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fact sheet

for property managers

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Combustible cladding in property leasehold and freehold acquisitions

This fact sheet provides tips for managing risk caused by combustible cladding in accordance with the applicable Acts, rules and requirements for non-corporate Commonwealth entities. Much of this factsheet will also be applicable to corporate Commonwealth entities.¹ It contains information for those officials involved in the acquisition of property (including the purchase, leasing or licencing of property) which is (or may be) affected by combustible cladding.

By 'combustible cladding', we mean external cladding which, either due to its composition or by inappropriate usage or installation, does not meet the requirements of the *Building Code of Australia*.

Combustible cladding is a complex problem for which there is currently no easy solution. The issue of non-compliant cladding is often only one part of a broader range of risks relating to the fire safety of a building.

In order to minimise risk to the Commonwealth, officials involved in the acquisition of property must be aware of:

- their duties and obligations as Commonwealth officials
- the range of foreseeable risks to the Commonwealth.

Legislation

There is a wealth of legislation, legislative instruments and guides (issued by the Department of Finance) applicable to the acquisition of an interest in land (including buildings) by the Commonwealth. In the context of an acquisition of an interest in a building such as a lease, the most relevant of these include:

- *Commonwealth Property Management Framework* (RMG 500)
- *Lands Acquisition Act 1989*
- *Public Governance, Performance and Accountability Act 2013* (PGPA Act)
- *Commonwealth Work Health and Safety Act 2011* (WHS Law)
- *Commonwealth Procurement Rules* (CPRs).

Obligations of Commonwealth officials

This fact sheet will provide an overview of the core obligations of Commonwealth officials involved in the acquisition of property in the context of combustible cladding, and provides practical guidance on how officials can minimise risk to the Commonwealth when considering a lease or freehold acquisition of a building affected by combustible cladding.

¹ Application of the PGPA Act can vary among Corporate Commonwealth Entities.

There are 4 focus areas:

1. core duties under the PGPA Act and CPRs
2. workplace health and safety obligations under the WHS Law
3. indemnity and insurance risk
4. insurance issues related to combustible cladding.

Given the number of duties on Commonwealth Officials and the range of foreseeable risks to the Commonwealth, this fact sheet can only provide an introduction to the issues raised. At the end of the fact sheet there is a list of further resources.

1 Core duties of accountable authorities and officials in property transactions

PGPA Act

The PGPA Act imposes duties on accountable authorities and officials of Commonwealth entities (both corporate and non-corporate) to:

- govern the entity in a way that promotes the proper use and management of public resources (including relevant money and property)
- establish and maintain systems relating to risk and control
- notify the responsible minister of significant decisions or issues.

It will be relevant for the Commonwealth landlord or licensor to consider the implementation of the Code in the State or Territory where the leased premises are located.

CPRs

The CPRs set out the rules for procuring goods and services for non-corporate Commonwealth entities and *some* corporate Commonwealth entities. The core concept of the CPRs is 'achieving value for money'. The CPRs are clear in stating that price is not the sole factor when assessing value for money. When conducting a procurement an official must consider, amongst other things, the whole-of-life costs of the procurement. In the context of property acquisitions, such costs could include:

- maintenance and operating costs
- costs involved in remedying any combustible cladding
- costs involved with temporary business shutdowns and interruptions due to cladding remediation works
- relocation costs (either for either temporary or permanent relocations due to combustible cladding).

RMG 500

Supplementing the PGPA Act and the CPRs is RMG 500 – the Commonwealth Property Management Framework. This framework applies to property owned or leased by the Commonwealth in Australia, and is mandatory for officials and accountable authorities of non-corporate Commonwealth entities.

RMG 500 provides that leasing must be based on value-for-money analysis, and must be consistent with the whole of Australian government leasing strategy.²

Tips for Commonwealth officials

- Even though the problems with combustible cladding are now widely known, states and territories have formulated varying approaches to deal with the issues.

² Department of Finance, 'Commonwealth Property Management Framework (RMG 500)', which can be accessed at: <https://www.finance.gov.au/sites/default/files/2020-08/rmg-500.pdf>.

- Officials should be very cautious when acquiring a leasehold or freehold interest in a potentially affected property. Even if rectification is not presently required, this does not mean that works will not be required in the future. There may be significant jurisdictional differences in the approach of each state and territory to resolving the issues. Any agreements to do with the acquisition of property should not just deal with the issue 'now', but well into the future as well.
- Officials must consider the possibility of cladding rectification works when calculating whole-of-life transaction costs or conducting a value for money analysis. As noted above, even if another party (such as the landlord) is required to carry out the works, the Commonwealth may still experience interference with its occupation of the building.
- Officials should ensure that landlords are well aware of the Commonwealth's requirements prior to the lease being signed. The best place to document the Commonwealth's expectations are in the heads of agreement. If an official suspects a property may be affected by combustible cladding, this issue could be dealt with at the commercial negotiation stage of an acquisition when agreeing the heads of agreement. For instance, the heads of agreement could contain:
 - a warranty by the landlord that the building is compliant with the *current* Building Code of Australia (BCA)
 - an acknowledgment by the landlord that the lease will require the landlord is to remain compliant with the BCA and any fire safety regulations throughout the term of the lease
 - (if the building is non-compliant) an express requirement that the landlord is to rectify all cladding and fire safety issues prior to the commencement date of the lease (where that is reasonably possible)
 - a requirement that the landlord compensate the Commonwealth for any disruption caused by remediation works. If the Commonwealth is required to relocate for any period of time, the landlord should be responsible for any relocation costs
 - a requirement that the landlord use the standard Commonwealth National Lease (note this document has recently been updated and specifically addresses combustible cladding).
- If heads of agreement have already been progressed using the former Commonwealth National Lease (CNL), there may be no specific mention of the combustible cladding but the former CNL required the landlord to comply with all laws relating to the premises, as well as to remedy any non-compliant materials used in the building. As state laws have generally been amended to make rectification of combustible cladding compulsory, these clauses create a contractual obligation between the landlord and the Commonwealth with respect to legal compliance.

2 Workplace health and safety obligations under the *Workplace Health and Safety Act 2011* (Cth) (WHS Act)

The WHS Act imposes duties on 'persons conducting a business or undertaking' (PCBU).

For non-corporate Commonwealth entities, the PCBU is the Commonwealth. For corporate Commonwealth entities, the PCBU will be the business entity conducting the business or undertaking.

The primary health and safety duties of a PCBU are so far as is reasonably practicable:

- to ensure the health and safety of their workers while they are at work in the business or undertaking
- to ensure that the health and safety of others is not put at risk from work carried out as part of the business or undertaking.³

³ *Workplace Health and Safety Act 2011* (Cth) s 19(1).

The WHS Act also includes specific obligations on the PCBU to provide and maintain:

- a safe work environment without risks to health and safety⁴
- safe plant and structures.⁵

Officials have a duty to exercise 'due diligence' to ensure that their PCBU complies with its duties and obligations.

In order to satisfy their 'due diligence' obligation when acquiring property, officials should make reasonable enquiries as to whether the building is affected by combustible cladding. If there is combustible cladding in the building, officials need have a thorough understanding of the risks to Commonwealth workers and to third parties.

Tips for Commonwealth officials

- Ask the landlord's agent (if any) about the history of the building, the outcomes of any assessments of the building and whether there are any works proposed (and the timing of those works).
- If there is an owners' corporation (or equivalent), obtain minutes of the most recent meetings to ascertain whether any investigations or compliance action has been initiated and how they were resolved.
- Ask the local council if there are any outstanding compliance or fire safety orders relating to the building.
- Commission an independent building inspection report and/or fire engineers report, which should require a physical inspection of the building, rather than just a desktop survey.

3 Indemnities and insurance tips for the acquisition of buildings with combustible cladding

As required by the PGPA Act and PGPA Act Delegation, officials must seek to limit the Commonwealth's risk exposure to the contingent liabilities created by indemnity clauses.⁶

In any acquisition, officials must take care to ensure that the Commonwealth is not assuming risk that should be borne by the landlord (including its building surveyor or other relevant contractor).

General Principles

The PGPA Act Delegation sets out the following principles:

- risks should be borne by the party best placed to manage them
- benefits to the Commonwealth should outweigh the risks involved.

Delegates can only agree to an indemnity where:

- the likelihood of the event occurring is remote (less than 5% chance)
- the most probable expenditure that would need to be made in accordance with the arrangement, if the event occurred, would not be significant (less than \$30 million).

⁴ *Ibid* s 19(3)(a).

⁵ *Ibid* s 19(3)(b).

⁶ See Department of Finance, 'Indemnities, guarantees and warranties by the Commonwealth (RMG 414)' which can be accessed at: <https://www.finance.gov.au/publications/resource-management-guides/indemnities-guarantees-and-warranties-commonwealth-rmg-414>.

Tips for Commonwealth officials

- If the Commonwealth is acquiring a leasehold interest:
 - The Commonwealth is unlikely to be the party ‘in the best position’ to manage the risk of combustible cladding. This risk should be managed by the landlord, who should ensure the building is compliant and assume the risk of any claims if it is non-compliant.
Accordingly, the Commonwealth should not assume any risk under the indemnity with respect to claims or losses caused or contributed to by combustible cladding. Note that this issue may not be addressed directly in the lease. Accordingly, officials must pay careful attention to the exact wording of the indemnity.
 - If the Commonwealth is required to assume some risk, ensure that appropriate carve outs, liability caps, litigation controls and mitigation obligations are drafted into the indemnity.
 - A common lease provision of a landlord’s lease is an ‘as is, where is’ clause. This type of clause requires the tenant to accept the property in its current condition (including any defects) and the risk associated with occupation of the property. Effectively it is a release clause. Officials should not accept these clauses where the building is non-compliant at the commencement date of the lease.
- If the Commonwealth is acquiring land and a building in freehold and is required to assume risks associated with combustible cladding from the date of settlement:
 - the Commonwealth will need to have measures in place to minimise any fire risk and reduce the chance of a claim
 - consider the allocation of risk under the contract and the extent to which the Commonwealth can seek recourse against the vendor in the event of any claim
 - consult with Comcover on the extent to which Comcover will cover any liability arising from a claim.
- Officials should ensure that release clauses do not prevent the Commonwealth from recovering damages from the landlord in circumstances where those damages are related to combustible cladding.
- In relation to indemnities, officials must ensure that (as far as possible) that indemnities ‘align’ with the Commonwealth’s insurance policy. In other words, the indemnities in the lease or sale contract should be negotiated so that the Commonwealth is only required to indemnify the landlord in circumstances where it will be able to make an insurance claim.

4 Insurance issues related to combustible cladding

Officials involved in the acquisition of property affected by combustible cladding must carefully review their Comcover insurance coverage to ensure that:

- they are complying with the requirements of their insurance policy to prevent loss
- the scope of the insurance policy is broad enough to protect the Commonwealth entity from foreseeable risks when entering into the lease.

Tips for Commonwealth officials

- In order to ensure the Commonwealth will be covered in the event an insurance claim is made, officials should be able to demonstrate they have taken reasonable steps to prevent and minimise loss. If a building is affected by combustible cladding, officials must actively take steps to ensure the issue is rectified or that reasonable steps are taken to minimise fire risk etc.

Further resources

We recommend the following publications for more detailed information on the areas considered in this fact sheet:

- AGS Fact Sheet Number 4: Public Governance, Performance and Accountability Act issues in Commonwealth property transactions
- AGS Fact Sheet Number 17: Work Health & Safety – Officer’s duty
- Department of Finance, Commonwealth Property Management Framework (RMG 500)
- for further information on indemnities, please see:
 - AGS Fact Sheet No. 5: Negotiating indemnities in leases
 - AGS Legal Briefing No. 105: Indemnities in Commonwealth Contracting
 - Department of Finance, Commonwealth Property Management Framework (RMG 500)
- Commonwealth National Lease User Guide (published by the Department of Finance).

More information

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