sell a completed dwelling to make the application viable, the proposal is not acceptable as a Home Loan or Investment Home Loan.

	Acceptable	Excluded
Applicant	AJ Smith Family Trust	TJ Development Trust
Director Occupation	Doctor	Engineer/Builder
Income Source	Medical Specialist- income derived from medical activities	Construction/Capital Gains- income derived from construction and sa
Purpose/Driver	Increase Property Portfolio- Looking to retain properties and obtain rental income	Make a profit- Looking to build with a view to generate short term pro
Servicing	Servicing can be demonstrated based on income from medical practice. Income position will be enhanced by the constructed dwellings.	Servicing is reliant on business activities and potentially the sale of c by the construction with sale proceeds and/or rental contributing to b

Costing Reports

A costing report to confirm the validity of a contract price with progress payment inspections at each stage will be required for residential buildings being constructed under a signed contract when any of the following circumstances arises:

- The contract price is out of line with the work being done.
- The contract price is not fixed (e.g. rise and fall) and is $1 million or more
- The fixed price contract price is $1 million or more.
- The construction type is uncommon either because the building site or the architectural design has features likely to give rise to unusual costs.
- The contract between the parties is not at arm's length.

Note: We will not accept a non-fixed or cost plus contract where the contract is for less than $1 million. Customers with non-fixed or cost plus contracts should be advised that they must ensure they have equity available to cover the price fluctuations.

Building Contracts

The difference between a Fixed Price contract and a Cost Plus contract are;

Fixed Priced contracts

A fixed price contract is a contract in which the builder has agreed to complete the work for an agreed fixed amount, there are no rise or fall clauses and therefore no provision for increases in labour or material costs.

Generally the contract provides for payment of an agreed amount with a provision for adjustments. Adjustments may be made for:

- variations to the work
- extra costs incurred as a result of certain delays
- variations in the cost of the work for certain unexpected difficulties in performing the contract, or
- latent ground conditions.

Note: This type of contract is still known as a fixed price contract.

Cost Plus Contracts

A Cost Plus contract is when the builder agrees to complete specific work for an amount but the contract contains rise and fall clauses that allow the builder to charge for increased labour or material costs.

Building contracts where the price is not fixed represent an increased risk to both the customer and the Bank as the cost may increase significantly and this could result in the customer having no access to further equity or borrowings to complete the construction. The customer should have access to substantial additional equity, borrowings or surplus funds to cover increased costs, should they arise.

How to Identify a Cost Plus Contract (Non Fixed Price contract)

- Front page of the building contract to state cost plus contract or simple works contract
- There will be no actual progress payment schedule
- The contract will note progress payments to be paid on a monthly basis
- Where architect details are included in the building contract this could mean they would be overseeing the project.

Insurances

- Builders Contract of Works Insurance covers the loss or damage to materials and work during the construction period.
  - The builder/tradesperson must hold this insurance.
  - the policy must include:
    - Insurance amount equal to the Building Contract Price
    - Name of owner
    - Address of construction property or 'Anywhere in Australia'. Variants to this description may include but are not limited to:
      - 'Australia wide', or
      - 'anywhere in ', or
      - 'within the boundaries of Australia and its territories', or
      - 'anywhere from to but including '
    - Expiry date
- Public Liability insurance must include all of the above but the insurance amount must be for a minimum of $5 million. It should also state the insured party as the building company carrying out the work at the security address.

Note: If any of the above are not on the policy the Broker must contact the customer and advise that they must provide an acceptable insurance policy.

Valuations and Inspections

Valuations are required at the following stages of the Construction loan process:

1. 'As if complete' valuation - at Credit Decision stage.
2. Progress Payment Inspection - when the first payment is released where construction has begun (contracts between $250,000 and $1,000,000).
3. Progress Payment Inspection - when the first payment is released where construction has begun (constructions costing > $1m).
4. Final Progress Payment inspection - prior to the release of the final draw down on the loan.

Building/Construction Product
Building/Construction Process