



Home Building Protection Review

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Government of
South Australia

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Home Building Protection Review

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Executive summary

Building indemnity insurance forms an important part of the home building protections in South Australia, which also involve licensing and supervision of builders and building work, contractual requirements, dispute resolution and consumer education and awareness.

The building indemnity insurance product has traditionally been supplied to builders and consumers by the private insurance market. However since 2010, in light of unfavourable economic conditions affecting the building industry, private insurers have progressively withdrawn from the market nationally. In 2013, the last two private insurers remaining in the South Australian market also ceased to offer this insurance. As the insurance is required by legislation, the Government of South Australia has assumed management of the building indemnity insurance risks and is currently in the process of developing an effective and sustainable long term solution to the withdrawal of private insurers from this market.

As a part of this process the Government of South Australia is reviewing the current insurance model in order to assess its relevance and value to consumers, builders and associated industry stakeholders. It is also taking the opportunity to assess non-insurance related home building protections as these can have an impact on the potential for insurance claims.

This consultation paper has been prepared to allow interested parties the opportunity to provide feedback and ideas regarding the home building protections in South Australia. This information will be used to inform the Government of South Australia's review of these provisions and be considered in the development of effective and sustainable home building protections that best meet the needs of South Australian consumers and builders.

The paper divides home building protections into two parts, being back end and front end protections. Its intent is to provide an outline of the current provisions in place and the enhancements or changes that are under consideration by the Government of South Australia.

The section relating to back end home building protections focuses on:

- the current mandatory last resort insurance model and possible amendments;
- alternative insurance models including:
 - » mandatory first resort scheme;
 - » mandatory last resort fidelity fund;
 - » voluntary insurance;
 - » the split risk model; and
- a government versus private market administered scheme.

The section relating to front end home building protections focuses on:

- the licensing of builders and supervision of building work;
- the requirements of a building work contract; and
- the dispute resolution process.

The final section of the paper discusses the information available to assist consumers who are undertaking building work to understand the rights, obligations and risks of the parties to a building contract.



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Reviewing the current framework

2.1 Introduction

Under legislation administered by the Minister for Business Services and Consumers (the *Building Work Contractors Act 1995 (SA) and Regulations*), it is compulsory in South Australia for builders to obtain building indemnity insurance to cover domestic construction projects valued at \$12,000 or above. Historically, building indemnity insurance products have been provided to the South Australian market by various private insurers.

In 2010, following a significant downturn in the building industry, insurers began withdrawing from building indemnity insurance markets nationally. The unfavourable economic conditions had resulted in a significant increase in builder insolvencies and consumer claims, making it unprofitable for insurers to remain in the market.

In 2013, the last two private insurers remaining in the South Australian building indemnity insurance market also withdrew. As building indemnity insurance is a compulsory home building protection, the Government of South Australia entered into short term reinsurance arrangements with these insurers to ensure continuity of cover for builders and consumers while it develops a long term solution to the private market failure.

As a part of the development of its response to these market changes, the Government of South Australia is taking the opportunity to review the current building indemnity insurance model. However, it also recognises that front end home building protections, such as licensing, supervision and dispute resolution, can have an effect on the number and size of insurance claims arising from a builder failure. As such, it is also interested in reviewing these areas. The aim of the review is to improve the performance of the insurance model and to develop home building protections that best meet the needs of South Australian consumers and builders.

This review is being conducted jointly between 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.

This consultation paper seeks to inform interested parties about the current home building protections in place and the possible reforms to this framework under consideration by the Government of South Australia. Interested parties are invited to submit responses to this paper for consideration in the development of a home building protection solution.

Details regarding how to make submissions to this review can be found in section 7 of this paper.



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Summary of questions

This section details a summary of the questions asked throughout the body of this paper.

4.2.1 Mandatory Last Resort Insurance

- Q1. Are the current insurance triggers sufficient or do they need amending?
- Q2. What are your views on the appropriate additional triggers that may supplement the current last resort model?
- Q3. Do you think that the current level of insurance coverage provides the necessary protection to consumers?
- Q4. What are your views in terms of an appropriate maximum insurance entitlement?
- Q5. Should separate limits be introduced for non-completion and defect claims? If yes, what limits are recommended?
- Q6. Is the current period of insurance appropriate for the South Australian market?
- Q7. What are your views on varying the insurance coverage period by claim type and what would be an appropriate length of coverage per type?
- Q8. Is the time frame for notifying an insurer of a claim appropriate?
- Q9. What are your views on the requirements for owner-builders to take out building indemnity insurance?
- Q10. What are your views on the inclusion or exclusion of developers as beneficiaries of a building indemnity insurance policy?

4.2.2 Mandatory First Resort Scheme

- Q11. What are your views on the introduction of a first resort insurance scheme, including the impacts it may have on consumers, builders and the costs involved in its administration?
- Q12. What are your views on how the private market may respond to the introduction of a first resort scheme?

4.2.3 Mandatory Last Resort Fidelity Fund

- Q13. What are your views on the introduction of a fidelity fund administered by a building industry stakeholder, including the benefits to consumers and builders?
- Q14. What kinds of financial risks may be involved in the set up and administration of an industry fidelity fund?

4.2.4 The Voluntary Insurance Model

- Q15. What are your views on making building indemnity insurance voluntary for all or some of the insurance risks?
- Q16. If a voluntary model was introduced, what information would consumers require to be able to assess the risk of not taking up the insurance?

3 Summary of questions

4.2.5 The Split Risk Model

- Q17. What are your views on the introduction of a split risk model for the South Australian building indemnity insurance market, including any financial benefits for the insurance provider?
- Q18. What are your views on the benefits to consumers and builders under a split risk model?

4.3 Government versus Private Market Administration

- Q19. Is it worthwhile for the Government of South Australia to seek to ensure that the building indemnity insurance market is attractive to private insurers in the long term?
- Q20. What are the necessary enhancements to the current home building protections that would make it more attractive to the private insurance market, while still supporting consumer and builder needs?

5.1 Licensing and Supervision

- Q21. Is the current licensing system for building occupations adequate in terms of protecting consumers? If not, what amendments could be made?
- Q22. Are the current processes around building work inspection and certification adequate, or should they be enhanced? If so, how?
- Q23. What are your views around the adequacy of the Statement of Compliance process, including any enhancements to the process?
- Q24. What are your views on the current disciplinary process for builders? What components are working well and what could be enhanced?

5.2 Contractual Requirements

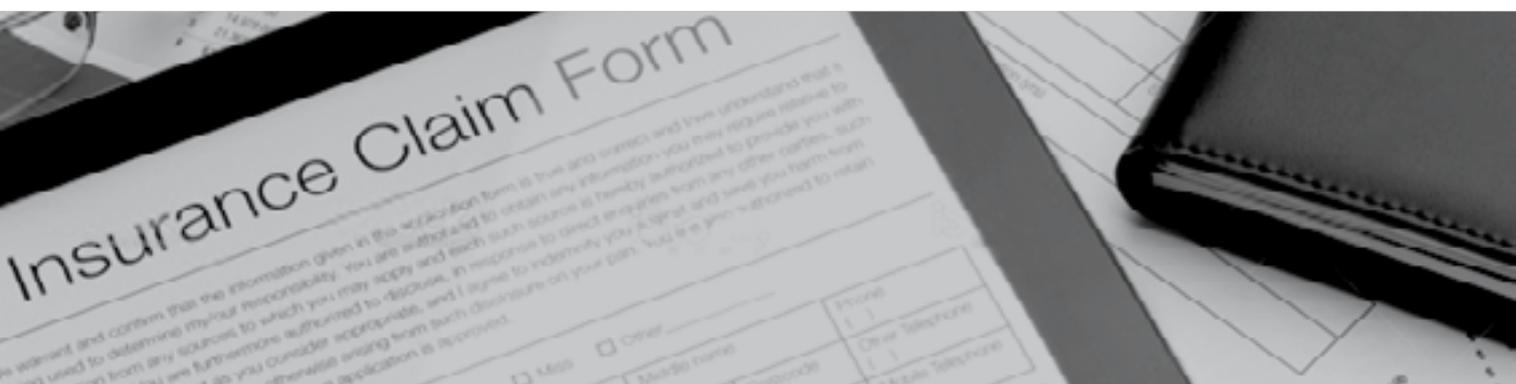
- Q25. What are your views on the current contractual requirements for major domestic building work? What components are working well and what could be enhanced?

5.3 Dispute resolution

- Q26. What are your views on the current dispute resolution process? In particular, what components are and are not working well?
- Q27. Would the introduction of binding rectification orders enhance the dispute resolution process?
- Q28. Are there any other amendments needed to the dispute resolution process?

6. Consumer Awareness and Education

- Q29. Is the current level of information available to consumers sufficient to provide them with the necessary information to make an informed building decision?
- Q30. Do you have a view on the possible amendments to improve the information available to consumers?



4

Back end home building protections

4.1 Insurance

Since the withdrawal of the remaining private insurers in 2013, the Government of South Australia has taken over the financial responsibility for building indemnity insurance risks in the South Australian market. This has been facilitated through the provision of 100% reinsurance arrangements with two private insurers who, in return for a fee, continue to provide underwriting and claims management services to builders and consumers.

These arrangements, where the provision of the insurance remains materially the same as when the private market was operational, have ensured the recent market changes have not impacted the economic health of South Australia's home building industry, while also providing the opportunity for this review to be completed.

Current Provisions

Under the requirements of the *Building Work Contractors Act 1995 (SA) and Regulations*, building indemnity insurance must be taken out by a building work contractor before commencing major domestic building work. This is work with a value of \$12,000 or more that requires approval under the *Development Act 1993*. Subcontractors to a building work contractor do not need to take out this cover, as their work falls under the head contractor's policy, which is usually the registered builder or a building company contracted to complete the project.

An owner-builder, who is not a building work contractor, does not need to take out a building indemnity insurance policy. However, any work performed for the owner-builder by building work contractors, such as the construction of the footings for a home, must be covered by a building indemnity insurance policy, taken out by the contractor, if the value of that work is \$12,000 or more.

Building indemnity insurance is different from most insurance products where consumers take out insurance to cover their own assets. It is most similar to compulsory WorkCover or third party bodily injury motor insurance where the insurance is taken out by one party to cover the possible losses of another party.

A building indemnity insurance policy is entered into by the builder, however the consumer is named as the beneficiary. The premium payable for the insurance policy is paid by the builder, however these costs are inevitably passed on to the consumer via the building work contract.

Building indemnity insurance protects consumers against losses arising from the insolvency, death or disappearance of their builder up to a maximum sum insured of at least \$80,000 per building project. This cover protects against a builder not completing a building project and the subsequent defect liability period, which in South Australia continues for five years. Legal costs incurred prior to the insurance policy being triggered are not covered, however those incurred after the insurance policy is triggered are covered.

In South Australia, a builder is required to provide evidence of eligibility for building indemnity insurance or over \$100,000 in net assets in order to be licensed. Eligibility for the insurance is tied to the financial health of the builder, their credit history, technical competence and build quality. Under the reinsurance arrangements currently in place, the Government of South Australia continues to rely on the risk assessment and underwriting practices of the private insurers administering the product on its behalf.

The process of underwriting the insurance is onerous and insurers are required to undertake detailed and careful assessment of a builder's financial health.

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In most cases, builders will obtain building indemnity insurance via an insurance broker who acts as an intermediary between the insurer and the builders, collating the data necessary for eligibility assessments. Brokers are generally paid a commission by the insurer.

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 their 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 premium pool in South Australia is relatively small and despite significant increases to the premium values by private insurers before exiting the market, the premium pool is still anticipated to be exhausted by claims costs and other expenses prior to the end of the defects liability period for all policies written in a premium year.

4.2 Insurance Models

There are a number of insurance models, or variations on insurance models, available for consideration by the Government of South Australia in developing a long term solution.

Five models are presented and discussed below, all of which have been identified as representing the most common models either available or under consideration by other state governments in Australia. Interested parties are invited to make submissions regarding alternative models should they choose to do so.

4.2.1 Mandatory Last Resort Insurance

This is the current model in place in South Australia, Western Australia, New South Wales and Victoria. Under mandatory last resort insurance a minimum standard of consumer protection is legislated.

In South Australia, legislation stipulates that a building indemnity insurance policy must be taken out by a building work contractor on all domestic building projects with a value of \$12,000 or more and which require development approval under the *Development Act 1993*. The policy, although taken out by the builder, benefits the owner of the home under construction.

According to the law, consumers in South Australia are entitled to insurance compensation, up to a limit of at least \$80,000 per dwelling, if their builder has died, disappeared or become insolvent and cannot be called upon to complete the building project or rectify defects within the statutory liability period, which in South Australia extends for five years. The law requires the insurance excess charged by insurers to be no higher than \$400 and stipulates that insurers must allow consumers at least 90 days to make a claim after they become aware of the insurance being triggered.

If the builder is not deceased, disappeared or insolvent, consumers must personally pursue the builder for rectification or completion of the work. In South Australia the avenue for pursuing such claims is via the Magistrates or District Court.

One of the benefits of the mandatory last resort insurance model is that it mandates a minimum level of protection for all major domestic construction projects in specific circumstances. Should the Government of South Australia elect to keep the mandatory last resort insurance scheme in its current format, claims experience is anticipated to remain as projected. Premium values may need to be reviewed to ensure financial sustainability given the anticipated claims experience.

The Government of South Australia is considering a number of possible amendments to the mandatory last resort insurance scheme currently in place. These are outlined in the following sections.

4 Back end home building protections

Insurance Triggers

One way to improve the consumer protections under the current model is to introduce additional insurance triggers. For example, the Victorian Government has recently announced its intention to add a trigger to its mandatory last resort insurance scheme whereby when a builder fails to comply with a rectification order issued by a regulatory body (i.e. council, court, licensing board) the insurance is triggered. This has the potential to enable consumers to avoid lengthy and costly civil litigation in order to pursue a builder to rectify defective building work.

Additional triggers such as this would have a flow on effect to the value of premiums, the costs of administering the insurance product and the regulatory bodies required to administer and enforce such orders. A detailed cost benefit analysis would need to be undertaken before such enhancements are considered. Nevertheless, an effective consumer protection framework is essential to the financial health of the home building industry and integral to the South Australian strategic plan, of which creating an affordable place to live is a key initiative of the Government of South Australia.



Q1. Are the current insurance triggers sufficient or do they need amending?

Q2. What are your views on any additional triggers that may supplement the current last resort model?

Any increase or decrease in the financial limits of building indemnity insurance will also have flow on effects to the value of premiums. For example, increasing the minimum contractual limit whereby the insurance is required may preclude some claimants from accessing compensation and lowering the limits may potentially increase claim exposure. This latter principle would also apply to an increase to the limit of liability on the insurance policy.



Q3. Do you think that the current level of insurance coverage provides the necessary protection to consumers?

Q4. What are your views in terms of an appropriate maximum insurance entitlement?

Q5. Should separate limits be introduced for non-completion and defect claims? If yes, what limits are recommended?

Limits of Insurance Compensation

The financial limits for building indemnity insurance are also under consideration for possible enhancement. In South Australia, the compensable amount of the insurance cover is capped at \$80,000 for both non-completion and defect claims. Other states in Australia have much higher compensable limits per dwelling, or different limits per claim type. For example, in New South Wales the maximum claimable amount for non-completion claims is 20% of the contract value, up to a limit of \$340,000. The limit for defects claims is also \$340,000. In Victoria, the same principles apply, but only up to a limit of \$200,000.

The minimum contractual limit whereby the insurance becomes a regulatory requirement also differs in other states. In New South Wales, contracts with a value of \$20,000 or greater are required to have a building indemnity insurance policy in place, yet in Queensland the minimum limit is \$3,300.

4 Back end home building protections

Length of Insurance Coverage

In South Australia, the statutory warranty period for defective work extends to five years following the completion of the building work. This is consistent with the limits in the Australian Capital Territory (ACT). In other jurisdictions, there are different periods of cover for different types of defect claims. For example, in Victoria and New South Wales, the defect liability period extends to six years following completion of the work for structural defects and two years for non-structural defects.

Changing the length of the insurance coverage to match other state jurisdictions is likely to change the claims experience as, all else being equal, a longer coverage period is expected to attract a higher number of claims and vice versa. Before the Government of South Australia could consider any amendments in this regard, it would need to carefully examine the impact this would have on both premiums and home building protections. A shorter claim period for non-structural defects may preclude some homeowners from seeking compensation in genuine circumstances. A longer claim period may require amendments to premium values to account for an increased claim exposure.

The time limits which consumers have to make a claim, once he or she becomes aware of a possible claimable event occurring, also differ around the nation. In South Australia, the ACT and Tasmania insurance policies mandate that claims must be notified to insurers within 90 days. In New South Wales, claimants have six months to lodge defect claims and one year to lodge non-completion claims. In Victoria, claimants have 180 days to lodge all types of claims.

Extending the time limit which consumers have to notify insurers of claims may result in increased claim numbers. However, it may also provide consumers with a fairer time frame to determine if they can or want to lodge an insurance claim.

 Q6. Is the current period of insurance appropriate for the South Australian market?

Q7. What are your views on varying the insurance coverage period by claim type and what would be an appropriate length of coverage per type?

Q8. Is the time frame for notifying an insurer of a claim appropriate?

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. In New South Wales and Victoria, when the reasonable cost of labour and materials meets the minimum insurance limits in those states, owner-builders are required to have a building indemnity insurance policy in place to cover such work as a statutory condition of the sale of their property. The beneficiary of the insurance policy is the new homeowner, not the owner-builder. The period of cover is limited to specified time frames following the completion of the work.

Introducing these sorts of requirements for owner-builders in South Australia would provide greater levels of protection for consumers purchasing homes in an environment where home renovation is increasingly being undertaken by homeowners themselves. However, it would also increase the costs and regulation involved in selling and buying a home and result in a new legal obligation on the vendor that may exist for several years after the sale of a home.

 Q9. What are your views on the requirements for owner-builders to take out building indemnity insurance?

Developer Exclusion

Also under consideration is the introduction of an exclusion that prevents developers from being a beneficiary of the insurance product. Developer exclusions are in place in New South Wales and Victoria and aim to prevent developers from forcing builders to undertake work at unprofitable rates and relying on the insurance claim settlement to complete projects when the builder becomes insolvent.

 Q10. What are your views on the inclusion or exclusion of developers as beneficiaries of a building indemnity insurance policy?

4 Back end home building protections

4.2.2 Mandatory First Resort Scheme

A mandatory 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.

The model assumes the consumer cannot effectively mitigate the risks of a home building contract and must be provided with a high level of protection from a third party source. This sort of model would provide a higher level of consumer protection. However, it would inevitably result in an increased volume of claims and a significant increase in the costs and resources required to administer the insurance product. The Government of South Australia would therefore need to undertake a detailed cost benefit analysis before a mandatory first resort insurance scheme could be considered.

Queensland is currently the only state in Australia to operate a mandatory first resort insurance scheme. The scheme is administered and funded by the Queensland Government and premiums are generally higher than in other Australian states.

Evidence suggests that private insurers have no appetite to invest in first resort schemes and should the Government of South Australia implement this sort of model, it would be unlikely to be attractive to the private market in the long term.



Q11. What are your views on the introduction of a first resort insurance scheme, including the impacts it may have on consumers, builders and the costs involved in its administration?

Q12. What are your views on how the private market may respond to the introduction of a first resort scheme?

4.2.3 Mandatory Last Resort Fidelity Fund

The ACT and the Northern Territory both have mandatory last resort fidelity funds in place. Under this model, the insurance product is 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.

A benefit of this type of building indemnity insurance model is that it is the industry association, not the insurance provider, that would act as a back-end consumer protection regulator. These associations may be well positioned to assess the building industry risks and develop products to effectively mitigate them.



Q13. What are your views on the introduction of a fidelity fund administered by a building industry stakeholder, including the benefits to consumers and builders?

Q14. What kinds of financial risks may be involved in the set up and administration of an industry fidelity fund?

4 Back end home building protections

4.2.4 The Voluntary Insurance Model

The previous sections of this paper have all discussed the insurance model under its current mandatory format. The Government of South Australia recognises that in other jurisdictions, such as Tasmania, building indemnity insurance is voluntary under law.

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

Under this model the regulatory burden of entering into a domestic construction project would be reduced and consumers may save time and money by not having to take out a building indemnity insurance policy. In removing all of the regulated minimum requirements for an insurance policy, the private market or industry bodies may be inclined to independently develop insurance products or warranties designed to demonstrate the quality of a builder or attract the risk averse consumer.

It may also be possible to have a mix of voluntary and mandatory insurance, depending on the claim risk. For example, some consumers may be willing to bear the risk of a defect claim and this risk could be made voluntary with the non-completion risk remaining mandatory. This sort of model could be managed in a similar manner to the split risk model outlined in the next section of this paper. As with that model, prudent management of the portfolio may make one or both of the claim risks attractive to the private insurance market in the long term. However, before this kind of amendment could be considered, the Government of South Australia would need to understand the capacity and ability for consumers to assess and accept defects risks in a building project.

One of the risks of the voluntary insurance model is that it could result in a significant weakening of consumer protection provisions. The mandated minimum protections would be removed and the consumer would need to take an active role in the decision to purchase the insurance. As such, they would need to have a sufficient level of awareness of the availability of the cover and an ability to weigh up the risks of not purchasing the insurance. It is possible that the take up rates for the product would be low, thereby potentially exposing large numbers of consumers to financial losses.



Q15. What are your views on making building indemnity insurance voluntary for all or some of the insurance risks?

Q16. If a voluntary model was introduced, what information would consumers require to be able to assess the risk of not taking up the insurance?

4.2.5 The Split Risk Model

Under a split risk building indemnity insurance model the non-completion and defects liability risks are split into two different products. The long-tail nature of the defects liability risks has been identified as one of the key factors causing the building indemnity insurance market to be unattractive to private insurers. The fact that claim reserves need to be maintained for such long periods of time has a negative impact on the balance sheets of the parties holding that financial risk.

Under a split risk model, it would be possible for one party, such as a private insurer, to supply the market with cover for the non-completion risks. Another party, such as a building industry association, or another insurer, would provide cover for the defects liability risk. The insurance may still be mandatory and only provide protection in the specific circumstances of death, disappearance and insolvency of the builder as it does under the current statutory provisions. However, it is also possible for the additional triggers or enhancements to cover outlined in section 4.2.1 of this paper to be included in this model, if it was costed appropriately.

The Government of Western Australia has recently published a report detailing an investigation into the building indemnity insurance provisions in Western Australia. The report found that a split risk model would offer the greatest benefits to the Western Australian community. It also suggests that the model could be administered by private insurers and industry associations, with some level of reinsurance from the Government of Western Australia.

4 Back end home building protections

The success of the proposed Western Australian model will be dependent on the willingness of the private insurance market and industry associations to deliver either one or both of the two insurance products.



□ Q17. What are your views on the introduction of a split risk model for the South Australian building indemnity insurance market, including any financial benefits for the insurance provider?

Q18. What are your views on the benefits to consumers and builders under a split risk model?

4.3 Government versus Private Market Administration

The Government of South Australia would ultimately prefer that building indemnity insurance be supplied by the private insurance market. This is because the private market, as experts in the insurance and risk management fields, is best placed to develop insurance products, underwriting practices and claims management services that support a fair and robust market that meets the needs of consumers and businesses.

The current economic climate is unlikely to make the building indemnity insurance market attractive to private insurers in the short term. This has been the case for the Governments of New South Wales and Victoria, which have assumed the full financial risk for building indemnity insurance since 2010. The models in these jurisdictions operate similarly to the reinsurance arrangements currently in place in South Australia. However, the government, not the insurer service provider, is named as the insurer on all policy documentation. The government is also responsible for all of the costs associated with the administration of the insurance product and there is no impact on the financial position of the insurance service provider, other than income from commissions received for the provision of claims and underwriting services. At this stage, it is understood that there is no appetite for private insurers to re-enter the market in either Victoria or New South Wales.

It is also understood that brand risk has been a contributing factor to the withdrawal of private insurers from the building indemnity insurance market. Its mandatory nature, the risk assessment and loss mitigation practices required for insurance eligibility, as well as the limited cover provided and the position of the insurance in the dispute resolution process, has resulted in significant contention regarding the value building indemnity insurance provides to consumers and builders. This in turn has an impact on the brand image of the entity providing the insurance product.

The Government of Victoria has recently implemented a number of changes to their home building protections that aim to enhance its value to the various parties involved in a home building project. These enhancements include increased regulation surrounding the supervision of a building project, fast tracked dispute resolution via binding rectification orders and additional triggers for the insurance product. Managed prudently, these enhancements may, in the right economic circumstances, mitigate the brand risks preventing insurers from engaging in the building indemnity insurance market.



□ Q19. Is it worthwhile for the Government of South Australia to seek to ensure that the building indemnity insurance market is attractive to private insurers in the long term?

Q20. What are the necessary enhancements to the current home building protections that would make building indemnity insurance more attractive to the private insurance market, while still supporting consumer and builder needs?



5

Front end home building protections

Building work in South Australia is regulated by several different agencies. Under the *Building Work Contractors Act 1995 (SA) and Regulations*, licensing and discipline of builders is performed by the Commissioner for Consumer Affairs, through Consumer and Business Services. Technical regulation of building work and approval of development applications is predominantly performed by Local Government via powers delegated under the *Development Act 1993*.

The *Building Work Contractors Act 1995 (SA) and Regulations* contains a number of protections aimed at creating fair and equitable conditions for consumers and builders. These protections include regulations applying to the format and wording of contractual documents, pricing and payment schedules, as well as statutory warranties. Any harsh and unconscionable terms in building contracts can be remedied by the Magistrates or District Court.

Disputes about building work that cannot be resolved by the parties themselves are addressed through the Consumer and Business Services advice and conciliation service or through legal advice and the courts.

5.1 Licensing and Supervision

A person (including a company) must be licensed as a building work contractor if they carry on the business of performing building work for others or performing building work with a view to the sale or letting of land or buildings improved by that work. Every building work contractor must have a registered building work supervisor to properly supervise their building work and ensure that it meets the required standards. It is common for licensed contractors to also be registered as supervisors and to perform this role themselves. If a contractor is not also registered as a supervisor or is registered but will not be supervising the building work themselves, they must have a nominated and approved supervisor to perform this role.

The legislation does not specifically define the tasks a supervisor is required to perform. However, it does impose a duty to personally inspect the building work when major structural events occur and to perform appropriate checks to ensure that the building is constructed in a proper workmanlike manner. The *Development Act 1993* gives Local Government the power and responsibility for building inspections in their area. Councils are required to develop and adopt a building inspection policy for any building work in their area.

The performance of a building inspection is at the discretion of each Council. Councils or authorised officers will check for compliance with approved plans and specifications and have the power to request that non-complying building work be rectified in a certain time frame.

5 Front end home building protections

Once the building work is completed, there is a requirement for a licensed building work contractor, registered building work supervisor or private certifier to sign a Statement of Compliance to certify that the building was constructed in accordance with the Council development approval and lodge it with the Council. The Statement of Compliance is comprised of two parts. The first part is to be completed by the building supervisor and the second part by the owner of the land. The document forms an agreement between the parties confirming that the dwelling is habitable, with the following standards having been met:

- the building is structurally sound and weatherproof;
- the building work has been carried out in accordance with the relevant approval;
- all smoke alarms have been installed and tested;
- the building includes toilet, shower, kitchen and laundry facilities;
- all connections required for the supply of water (including rainwater tanks) and the disposal of water and effluent have been completed; and
- the provisions required to protect the building from bushfires, if required.

There is no further obligation for the Council or any other authority to complete a post inspection check once the Statement of Compliance has been agreed and lodged by the supervisor and the consumer.

Licensing criteria for a building work contractor broadly relate to honesty, business competence and financial capacity. The criteria required to be met in order to become a licensed building work contractor are detailed in the *Building Work Contractors Regulations 2011*.

Criteria for registration as a building work supervisor are also set out in these regulations. These criteria relate to technical knowledge and experience. Applicants must supply copies of relevant trade certificates, technical qualifications or evidence of experience and may be required to attend an interview to assess their relevant experience and technical skills. Detailed information for each licence type is available at www.cbs.sa.gov.au.

Under the legislation, a contractor or supervisor can face disciplinary action if they are no longer eligible for a licence or are found to be acting unlawfully, negligently or unfairly in the course of their business or role. Disciplinary action is taken through an application to the District Court. Although any person can instigate this sort of action, it is normally undertaken by the Commissioner for Consumer Affairs. From early 2014, changes under the *Statutes Amendments (Occupational Licensing) Act 2013* will mean that the Commissioner for Consumer Affairs will be able to administratively cancel or impose conditions on a licence if the person is no longer eligible to hold that licence.

Possible Amendments

In 2008, the Council of Australian Governments (COAG) agreed to the introduction of a National Occupational Licensing System (NOLS). This encountered several difficulties and COAG decided to discontinue this project in December 2013. Building and building related occupations were proposed to be regulated under NOLS in late 2015 and, as such, it was not intended that a comprehensive review of the licensing requirements for builders in South Australia would form a substantial part of this review.

Due to the cancellation of the NOLS project, the Government of South Australia is now able to consider suggestions from interested parties regarding enhancements to licensing that could reduce potential building indemnity insurance claim exposures whilst not creating barriers to entry or excessive costs for builders or industry stakeholders.



- Q21. Is the current licensing system for building occupations adequate in terms of protecting consumers? If not, what amendments could be made?
- Q22. Are the current processes around building work inspection and certification adequate, or should they be enhanced? If so, how?
- Q23. What are your views around the adequacy of the Statement of Compliance process, including any enhancements to the process?
- Q24. What are your views on the current disciplinary process for builders? What components are working well and what could be enhanced?

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5.2 Contractual Requirements

The *Building Work Contractors Act 1995* contains a range of contractual requirements to protect consumers. Those applying to major domestic building work are listed below:

- **Contract documents.** Contracts must be in writing, set out all terms and include prescribed information about the customer's rights and obligations.
- **Price requirements.**
 - » There must be a fixed price if no time is specified for completion.
 - » A "rise and fall" clause can be used where a set time for completion is specified. There are various requirements relating to disclosure and pricing of work after the completion date has passed.
 - » For "cost plus" contracts and "prime cost" items, the price cannot exceed the actual cost to the builder plus 15%.
 - » The price listed for any "provisional sums" must be fair and reasonable.
 - » There are restrictions on allowable deposits.
 - » A builder must not seek payment (other than the deposit and some third party costs) in advance of performing the work (genuine progress payments).
- **Statutory warranties.** A person may claim under the following warranties within five years from completion of the building work.
 - » The work must be performed in a proper manner to accepted trade standards and in accordance with the plans and specifications agreed to by the parties.
 - » All materials supplied must be good and proper.
 - » The work must be performed in accordance with all statutory requirements.
 - » If the contract does not stipulate when the work must be completed, it must be performed with reasonable diligence.
 - » If constructing a house, it must be reasonably fit for human habitation.
 - » If the customer has made known to the builder the purpose or result required, so as to rely on the builder's skill or knowledge, there is a warranty that the result will be reasonably fit for that purpose.
- **Harsh or unconscionable terms.** The Magistrates and District Courts can grant a remedy to any harsh or unconscionable terms in a building contract.

Possible Amendments

At this point in time, the Government of South Australia has not identified the need to review protections relating to the regulation of contractual documentation, pricing and payments or statutory warranties. However, interested parties are invited to make submissions regarding their experiences with these protections for consideration in this review.



Q25. What are your views on the current contractual requirements for major domestic building work? What components are working well and what could be enhanced?

5.3 Dispute Resolution

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 proceedings in the Magistrates or District Court, depending on the value of the dispute.

Consumer and Business Services provides a conciliation service for consumer disputes. This involves an officer from Consumer and Business Services assisting the consumer and the builder to reach a resolution of the dispute through negotiation. Successful negotiation relies on the willingness of both parties to reach a mutually agreeable outcome. Consumer and Business Services has no legal authority to impose any action or resolution on either the builder or consumer. However, under the *Fair Trading Act 1987*, the Commissioner for Consumer Affairs has the power to call a Compulsory Conciliation Conference where the builder is required to attend to discuss the issues with the consumer and a senior officer from Consumer and Business Services. This sort of conference is designed to avoid the need for the consumer to pursue a remedy via litigation, which can be lengthy and expensive.

Failure to attend the conference by the consumer, without reasonable excuse, may result in Consumer and Business Services ceasing to provide any further assistance in the dispute resolution process. Builders are required to attend or risk being issued with an expiation notice or prosecuted.

If the parties reach agreement through a Compulsory Conciliation Conference, this can be documented in a written agreement that can then be enforced through the Magistrates or District Court. If an agreement is not reached, the consumer may need to consider taking civil action through the courts.

There is no direct cost to either party for the Consumer and Business Services conciliation service. The service is funded through general government revenue, including builders' licence fees. Consumer and Business Services staff are experienced conciliators and are knowledgeable in consumer law. However, they are not technical experts in building matters and so rely on expert opinion provided by the consumer and the builder. These sometimes conflict, which can make resolution more difficult. Each party must pay for their own expert reports, if they are needed. Consumer and Business Services cannot compel either party to obtain an expert report.

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In 2012/13, Consumer and Business Services received 975 requests for assistance with residential building disputes and achieved the following results:

- Fully resolved 45.7%
- Partially resolved 12.6%
- Not resolved 41.7%

Consumer and Business Services does not provide legal advice to either party or represent a consumer in court. If the dispute cannot be resolved by agreement, the consumer must obtain their own legal advice and representation to pursue the matter through the courts. The cost and time involved in such proceedings may serve as a deterrent to aggrieved consumers and may also serve as an incentive for some builders to avoid settling disputes through conciliation.

Some consumers involved in building disputes that have escalated to court action have reported that it has taken in excess of three years (including their own initial attempts to resolve the disputes) and cost over \$40,000 in legal costs to pursue their claims.

There is a concern that delays and costs in dispute resolution processes could lead to a higher number of affected consumers, and subsequently higher claims on building indemnity insurance, in the event of a financial collapse of a builder.

Possible Amendments

One area identified by the Government of South Australia for consideration is enhancement of the dispute resolution process. The current conciliation process is successful in many cases and there are benefits in maintaining this service. However, conciliation is not effective in a number of cases where there is an unwillingness to resolve the dispute. It can also lead to consumers accepting a partial solution, rather than risking the time and expense of pursuing a matter through the courts.

One way to enhance the dispute resolution process is to introduce binding rectification orders, where an independent authority (such as Consumer and Business Services) can make an order that is binding on the builder to rectify defective or incomplete work within a set time. The Victorian Government has recently announced its intention to implement a number of changes to its home building protection framework, including the introduction of binding rectification orders. The main features of the Victorian rectification order provisions are:

- The Victorian Building Authority (VBA) can issue rectification orders where building work is assessed as defective or incomplete by a VBA inspector.
- A rectification order can also direct a consumer to make a payment to a builder where an allegation of defective work is not upheld or does not justify the amount being withheld. The order can also require the consumer to pay an amount into a trust account, which will be released to the builder when the rectification work is completed.

- If either party to the dispute disagrees with the order, they can apply to the Victorian Civil and Administrative Tribunal (VCAT) for review. However, the order is binding unless the review is sought within a prescribed time.
- If a builder fails to comply with a rectification order, the builder will be liable to disciplinary sanctions and the consumer can claim under their mandatory insurance. The insurer is entitled to recover their costs from the builder.
- VCAT will be able to order costs against a party that has unjustifiably requested VCAT to review a rectification order.

Adoption of a similar scheme by the Government of South Australia may require additional resources with building expertise to make assessments of building work quality and compliance with codes and contractual requirements. Both the benefits and costs of these sorts of changes would need to be analysed by the Government of South Australia before a decision is made on the adoption of a rectification order scheme.



Q26. What are your views on the current dispute resolution process? In particular, what components are and are not working well?

Q27. Would the introduction of binding rectification orders enhance the dispute resolution process?

Q28. Are there any other amendments needed to the dispute resolution process?



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Consumer awareness and education

Building or renovating a home is often one of the most significant financial and emotional investments a consumer will make in their lifetime. For most, they will undertake the process only once or twice and they will generally have little prior experience to assist them in how to go about undertaking the task, which involves negotiation of a number of rigorous regulatory processes.

The information provided to consumers regarding how to approach a building project and what to do in the event of a dispute or an insured event is therefore a very important aspect of the home building protections in South Australia.

Consumer and Business Services provides a large volume of useful information on their website regarding the roles, rights and obligations of the various parties involved in a building project under the regulations, as well as the regulations themselves. It also includes practical advice on builder selection, the dispute resolution process, including some basic information on managing civil disputes via the court system, advice on insurances and development applications and sample correspondence for use throughout the process.

Consumer and Business Services also publish a number of brochures detailing the information outlined above, as do some Councils, particularly in relation to the requirements under development applications.

Information regarding insurance policy coverage, insurable events and the claim process is also available on the websites of the private insurers that are currently managing building indemnity insurance on behalf of the Government of South Australia. According to the regulations, insurance policy documentation must be supplied to the consumer by the builder before any building work commences.

One of the contributing factors to consumer dissatisfaction across building indemnity insurance models in other state jurisdictions has been identified to be the quality and availability of information regarding builders' histories, the insurance coverage and the dispute resolution process. As part of this review, the Government of South Australia is considering how to best inform consumers and builders of their rights and obligations in the building process.



Q29. Is the current level of information available to consumers sufficient to provide them with the necessary information to make an informed building decision?

Q30. Do you have a view on the possible amendments to improve the information available to consumers?



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Request for submissions

The Government of South Australia invites all interested parties to submit feedback regarding the current and proposed enhancements to the home building protections set out in this paper.

Submissions may address all or only some of the questions set out in this paper. Feedback and ideas outside the scope of this paper are also welcome.

Electronic submissions can be sent to **HBPReview@sa.gov.au**

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

Attention: Home Building Protection
South Australian Government Financing Authority
GPO Box 1045
ADELAIDE SA 5001

Fax: +61 8 8115 1366

Electronic, postal and fax submissions will close on Friday 21 February 2014.

If you do not wish to make a detailed or confidential submission to this paper, you can comment on the home building protection blog by logging on to **www.saplan.org.au/yoursay/home-building-protection**.

Submissions to the YourSAy blog will close on Friday 14 February 2014.

Please be aware that information contained in any submission may be referred to publicly or published. If you do not wish for your submission to be quoted or published please make this clear in your submission. However, please note that confidentiality of submissions cannot be guaranteed and submissions may need to be disclosed in some instances.

You may wish to disclose information in your submission in an anonymous form, for example by removing reference to specific individuals, companies or situations.

If you would like more information regarding the circumstances in which disclosure of submissions may be necessary please forward your query to Home Building Protection, South Australian Government Financing Authority at the address listed above.