



# Home Building Protection Review

Consultation Responses

November 2014



Government of  
South Australia

## Contents

<b>1</b>	<b>Introduction</b>	<b>1</b>
<b>2</b>	<b>Response overview</b>	<b>2</b>
<b>3</b>	<b>The insurance model</b>	<b>3</b>
	First resort model	4
	Mandatory last resort fidelity fund	4
	Voluntary Insurance	4
	Split risk model	5
	Government vs private	5
<b>4</b>	<b>Features of the insurance product</b>	<b>6</b>
	Claim triggers	6
	Minimum contract value	6
	Maximum insurance entitlement	6
	Period of insurance and notification	7
	Owner-builders	7
	Developers	7
<b>5</b>	<b>Front end protections</b>	<b>8</b>
	Licensing and supervision	8
	Contractual requirements	8
	Dispute resolution	9
	Consumer awareness and education	9
<b>6</b>	<b>Development of the long term solution</b>	<b>10</b>

## Home Building Protection Review

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# 1

## Introduction

Building Indemnity Insurance is a requirement of the *Building Work Contractors Act 1995 (SA) and Regulations* for all domestic construction projects valued at \$12,000 or above and requiring development approval by a local council. A building indemnity insurance policy provides consumers with cover for non-completion and defective building works, up to \$80,000 per building project, in the event their builder dies, disappears or becomes insolvent. It is an important home building protection that provides a last resort financial safety net for consumers undertaking building work. It is one of a number of home building protections that aim to support a fair and robust domestic construction market in South Australia. Other protections, referred to as 'front end protections', include the licensing and supervision of builders and building work, contractual requirements, dispute resolution processes and consumer education and awareness.

In January 2014 the Government of South Australia released the *Home Building Protection Review* consultation paper which sought to inform interested parties about South Australia's current home building protections and to encourage feedback and ideas regarding how they may be enhanced. The consultation was part of a wider review being conducted in response to the withdrawal of private insurers from the building indemnity insurance market in 2013. The Government's objective in this review is to develop and implement an effective, sustainable and long term building indemnity insurance solution that meets the needs of consumers and builders and supports the return of private insurers to the market in the long term. Front end home building protections are being included in the review due to their potential to impact insurance claims and the performance of the insurance market overall.

This paper provides a summary of the submissions received in response to the *Home Building Protection Review* consultation paper. Overall ten written submissions were received and a small number of comments were made on an online blog linked to the paper. The responses provided several different perspectives from a variety of stakeholders including consumers, insurers, building associations and local councils.

The summary of responses has been broken down into the following sections:

- the insurance model;
- features of the insurance product; and
- front end protections.

The *Home Building Protection Review* is a joint initiative of the South Australian Government Financing Authority (a branch of the Department of Treasury and Finance), in its capacity as the captive insurer for the Government of South Australia, and Consumer and Business Services (a division of the Attorney-General's Department) as the licensing and regulatory authority for the South Australian building industry.



# 2

## Response overview

Below is a high level overview of the most salient views expressed by stakeholders in their responses to the *Home Building Protection Review* consultation paper:

- there is no strong support for the implementation of an alternative insurance model in South Australia;
- a number of features of the insurance product need updating, including the claim triggers, the minimum contract value and the maximum settlement limit;
- owner-builders should be required to take out a building indemnity insurance policy to cover subsequent owners of a home against defective work;
- the insurance coverage for developers should exclude the non-completion risk; and
- the following front end protections should be reviewed and enhanced where practical:
  - » builder licensing and supervision;
  - » dispute resolution procedures; and
  - » consumer awareness and education.



# 3

## The insurance model

South Australia's current insurance model is one of mandatory last resort. That is, the insurance is compulsory and claims can only be made when the builder has died, disappeared or become insolvent, which is effectively when there are no further avenues available to the consumer to compel the builder to complete a project or rectify defective works.

It is the builder who takes out a building indemnity insurance policy on behalf of the consumer. The cost to purchase the insurance policy is generally included in the contract price charged to the consumer for the building work. Prior to approving eligibility for the insurance, an insurer will undertake detailed and careful assessment of a builder's financial health and experience. Eligibility is granted in the form of an approved turnover limit and job specific endorsements, such as a specified project value for a particular construction type. Insurance policies for individual building contracts are then accessible under these eligibility limits. For example, a builder may have an approved turnover limit of \$5 million per annum, based on their current financial position, with an endorsement that contract values for new single dwellings must not exceed \$500,000. The builder can apply to undertake contracts outside these conditions, subject to a further review by the insurer. As such, the process of underwriting building indemnity insurance risks can be an onerous task for an insurer.

In most cases, an insurance broker is required to act as an intermediary between the insurer and the builder, collating the data necessary for eligibility assessments and negotiating eligibility outcomes on behalf of a builder. Brokers will also apply for individual certificates of insurance. Brokers may be paid a commission by the insurer or a fee by the builder.

The premiums charged for each building indemnity insurance policy are generally a set standard value which is based on a combination of the financial and technical risks associated with a builder, the complexity of the project and the contract value. In some circumstances, the premium will be based on an assessment of all of these factors, plus the volume of policies taken out by a builder per year. Premiums will vary if a risk assessment of a builder's financial health or technical competence requires a unique premium value to be applied. Particular building projects may also attract a unique premium value depending on its complexity.

The claims experience across the overall portfolio will impact premium values and a higher number of claims will result in higher premiums. A significant portion of the premium collected needs to be maintained in reserve as claims can sometimes be received up to seven years after the policy is taken out, depending on when the building work is commenced and completed.

The *Home Building Protection Review* consultation paper sought comments on whether an alternative insurance model should be introduced in South Australia as well as views on the government's role in providing this type of insurance. The views of respondents have been summarised in the following sections.

### 3 The insurance model

#### First resort model

A first resort insurance scheme provides cover for non-completion and defective building work without the need for the builder to be deceased, disappear or insolvent. Consumers have access to compensation early in a dispute, with responsibility for pursuing the at fault entity or builder resting with the insurance provider.

Respondents were almost unanimously against the introduction of a first resort model, highlighting that while a first resort scheme could potentially provide consumers with a higher level of protection, it would also be expected to give rise to a higher number of claims and therefore increase scheme costs. Some responses argued that this would affect housing affordability, presumably as premiums would need to increase substantially to cover the increase in the expected cost of claims.

Some respondents observed that a first resort scheme would be administratively onerous to operate and would absolve homeowners from any real responsibility when entering a contract, while other respondents put forward suggestions to improve front end protections rather than changing to a first resort model. Respondents noted that it would be unlikely for any private sector insurer to be interested in offering the insurance product if the scheme was changed to a first resort scheme.

#### Mandatory last resort fidelity fund

Under this model, the insurance product would be managed and funded by an industry stakeholder, such as a building industry association. The model has the capacity to operate in a very similar fashion to the mandatory last resort insurance scheme in that the builder would be required to take out the insurance on behalf of the consumer and be subject to the same rigorous financial checks before eligibility for the insurance is approved.

The general consensus of respondents was that a last resort fidelity fund model would not be appropriate for South Australia. Some responses cited that while schemes such as this existed in the ACT and Northern Territory, these were small and unique markets and it would not be feasible in a market the size of South Australia. Additionally, respondents commented that if the fidelity fund were to have the same benefits and obligations as the current last resort scheme, then it would be difficult to see what additional benefit would be gained.

Some commented that holding aside a pool of money in order to fund claims would expose the industry body to risks that are outside of their normal expertise. The existence of a number of larger sized builders in the market would present challenges in such a fund being able to build up an appropriate level of capital to cover large builder insolvencies in the short to medium term. Additionally, if a fidelity fund

scheme was unable to meet claim cash flow commitments then members of the building association would be responsible for the consequences of the collapse. If they were unable to fund such a shortfall then it is conceivable that the government would be called upon to bail out the fund.

In general, the funding and administration of a fund by the industry (body) for failure of the industry participants was seen to be challenging.

#### Voluntary Insurance

Under a voluntary insurance model the statutory requirement to have a building indemnity insurance policy is removed. The purchase of the insurance policy would be at the discretion of the consumer or the builder.

Most respondents thought that a shift to voluntary insurance would not be a viable model for South Australia, with the main reason being that it would significantly reduce the level of consumer protection. Some submissions cited the experience in Tasmania where, once the scheme became voluntary, the product was effectively withdrawn from the market and in essence coverage became unavailable.

It was also noted that from a practical perspective, switching to a voluntary model would be likely to reduce the premium pool which limits the ability for insurers to cover liabilities.

Some respondents however, were not opposed to the introduction of a voluntary scheme but did identify that further enhancements would be required for a voluntary scheme to work. Some of the suggested enhancements included:

- methods to increase consumer awareness so that the ramifications of not having insurance are understood, including the risk of workmanship defects and the difficulties involved in work rectification if a builder has disappeared, died or become insolvent;
- provision of better information to be able to assess the financial position of a builder;
- stricter contract conditions and mandatory disclosure on the sale of a property so that purchasers are aware of whether protection exists; and
- more stringent licensing conditions and continuing professional development for licences.

A greater focus on increasing front end protections was seen as necessary for implementing a voluntary scheme, which would likely lead to a significantly increased regulation of the building industry.

## 3 The insurance model

### Split risk model

Under a split risk model the non-completion and defects liability risks are split into two different products, which may be supplied by different insurance providers.

The proposal to implement a split risk model received mixed views, although on the whole it was not considered to be a viable option. A couple of submissions did support a split risk model, with some suggesting that insurers were more likely to want to insure the non-completion risk. Some argued that a split risk model could create more competition and allow better performing insurers to charge lower premiums.

Some respondents commented that the implementation of a split risk model would require much more administration than the current system and have the potential for more disputes over coverage such as whether a claim is covered under the definition of defective works or non-completion. Also, for the reasons provided for the voluntary model, respondents thought that a split risk model is also likely to reduce the overall premium pool without a similar reduction in the capital required to support the scheme.

### Government vs private

The Government of South Australia would ultimately prefer that building indemnity insurance be supplied by the private insurance market and as such, supporting the return of private insurers to the building indemnity insurance market is a stated objective of the long term solution. The *Home Building Protection Review* sought to engage stakeholders on the value of the Government pursuing this goal and the best strategies to achieve it.

The submissions regarding this issue were mixed, although many respondents did demonstrate a preference for a longer term private market based solution. However, these submissions also noted that given the current domestic construction market in South Australia, private insurers are unlikely to be willing to re-enter the market, particularly as there is little possibility of securing reinsurance in the commercial market. Bearing this in mind, submissions made recommendations around ways to attract private sector insurers into the market. In particular, there would need to be a significant reduction in the uncertainty surrounding the claims experience, which may include:

- a more robust alternative dispute resolution system; and
- improved front end protection mechanisms including enhanced supervision and licensing.



# 4

## Features of the insurance product

The *Home Building Protection Review* asked respondents to provide comments on features of the current insurance product, including any suggestions on enhancements to claim triggers, limits of coverage and entitlements.

### Claim triggers

This feature received mixed responses in the consultation process with some respondents believing the current three triggers of death, disappearance or insolvency are adequate. However, some believed that additional claim triggers were required to increase consumer protection, in particular where significant legal costs are spent pursuing a builder before they enter insolvency. Some respondents suggested that the insurance could be triggered if a builder's licence was suspended, which would avoid consumers needing to wait until a builder was insolvent before making a claim.

Some other respondents suggested that should a rectification order scheme be adopted, as is the case in Victoria, where a regulatory body can make an enforceable order compelling a builder to rectify defective works, then failure to comply with the order should be a trigger for an insurance claim. Other respondents expressed strong views that this sort of trigger should not be adopted, citing that this would lead to a significant increase in the number of claims and may move away from a last resort type model towards a first resort type model.

### Minimum contract value

Under the current regulations the minimum value for building work contracts requiring a building indemnity insurance policy is \$12,000. All respondents who provided a response on this topic believed that \$12,000 was too low, with suggestions to increase the limit to between \$15,000 and \$20,000. These suggestions cited that the existing amount was out of date and should be updated to keep pace with inflation.

### Maximum insurance entitlement

At \$80,000 South Australia's maximum insurance entitlement is significantly lower than for other jurisdictions in Australia. Even so, some respondents believed that this limit was adequate and provided adequate protection for non-completion and defect claims. However, one respondent clarified this position to be based on consumers agreeing with a builder on a payment scheme that reflected the work completed to date, ensuring that these payments were not front end loaded.

Many of the respondents believed that the current limit of \$80,000 was too low compared to the cost of a standard house and suggested increasing the limit, once again citing the need to keep pace with inflation, with limits ranging between \$100,000 and \$200,000 being put forward in the submissions. Some submissions also suggested that the maximum entitlement should be set as a percentage of the value of the work, subject to an upper limit, while others rejected this idea as it would be harder to assess.

The consultation paper also asked whether separate limits should be introduced for non-completion and defect claims. There was a mixed response, with some respondents believing that separate limits would be appropriate given the different risk profiles. However, some opposed the separate limits, arguing that it would increase premiums and reduce affordability.

# 4 Features of the insurance product

One response even went as far to say that the Government should have a scheme which entitles builders to have any level of warranty coverage they want, with premiums set by the insurer based on risk, turnover and performance arguing that it would increase competition and reward good builders.

## Period of insurance and notification

Under the current regulations claims for defective work can be made up to five years following the completion of the building project and consumers must notify their insurer of a potential claim within 90 days of becoming aware of the circumstances giving rise to the claim.

Most submissions commented that the current five year period of coverage for defective work was adequate, citing that it should continue to align with the statutory warranty period in South Australia. Some respondents went further to address the distinction between structural and non-structural defects which have differing periods of coverage in other states. Responses were mixed, with some submissions seeing no clear benefit to changing the periods of coverage, while some acknowledged that having different coverage periods may have some merit due to the different nature of when the defects would materialise.

Regarding the 90 day time limit for notification, some responses suggested the need for greater clarity around when the notification process was deemed to have begun or that there may be merit in varying the notification period by type of claim. However, there were no strong arguments for wholesale change to the current notification period.

## Owner-builders

In South Australia, only licensed builders are required to obtain building indemnity insurance policies. When an owner-builder, who is not a licensed builder, personally undertakes building work on their property there is no obligation for them to take out insurance that covers a subsequent owner of their property against defective building work.

Respondents thought that owner-builders should be required to take out a building indemnity insurance policy to cover subsequent owners of a home against defective work.

Some suggestions to enhance the current system included:

- requiring owner-builders to take out defect-only insurance if the property is to be sold during the warranty period;
- requiring owner-builders to take out builder permits or removing the idea of owner-builder altogether so that all work requiring building indemnity insurance be undertaken by Building Work Contractors and monitored by Registered Building Supervisors;
- increased disclosure around whether insurance exists for the dwelling or alteration; and
- requirement of basic training courses for owner-builders.

## Developers

Under the current insurance model, there is no distinction between a developer engaging a building contractor to undertake domestic construction for commercial purposes and a consumer seeking to undertake building work for personal residential purposes. Both types of consumers have access to the same consumer protections, despite their very different risk profile.

There was a general consensus among respondents regarding the exclusion of developers from claiming for non-completion compensation under the insurance product. Generally, unlike other consumers, developers were seen to be entering into a commercial transaction when engaging a builder to undertake domestic construction, with less need for traditional consumer protection. However, there were a range of considerations put forward around this issue. Some comments include:

- the inclusion or exclusion of developers would raise undue complex argument in defining who is or is not a developer;
- the insurance coverage for developers should be limited to the rectification of defects only, ensuring the subsequent owners of homes built by developers are protected from defective building work; and
- a moral hazard exists if the insurance covers developers, who should be able to assess risks and are commercial entities that do not require protection.



# 5

## Front end protections

The *Home Building Protection Review* also considered enhancements to South Australia's front end home building protections, covering licensing, supervision, dispute resolution and consumer education. These broader home building protections were included in the review due to their potential to impact insurance claims and the performance of the insurance market overall.

Generally, most submissions felt very strongly that greater front end protections were necessary and to the extent that these mechanisms can be improved, it may result in reducing the number of insurance claims and help to entice private insurers back into the market in the long term.

### Licensing and supervision

Many of the respondents called for greater enhancements to the licensing system, including both the coverage of who requires licences, requirements for holding a licence and changes to the ability to revoke or suspend licences.

Some suggestions for enhancement included:

- the licensing of occupations beyond electrical, gas and plumbing to other trade contractors, as well as building consultants;
- more stringent licensing requirements to assess the competency of builders and continuing professional development (CPD) requirements;
- greater clarity around the scope of work permitted under a licence; and
- greater ability to enforce partial suspension or revoke licences.

There was also general feedback that improvements could be made to current building work inspection processes. Building inspections are the responsibility of the local councils and some respondents believed that the current level of inspections is not adequate or even clearly defined. One suggestion put forward was that mandatory inspections should be undertaken at critical stages, requiring councils to inspect a minimum percentage of new houses built in their jurisdiction.

Some respondents also expressed views that, as with licensing of builders, there should be some level of technical expertise required for inspections. In addition, some believed that there needs to be improvements in the feedback loop between inspection and builder licensing, making a building work contractor or supervisor more accountable for their performance.

### Contractual requirements

The *Building Work Contractors Act 1995* details a range of requirements that a building works contract must comply with. The requirements are aimed at protecting consumers and guiding builders as to their obligations. The *Home Building Protection Review* sought feedback regarding possible enhancements to the requirements.

Some respondents suggested that contracts could be better improved by increased standardisation and others highlighted specific areas where they believed better definitions could benefit consumers. Overall, there were no strong views regarding changes to the requirements for building contracts under the current legislation.

# 5 Front end protections

## Dispute resolution

Under the current provisions, if a consumer has a dispute with a builder that they are unable to resolve, they have the option of lodging a request for assistance with Consumer and Business Services or commencing civil proceedings in the Magistrates or District Court, depending on the value of the dispute.

Many respondents believed that better dispute resolution mechanisms were required to provide better outcomes for consumers who have issues with their building work contractors. The current voluntary conciliation process was considered flawed because there was no direct incentive for builders to participate or comply with settlement.

A number of submissions called for the establishment of an administrative tribunal to hear all building disputes. They suggested that this tribunal should have specialised technical expertise in order to make determinations, and envisaged it would reduce the time and cost burden of civil proceedings. Some respondents also identified that such a body would assist consumers when dealing with uncooperative builders.

Some submissions supported the introduction of binding rectification orders issued by a regulatory body to enhance the dispute resolution system, in particular if the failure to comply with the order could lead to disciplinary action such as suspension or cancellation of a licence.

A few submissions suggested that South Australia should consider the proposed Victorian system whereby failure to comply with a rectification order may lead to disciplinary action against the builder such as partial suspension of a builders licence. A partial suspension of a licence would mean that a builder would not be able to enter into new contracts or commence new work until they rectify the work the subject of the order. They would however, be able to fulfil existing contracts. For this type of approach to work in practice, many submissions highlighted the need for an independent assessment of the building work disputes by technical experts and the need for the right to appeal within certain circumstances. Many submissions also noted that having the Victorian system (where non-compliance with a rectification order is a trigger for the insurance) may not be appropriate as it may increase scheme costs.

## Consumer awareness and education

One of the main factors contributing to consumer dissatisfaction across building indemnity insurance models in interstate jurisdictions is identified as the quality and availability of information regarding builders' histories, the insurance coverage and the dispute resolution process. The *Home Building Protection Review* sought feedback as to how to best inform consumers and builders of their rights and obligations in the building process.

Views were varied across the submissions that commented on this issue, with some respondents commenting that consumers will be ill informed no matter how much information was out in the public domain while others commented that the general public doesn't have the information necessary to protect themselves. Some respondents recognised that consumers of this product were infrequent purchasers and therefore would not be as familiar with the product as builders.

Some suggestions on how consumer awareness could be enhanced included:

- developing consumer fact sheets which could be distributed through local councils where new home owners often sought information or mailed to property owners when applications are made; and
- having more "user friendly" access to a builder's disciplinary history, noting that the disciplinary history for licensed builders is already shown on the online public register.



# 6

## Development of the long term solution

The Government of South Australia is currently in the process of developing the framework for the long term solution, which will be based on feedback received in the consultation process and from other industry stakeholders, consultation with interstate government insurers, funding and cost considerations, regulatory requirements and the needs of the market in general.

This process is anticipated to be completed in 2015 and, subject to Cabinet approval, parliamentary process and any other unforeseeable changes within the market, implementation of the long term solution will follow.

If you have any other feedback that you would like to be included in the review please forward an email to:  
**[HBPReview@sa.gov.au](mailto:HBPReview@sa.gov.au)**

Submissions by post or fax can be sent to the following address:

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