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Australia's property industry

Creating for Generations

15 January 2020

Ms Liz Livingstone
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Dear Ms Livingstone

Review of Home Building Compensation In NSW

The Property Council of Australia is grateful for the opportunity to provide comments to Independent Pricing and Regulatory Tribunal (IPART) to assist its review of Home Building Compensation (HBC) in NSW.

As Australia's peak representative of the property and construction industry, the Property Council's members include investors, owners, managers and developers of property across all asset classes, including residential development. Many of our members across New South Wales undertake residential building work that requires the purchase of a compliant home building compensation insurance product.

We are pleased to provide the following comments for your consideration:

Home Building Compensation Scheme

We welcome the announcement of IPART's review of the consumer protections available to homeowners through the mandatory HBC scheme. In NSW, the HBC scheme and earlier schemes (previously known as home warranty insurance) have been the subject of considerable criticism over the years from both consumers and builders. The collapse of private insurers, particularly HIH and FAI in 2001 and financial losses of Government-backed schemes have contributed to calls for major reform of the scheme.

It must be recognised that HBC insurance is a last resort product that provides a safety net for homeowners in the event of their builder not completing residential building work or rectification of defects due to insolvency, death, disappearance or licence suspension. In the context of community concerns about major building defects, combustible cladding and private certification of development, it is important that policy makers, industry groups and the wider public understand how the current HBC scheme operates.

Currently, residential building work valued over \$20,000 is required to be covered by HBC insurance cover unless an exemption applies. Since 2003, when the *Home Building Amendment (Insurance Exemptions) Regulation 2003* was published, multi-storey buildings (more than 3-storeys in height and more than 2 dwellings) have been exempt from the need for HBC insurance cover. This means that the current HBC insurance market is limited to detached houses, home renovations and low-rise medium density developments (for example, duplex, townhouse and 3 storey apartments).

In 2010, the NSW Government made legislative amendments to establish a government insurer as the sole provider of home warranty insurance due to the imminent withdrawal of private insurers from the home warranty insurance market. Despite the need for significant reform of the scheme, no substantive changes were made to home warranty insurance product (such as coverage or thresholds) at this time.

The current HBC scheme arrangements commenced in January 2018 and came after the implementation of major legislative reform of the scheme. The Government argued these reforms were needed to deliver structural changes to bring financial stability to the HBC Fund which was paying more in claims than it was receiving in policy premiums. It also sought to encourage the re-entry of private insurers into the market.

As these reforms have now been in place for two years, it is appropriate that their effectiveness be independently reviewed.

Terms of Reference for the Review

The terms of reference for the conduct of the review that were issued to IPART by the Minister for Customer Service suggest the Government's intention is to improve the efficiency of the HBC scheme's operation for the benefit of homeowners. Should this be the case, we support this objective.

It is important to recognise that homeowners building and renovating their homes have access to a number of consumer protection options available before making a claim on their HBC insurance premium. These protections include protection of licensed builders, access to advice from the NSW Department of Fair Trading, statutory warranties under the Home Building Act 1989 and legal rights to remedy any breach of those warranties by a builder. The HBC scheme operates as only a last resort means of consumer protection.

IPART has been given very broad terms of reference to inquire into the operation of the HBC scheme and related matters. From the experience of our members (developers and builders), we see scope for further efficiencies in the HBC scheme that could meet these objectives.

Impact on Housing Affordability

The requirement to obtain HBC insurance can be perceived as worsening housing affordability. Published data indicates that taxes, charges and levies contribute around 30% of the cost of house in Sydney and HBC insurance becomes another cost paid by a homebuyer when purchasing a house.

Buyers of detached houses and medium density housing usually pay for the cost of HBC insurance at the time of entering into the contract to purchase or build a new home or undertaking renovations. In some cases, the cost of the insurance is passed through to the consumer when a contract is signed or in some situations the cost of the insurance will be absorbed by the

developer and the cost of the premiums just become another business expense that the developer will incur on a residential development project.

Legislative framework

The HBC scheme is regulated by the relevant provisions of the *Home Building Act 1989* and supported by the relevant provisions contained within the *Home Building Regulation 2014*. These together with various guidelines issues by the State Insurance Regulatory Authority (SIRA) provide guidance regarding the scheme for consumers and the construction industry. The current regulatory framework for the scheme is complex and can be confusing for homeowners to understand.

The Minister for Customer Service currently has ministerial responsibility for the operation of the HBC scheme. Given the primary purpose of HBC scheme is consumer protection, it is appropriate that ministerial responsibility for the scheme remain with the Minister for Customer Service.

Consumer Protection

The purpose of the HBC scheme is to indemnify beneficiaries under an insurance contract for losses or damages incurred as a result of:

- Non-completion of work because of the insolvency, death, disappearance and licence suspension of a builder, or
- Breach of a statutory warranty where the beneficiary cannot recover compensation from the builder because of insolvency, death, disappearance or licence suspension of a builder.

Claims on insurance would normally only be available where all other options to recover a loss or damages have been exhausted, including legal claims through the tribunal (NCAT).

It is important that the public, consumers and other stakeholders have a realistic understanding of the HBC scheme, what it does and does not cover. There may be further work that can be done by the relevant authorities (such as SIRA, the Commissioner for Fair Trading, local councils and industry bodies) to increase the public's knowledge and perception of how the HBC scheme operates and what the insurance actually covers.

Premium Increases

Following the commencement of the 2018 legislative reforms, iCare announced a series of premium increases based on risk profiles of builders and intended to bring the HBC scheme to a break-even position. We understand the HBC scheme has been operating for many years at a loss and had become a burden on NSW taxpayers. It has been reported that during 2016 the scheme was more than \$375 million in deficit. In 2018/2019 the scheme posted a \$202 million loss.

iCare's annual report for 2018/2019 indicates that its post-reform portfolio is currently 75% funded as at 30 June 2019. It is closely monitoring its financial performance and working towards sustainable underwriting and pricing. iCare is focused on delivering a post-reform portfolio that is operated on a sustainable or break-even basis across all classes of construction without the need for further Treasury support.

A series of premium increases have been applied to all types of residential development, including a number of increases to be implemented over three years (2019 to 2021) that are targeted at multi-dwelling construction. From 1 August 2019 until 1 January 2021 a series of four premium increases were announced to the base premium rates. Future premium increases of 4.11% to

come into force on 1 July 2020 and 4.79% to come into force on 1 January 2021. As the costs of these insurance premiums are generally passed onto the homebuyer, they do impact on housing affordability in certain parts of NSW, particularly in Sydney.

Availability of Insurance Cover

It is important that Government policy settings do not unreasonably restrict the availability of HBC insurance cover to builders. It is understood that before a builder can obtain insurance they are required to first apply for eligibility. A builder's eligibility is assessed by the NSW Government insurer (iCare) against a published set of criteria issued by SIRA (*Home Building Compensation (Eligibility) Insurance Guidelines*).

We support the development of further guidance to assist builders meeting the relevant eligibility guidelines and accessing HBC insurance cover on behalf of homeowners. If further education or training is required for high risk builders, the NSW Government should consider what actions it can take to make it easier for those builders to gain access to those training opportunities.

Current Exemptions from HBC scheme

The provisions of the *Home Building Regulation 2014* include a number of exemptions from the requirement to hold insurance cover. This includes retirement villages, work funded by the Teacher Housing Authority, community care work funded by State or Commonwealth Governments and other identified types of building work. These exemptions avoid the need for insurance cover to be purchased.

A significant exemption applies to "multi-storey buildings" (defined as buildings of more than 3 storeys that contain 2 or more separate dwellings) from the requirement for insurance. This exemption has been in force since December 2003. This exemption was reconfirmed in 2012 following a review of the *Home Building Act 1989*.

A recent review of the HBC scheme in 2015 looked at whether the insurance exemption for high-rise flat buildings over three storeys should be broadened to also exempt low-rise multi-unit residential buildings. A majority of responses provided in an anonymous online survey rejected an expansion of the current exemption to low-rise residential flat buildings.

Figures provided by SIRA to NSW Parliament Inquiry in August 2019 indicate that between 2002/03 and 2017/18 insurers reported a total of 8,88 claims of which:

- 57% (5,083 claims) related to the construction of new single dwellings; and
- 17% (1,574 claims) related to the construction of new multi-dwelling (up to 3 storeys) buildings.

We suggest the Government reconsider its position regarding expanding the current exemption to other types of buildings including:

- Any Class 1a building more than 3 storeys high;
- Any Class 2 building (irrespective of rise of storeys) managed under a strata scheme; and
- Any building(s) constructed under a single contract (irrespective of classification) valued above \$10 million.

This would effectively limit the requirement for insurance under the HBC scheme to contracts for the construction of Class 1a buildings (including those with dual classifications) up to 3 storeys high valued under \$10 million. The impact on the affordability of low-rise strata and other large scale, higher density, hybrid classification housing delivered by developers would be significant.

Given the application of the Home Building Act 1989 and associated statutory warranties to developers of developments consisting of 4 or more dwellings, the risk to consumers of incomplete or defective work by builders in the expanded categories for exemption proposed above is low.

The potential liability for Home Building Act warranty claims ensures that developers negotiate the requirement for appropriate security (for both completion and defects liability) that can be called on in the event of a builder's insolvency into construction contracts. Additionally, it provides an incentive for developers entering high value contracts with builders to conduct detailed financial due diligence on their builders.

There is scope for the Government to further mitigate this risk through the introduction of 'minimum financial requirements' and annual reporting for licensed builders similar to those administered by the Queensland Building and Construction Commission (QBCC).

Private Insurers

Since the commencement of legislative amendments passed by the NSW Parliament in January 2018, private insurers have been authorised to offer HBC insurance products. It is understood that to date no insurers have indicated they will be offering HBC insurance products.

Participation of private insurers in the HBC scheme may be discouraged by the cost of managing the types of claims that could more appropriately be dealt with directly by developers and would be if the exemptions proposed were applied.

There are instances of Owners Corporations of Class 2 buildings making claims to iCare (Insurance and Care NSW) following insolvency of the builder despite there being a solvent developer who owes Home Building Act warranties available

Should you have any questions, please do not hesitate to contact Troy Loveday, Senior Policy Advisor, on (02) 9033 1907 or tloveday@propertycouncil.com.au

Yours sincerely



Jane Fitzgerald
NSW Executive Director
Property Council of Australia