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4 August 2023

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Mandating Decennial Liability Insurance (DLI) – Regulatory Impact Statement (RIS)

Dear Better Regulation Division,

The Property Council of Australia welcomes the opportunity to provide a submission to the Department of Customer Service (the Department), regarding the release of the Regulatory Impact Statement for the mandating of Decennial Liability Insurance in NSW.

The Property Council have been deeply engaged in the building reform work across NSW, including making a submission in March 2022 regarding the *Home Building Act 1989 (NSW) & Tranche II Construct NSW Reforms*. We have already begun delivering our feedback for this latest tranche of building reforms, including making a submission for the proposed licensing framework of the draft Building Bill. We commend the work of the NSW Government, the Building Commissioner and Fair-Trading Commissioner in their achievements to date in ensuring the integrity and quality of built form in multiple classes of buildings.

Our members are the nation's major investors, owners, managers, and developers of properties of all asset classes. They create landmark projects, environments, and communities where people can live, work, shop, and play. The property industry shapes the future of our cities and has a deep long-term interest in seeing them prosper as productive, sustainable, and safe places.

The Regulatory Impact Statement (RIS) outlines the proposed transition to mandated Decennial Liability Insurance (DLI) for Class 2 Buildings. Currently, consumers are protected under the Strata Building Bond Inspection Scheme (SBBIS), but this will be transitioned out under the proposed model. The RIS outlines how, to date, SBBIS has failed to provide the necessary form of consumer protection, and that a move to mandated DLI will provide a more robust protection outcome for homeowners without unnecessary burden to the development and construction industry.

The RIS outlines detailed modelling comparing the three regulatory options up for consideration, mandated DLI, voluntary DLI, and no action. From the modelling provided, mandated DLI is demonstrated to provide the best society net-benefit, with consumer benefit weighed against cost to developers and broader economic benefit.

The Property Council is broadly supportive of the introduction of mandated Decennial Liability Insurance and the intended outcome to improve the quality of, and restore confidence in, the built product. The RIS proposes that DLI be mandated from 1 January 2028, with a transition period commencing on 1 January 2024 during which the amount and duration of the building bond under the SBBIS will increase, along with the number of inspections under the SBBIS.

The Property Council and its members recommend that DLI not be mandated unless certain pre-conditions are met, and the industry continues to be engaged through further consultation to ensure the finalised solution for DLI is appropriate for the local market context and stakeholders. These pre-conditions are detailed in the recommendations outlined below.

DLI Market Maturity

As the RIS outlines, the maturity of the DLI market is integral to the success of the scheme. Sufficient depth in the market is required to avoid monopoly/duopoly pricing by insurers and impacts on affordability for consumers. A minimum of two providers will not generate sufficient competition in DLI pricing. Therefore, we recommend that DLI not be introduced unless the following conditions for market maturity are met:

- Three to four insurance providers offering localised DLI products to ensure the cost of premiums remain in the range used in the Department's feasibility modelling.
- At least three global markets provide DLI coverage and international capital for DLI to remain available.
- DLI products in the market comply with the RIS coverage requirements to ensure consumer expectations match available coverage (see more detail below).
- Average premiums sit between 1.5 – 2 per cent of construction costs, calculated based on a sizeable number of DLI policies, spanning developments of small, medium and large size, scale and complexity.

If these conditions for a mature competitive market are not satisfied, the Department should not mandate projects hold DLI in 2028. While the Property Council is supportive of the transitional model proposed in the RIS, with incremental increases to the percentage of the SBBIS to incentivise uptake of DLI, it is critical that these strata bond increases be aligned with the maturity of the DLI market to avoid acute pricing for projects over the transition period.

Finally, the Department must also consider a backstop mechanism, if one of the three viable insurance providers exits the DLI market after the 2028 mandate period. In this instance, the NSW Government may have to consider stepping in as insurer of last resort to stabilise pricing for DLI products.

DLI Coverage and Consistency

The coverage of DLI, as outlined in the RIS, identifies several additional building elements that are not included in the version of DLI or Latent Defect Insurance (LDI) currently offered. As explained above, if DLI products offered in the market do not comply with the RIS coverage requirements, a critical condition for a competitive mature market will not have been met. It is vital therefore that the Department work with the insurance market to ensure that the following critical building elements in common property are covered in future DLI products:

- Fire safety systems for a building within the meaning of the Building Code of Australia (BCA).

- Waterproofing.
- Internal or external load-bearing components of a building that is essential to the stability of the building, or a part of it (including but not limited to in-ground and other foundations and footings, floors, walls, roofs, columns and beams).
- Components of a building that is part of the building enclosure.
- Aspects of the mechanical, plumbing and electrical services for a building that are required to achieve compliance with the National Construction Code (NCC).

Overseas DLI markets demonstrate that the price of premiums increases significantly with the additional coverage of certain building elements. If the local DLI product follows the same model, it will be crucial that price modelling has considered how providers will process these additional elements in the premium.

In addition, the industry would benefit from further clarification of the proposed regulatory context in which DLI cover will be mandated within NSW, and applicable DLI policy requirements that need to be satisfied in order to comply. In the UK for example, this is incorporated within UK Finance (formerly Council of Mortgage Lenders) requirements in connection with the provision of finance for new build residential market sales. The Better Regulation Division also needs to ensure any cover in NSW is designed to specifically work with Strata Law, which does not apply in the UK or other jurisdictions where there is market maturity.

It's important to note the disclosed pricing of DLI (between 1.5 and 2 per cent of the construction cost) relates to premiums only. Given there will be additional charges payable by developers in respect of technical audits and inspections undertaken by DLI providers, this should be calculated into the total cost of the DLI pricing by the Department. Further information is also required to understand the additional cost to consumers arising from applicable deductables in the event of an insured event, practicalities around minimum claim thresholds, and responsibility for payment.

Regulatory Confidence

The role of insurers should not duplicate (or be a substitute for) the role performed by the Regulator. The *Design and Building Practitioners Act 2020 (DBP)* provides that regime, and it is the role of the Regulator to audit compliance.

The successful implementation of the 'design, declare, build' regime under the DBP - whereby registered design practitioners must declare regulated designs are compliant, and registered building practitioners must declare construction is compliant and has occurred in accordance with the regulated design - should provide the necessary confidence to DLI providers without the burden of additional proof. It is the responsibility of the Department to develop insurer confidence in that regulatory framework to eliminate the need for extensive insurer due diligence.

There may be cases where insurer's technical advisers require that designs be over-engineered as a condition to providing DLI (due to the risk mitigation benefits). This approach could add significant cost to a given development impacting affordability for the end consumer, or alternatively making developments no longer feasible, constraining supply. It is critical therefore that insurers have confidence in regulated design standards to ensure over-engineered solutions do not become the norm.

As such, the Department must ensure DLI providers are fully aware of the stringent standards projects must meet under new and existing regulatory frameworks, and do not have recourse to

challenge approved regulated designs or refuse to provide cover prior to OC where compliance declarations have been issued.

DLI cover is taken out early in the development process (prior to the first construction certificate), and then validated as effective by the insurer prior to OC. To ensure confidence in the application of DLI, there should be restrictions on the circumstances in which an insurer can elect not to validate the effectiveness of DLI cover prior to OC, particularly given the operation of the regulatory framework. Ultimately, the insurer should not have the right to terminate the policy in the period between CC and OC as it would fundamentally undercut the operation of the RAB Act.

It is the role of the regulator to stop projects that are proceeding with "serious defects", not the insurer's role. If an insurer considers there is a serious defect, they should report that to the Regulator, and the Regulator may take action under the RAB Act (e.g. the Regulator will issue a Prohibition Notice, meaning that OC can't be granted until the defects are fixed, delaying the commencement of the insurance policy).

Consideration must also be given as to the timing of when DLI becomes effective on multi-staged developments, where there can be a significant lag until issue of the final OC for the development (for example, where there are retail fit outs works being done, which post-date completion of residential components).

Although the RIS provides a detailed analysis of the proposed policy, there are several areas requiring clarification beyond those issues identified above. This includes a more detailed example of standard DLI product coverage, additional measures the Department may take if the market is not deemed mature in 2028, explanation of why DLI is said to be a 'statutory guarantee', how deductibles will apply and be accounted for in pricing, and how rights of subrogation will operate (particularly for integrated builder/developers).

Furthermore, it is critical that the Department consider how significant defects arising from operational maintenance will be managed through the DLI scheme. The Department should also give further detailed consideration to the statutory limitation period and the potential impacts any extension may have on the entire contracting chain on a project.

We would like to thank the Department for the opportunity to provide feedback on the proposal to mandate Decennial Liability Insurance. As Australia's peak industry body for the Property Industry, the feedback in this submission will be integral to ensuring this policy is responsive to the concerns of the industry and supports the NSW Government's overarching objectives.

Yours sincerely,

Katie Stevenson
NSW Executive Director
Property Council of Australia