

**Supplementary
Submission**

No 16a

INQUIRY INTO THE OPERATIONS OF THE HOME BUILDING SERVICE

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Summary

NSW Office of Fair Trading

Supplementary Submission to the General Purpose Standing Committee No 4

Inquiry into the operations of the Home Building Service

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1 Builder licensing system

1.1 *Licence processing*

During the course of the inquiry the greatest level of misunderstanding arose in relation to the manner in which applications for builder licences are processed by the Home Building Service. It was apparent from comments made during the course of the Inquiry that many stakeholders do not fully understand the licence application assessment process, and in particular, have misconstrued the manner in which criminal record, insolvency and bankruptcy checks of applicants for building licences are conducted.

The suggestion was made several times during the inquiry that the Home Building Service only checks 10% of the licence applications it receives. Such suggestions are simply misleading and untrue.

Every application for a licence received by the Home Building Service is thoroughly assessed against the requirements of the *Home Building Act 1989* and the Home Building Regulation 2004, in particular clause 25 of the regulation, to ensure that only well-qualified and appropriate people obtain building licences.

Evidence of the close scrutiny applied to the licensing assessment process can be found by examining the number of applications refused or withdrawn during 2005/2006. Of the almost 13,000 licence applications received by the Home Building Service during the last financial year, some 3,878 were either refused or withdrawn.

Clearly, the rejection of over one quarter of the applications received is not indicative of a regime that only checks 10% of the applications it receives.

For the sake of clarity, the licence assessment process involves:

- 100% checking of the TAFE or University qualification of the applicant; and
- 100% criminal record, bankruptcy and insolvency checks of the applicants who disclose that they have a criminal history or have previously been a bankrupt or involved with an insolvent company.

In addition to this, as a risk management strategy, the Home Building Service also carries out criminal record, bankruptcy and insolvency checks on a 10% random selection of those applicants that have not declared a criminal record or a problematic financial history.

These random checks are also applied to 10% of renewals received by the Home Building Service each year.

NSW is the only jurisdiction in Australia to have this additional layer of checks of licence applicants.

1.2 *Old Licence Applications*

During the public hearings the Building Action Review Group raised a number of licence

applications, which they were critical of.

The first point that needs to be made here is that all of the licence applications referred to by BARG were lodged and assessed years before the Home Building Service was established. In fact, many, if not all, of the licence applications were assessed and approved by the former Building Services Corporation or its predecessor.

The licence application process has changed considerably since it was administered by the Building Services Corporation and much work has been done in recent years to make the process more robust. I draw to the Committee's attention our first submission which details the enhancements made, which include:

- abandonment of the '20 year rule' experiential pathway to obtaining a building licence [1 January 2006];
- new qualifications for builder licences based upon Australian Qualification Training Framework [1 January 2006];
- revised internal licensing procedures [1 January 2006]; and
- a register of referees supplying supporting references to applicants [1 January 2006].
- proof of identity checks [1 March 2006]; and
- new qualifications for non-specialist trade licences based upon Australian Qualification Training Framework [21 August 2006].

The claims made by BARG of licensing anomalies, whilst not conceded, if true, are relatively few in number when you place them into the context of a licensing regime containing more than 165,000 licensees and 13,000 applications per annum.

It is our submission that this relatively low number of licensing issues is clearly not evidence that there are systemic problems with the licensing regime.

To the contrary, the significant enhancements made to the licensing regime since the establishment of the Home Building Service make NSW 'best practice' when it comes to licence processing. Officers of the Queensland Building Service Authority have visited our Parramatta offices to study our practices and systems with a view to implementing them in Queensland.

1.3 Continuing professional development

During the course of the Inquiry's public hearings, a number of adverse comments were made in relation to the operation of continuing professional development requirements for builders and pool builders. These comments were not based on any evidence of how the scheme operates in practice.

NSW was the first jurisdiction in Australia to introduce continuing professional development and make it a mandatory requirement for renewal of a builder's licence. Tasmania has since also introduced a mandatory requirement, Victoria has introduced a voluntary regime and Queensland is yet to implement continuing professional development.

Much work has been put into the development of the requirements in NSW to make it fair, equitable and accessible to all builders and pool builders. The Minister for Fair Trading has asked for the regime to be reviewed and that review is currently under way.

Points are allocated for various activities including trade nights and seminars. The more rigorous the activity, for example a TAFE course, the higher the number of points that are accrued. Industry associations, trade suppliers and other training providers can conduct continuing professional development activities. However, they are required to apply to the Office of Fair Trading for recognition of these activities for the purpose of accruing continuing professional development points. Applications for recognition are assessed to ensure that they meet the standards set by the Commissioner and the appropriate number of points are allocated to that activity. Officers from the Home Building Service attend these sessions from time to time to ensure that the standards relating to the continuing professional development activity are met.

The vast majority of builders and swimming pool builders undertake continuing professional development. Introduction of the requirement was not a major issue for the building industry as many in the industry had for years been engaged in the practice of continually updating their product and technical knowledge in order to compete with other builders. For many, the requirements merely formalised this process. As with any new requirement there will always be some detractors who will comment adversely about it.

Notwithstanding this, it is acknowledged that now that the requirement has been in place for some time, new compulsory courses designed to address specific technical issues need to form part of the regime.

2 The home warranty insurance scheme

2.1 *Comparison with the Queensland home warranty scheme*

Submissions made by the Queensland Building Service Authority and the Builders Collective of Australia attempted to make comparisons between the NSW home warranty regime and the regime that operates in Queensland.

Unfortunately, neither the Queensland Building Service Authority nor the Builders Collective have sufficient information about the NSW regime to make such a comparison.

Both the written submission by the Queensland authority and the oral submissions of the Builders Collective suggested that premiums in NSW are two to three times higher than those in Queensland. The Builders Collective also suggested that the home warranty regime in NSW was not providing any protection to consumers and that many builders are required to lodge substantial security or bank guarantees with private insurers in order to obtain eligibility. Both submissions were clearly based on anecdotal information at best and are simply wrong. It is Fair Trading's view that the Committee should place more emphasis on factual evidence relating to the performance of the scheme, some of which was provided to the Committee in the public submission made by the Director-General of Commerce.

As indicated in our original submission to the Inquiry, the Home Warranty Scheme Board has been collecting data from home warranty insurers since December 2005. The collection of this data has allowed the Scheme Board to effectively monitor the operation of home warranty insurance in NSW. The collection of the data also allows for an objective comparison to be made with the regime in operation in Queensland. To allow an effective

2. THE HOME WARRANTY INSURANCE SCHEME

comparison to be made the Home Warranty Insurance Scheme Board has authorised the release of the data outlined below relating to the performance of the regime in NSW:

Notable aspects of the premium and claims experience of the Scheme as at September 2006 are:

(i) Premiums in NSW

- The average premium in NSW, as a percentage of contract value, is currently 0.48%¹. [This compares favourably with that of Queensland, which is currently 0.73%³.]
- The average premium per project is \$806 and the average for a new dwelling is \$921.
- The average premium for renovations (non-structural – including kitchens & bathrooms) is \$317.

(ii) Claims

- Insurers in NSW have received 651 claims in three and three quarter years of the Scheme.

Of the 651 claims received:

- 175 or 27% have had liability accepted (either in full partially or deemed accepted);
- 128 or 20% have had liability fully declined; and
- 348 or 53% are in the process of having liability assessed by insurers.

Of the 128 claims that were denied:

- 29 or 23% have been not deemed a defect;
 - 6 or 5% the builder was located;
 - 27 or 21% the builder was found not to be insolvent;
 - 17 or 13% claims made outside time limits; and
 - 49 or 38% reason unknown.
- the average claim size is \$14,995. It is expected that there will be further development in average claim size for all years but particularly the more recent years. It is not possible to estimate the extent to which average claim size will develop over time;
 - the dominant principal causes of claims are:

○ insolvency	71%
○ cause not yet determined	18%
○ disappearance	8%
○ death	3%
 - failure to complete and structural defects are the most common claim types across certificate years representing 43% and 32% of all claims received. Other losses such as general defects represent 25% of all claims received;

(iii) Bank Guarantees & Securities

¹ Based on data provided by the insurers

² Figures contained within the Victorian Competition and Efficiency Commission in its report – *Housing Regulation in Victoria – Building Better Outcomes (October 2005)*, p.209.

³ Regulatory Impact Statement for Amendments to Queensland Building Services Authority Regulation 2003; July 2006

- The data obtained from insurers revealed that the number of bank guarantees or securities held by an insurer was 640 which represents 5.2% of builders who have home warranty insurance eligibility.

2.2 *Interpretation of scheme data*

The actuaries engaged by the Home Warranty Scheme Board to analyse the data collected have urged caution in interpreting the claims data and even more so in attempting to arrive at any conclusions on the Scheme's progress and financial dynamics. The main reasons given by the actuaries for exercising caution against misinterpretation of the data collected to date are as follows:

- Home warranty insurance is a very long tailed class of insurance. While claims are notionally reported for six years after the building is completed, in practice, claims are received by insurers for up to ten years after the inception date of the project certificate. There can be a delay between the date of the project certificate and when building construction commences and that delay may be significant. It can also take some time to complete a building, possibly in excess of one or two years. It can then take considerable time to assess and pay a claim, depending upon the complexity of the issues and the number of builders involved in the work over time.
- The Scheme Board's actuaries expect the claims experience of the Home Warranty Insurance Scheme to be volatile over time since:
 - the claims experience depends heavily on the building cycle (i.e. building activity). The cycle has a complex impact on the claims experience and lower building activity may not necessarily result in fewer claims or a lower average claims size;
 - the economic cycle impacts the building industry and this cycle may be different to the building cycle. For example at times there may be a boom in residential investment properties but not owner occupied dwellings;
 - changes in building codes and regulations can impact the claims experience over time; and
 - there can be significant volatility in the size of builders that experience financial stress. For example the collapse of one large builder could have a major impact on the HWI Scheme's financial situation but this only happens infrequently.

The actuaries advise that it is difficult to interpret the emerging experience of the Scheme and come to any conclusion on the trends and general experience due to:

- possible further significant changes to the data already submitted;
- the limited amount of data available at this stage;
- the long term nature of the Scheme (e.g. it is possible that less than half the claims for the first certificate year of the last resort scheme have been received by insurers despite being three and a half years since the start of the first certificate year);
- the volatile nature of the claims experience;
- the presence of incomplete data, data anomalies and errors; and
- the last resort scheme is a new scheme with no comparable claims experience in other states nor, it is understood, in overseas countries as to how the claims experience will emerge. Claims experience of the prior first resort scheme is of limited use since the claims eligible under that scheme are fundamentally different to those eligible under the last resort scheme.

Notwithstanding these cautions, the data collected on home warranty insurance in NSW shows average premiums are lower in NSW than Queensland, contrary to many of the submissions made to the Committee. More importantly, viewed within the context of the building dispute resolution processes provided to consumers in NSW, it is clear that home warranty insurance is providing protection to consumers.

The suggestion by the Builders Collective that the Queensland scheme is 'infinitely better than the NSW system' is not supported by the evidence.

It is acknowledged, however, that more can be done to improve the insurance product for consumers. Following a recommendation made by the Home Warranty Insurance Scheme Board, the Government recently announced an increase in the threshold level of cover from \$200,000 to \$300,000 from 1 March 2007 and the removal of the requirement for the consumer to pay a \$500 excess from 1 July 2007. The Home Warranty Insurance Scheme Board continues to examine further enhancements to the scheme.

2.3 Governance and complaint mechanisms

The Builders Collective submissions also suggested that the system is not accountable. This is simply not the case. Section 4.3 of our original submission details the governance structure implemented in NSW following the Grellman Inquiry in 2003.

The governance structure comprises:

- the Home Warranty Insurance Scheme Board;
- the introduction of conditions of approval for insurers to operate in NSW;
- legislative powers within the Home Building Act 1989, that allow the Minister to sanction an insurer for non-compliance with their conditions of approval;
- the introduction of Market Practice & Claims Handling Guidelines;
- the industry deed entered into by Government and insurers;
- the mandatory data reporting requirements; and
- the collection and analysis of industry data by the Scheme Board;

The Builders Collective also raised the issue of who can a builder complain to if they can't get eligibility with an insurer. A Home Warranty Scheme Board secretariat has been established within the Home Building Service to support the work of the Scheme Board and to receive and handle complaints relating to the conduct of insurers. Builders and consumers are able to lodge complaints in writing. Complaint forms are available from Fair Trading's website or by calling 13 32 20.

3 The resolution of complaints

3.1 Resolution of BARG matters

During the course of the public hearings the Building Action Review Group brought forward some extremely unfortunate cases and Fair Trading acknowledges the impact on the lives of the home owners involved. The Home Building Service continues to attempt to assist, wherever possible, these people resolve their issues.

Having said that, the number of these cases is relatively few when compared with the number of matters successfully resolved by the Office of Fair Trading, the Home Building service and the Consumer, Trader and Tenancy Tribunal since the Home Building Service was established only three years ago.

Fair Trading considers that only five Building Action Review Group matters have compliance or other action continuing. All other matters have been finalized.

Since its establishment the Home Building Service has successfully resolved over 7,000 building disputes between consumers and traders.

If we compare this number with the 50 cases BARG suggests it has had some involvement in over the years, this represents only 0.7% of the total building disputes in NSW since 2003. This is clearly not evidence of systemic failure of the regulatory systems or the Home Building Service to adequately deal with building disputes in NSW.

3.2 Comparisons with the Queensland system for resolving disputes

In its submissions to the Committee, the Builders Collective extolled the virtues of the Queensland dispute resolution model indicating that consumers in NSW are left to spend years in the court system to resolve their disputes.

The dispute resolution system established in NSW in 2003 is almost identical to the regime in operation in Queensland, except for the fact that in Queensland a builder can dispute a rectification order issued to him and take the matter to the Commercial & Consumer Tribunal. In NSW a builder issued with a rectification order by a Home Building Service inspector must comply with that order and sanctions apply for non-compliance.

In terms of the comparative success of our dispute resolution regime, the Committee's attention is directed to the table presented in section 7.5 of our original submission, which reveals a dispute resolution rate in NSW of 89% in comparison to 74% in Queensland.

3.3 Expertise of Home Building Service Building Inspectors

The Building Action Review Group suggested to the Committee that the building inspectors employed by the Queensland Building Service Authority were of a superior quality to those in NSW. This is simply not the case. The entry requirements for building inspectors in Queensland are exactly the same as in NSW. Both States have the holding of a building licence as the requisite for employment as a building inspector.

Whilst holding building licences and related qualifications, the building inspectors in NSW have a range of specialist skills. One inspector hold degrees in structural engineering, others specialise in electrical, hydraulics and other fields. In addition to the skills they bring to the position of building inspector, they have received substantial training in dispute resolution and technical issues. All inspectors have completed the LEADR mediation training course and many have received accreditation. The inspectors also receive continuing training to ensure that they are up to date with the latest building technology, practices and codes.

In attempting to mediate extremely complex matters, the Home Building Service has, from time to time, engaged the services of other experts from the private sector or the Government Architect's Office. The Home Building Service will continue to call on this expertise when required. However, in the vast majority of cases this is not required and the skills, qualifications and experience of the Home Building Service inspectors makes them more than capable of dealing with these cases. Again, the Committee's attention is drawn to table 7.5 of our original submission, which provides evidence of the effectiveness of the

building inspectors employed within the Home Building Service.

4 The exercise of disciplinary powers

During the course of the public hearings, both the Builders Collective and Building Action Review Group suggested that the Home Building Service was not effective in its use of disciplinary powers under the *Home Building Act 1989*. Once again the Committee's attention is drawn to table 7.5 of our original submission to the Inquiry.

The statistics contained in this table indicate that the Home Building Service has been, in real terms and comparatively, rigorous in its use of the disciplinary powers conferred by the legislation with 12 disqualifications and five suspensions during the course of 2005/2006. These actions do not include the 105 licences cancelled during the same year following the ICAC's investigation – Operation Ambrosia.

The Home Building Service is properly exercising the disciplinary powers provided by the legislation as demonstrated by data and evidence given by other stakeholders to the Inquiry.

4.1 *The enforcement of relevant legislative and regulatory programs*

During the course of the public hearings both the Builders Collective and Building Action Review Group suggested that the Home Building Service was not effective in its enforcement of the legislative requirements and regulatory programs. Again the Committee's attention is drawn to section 7 of our original submission to the Inquiry.

Section 7 of our original submission clearly demonstrates a substantial increase in the enforcement activity since the establishment of the Home Building Service. In summary this includes:

- 10 major compliance programs resulting in the issue of 1,056 penalty notices;
- the completion of over 1,600 compliance investigations;
- the prosecution of 289 offences resulting in fines and penalties totalling over \$500,00;
- the issuing of penalty notices to 1,300 for 1,700 offences totalling over \$720,000;
- 206 disciplinary actions resulting in 39 individuals having their licences suspended, cancelled or disqualified; and
- major prosecutions and injunctions resulting in the issuing of jail sentences.

Evidence to the Committee from the Master Builders Association and the Housing Industry Association was complementary of the increased compliance activity undertaken by the Home Building Service.

Again, the suggestion that the Home Building Service is not adequately enforcing the legislative requirements is clearly not supported by both the statistics and evidence given by other stakeholders to the Inquiry.

5 Other matters

5.1 *Independent building commission and licensing fee revenue*

In both written and oral submissions made to the Inquiry a number of stakeholders suggested the need to establish an Independent Building Commission. Our original submission outlined that the reason for not proceeding with the establishment of such an entity was on the basis of cost.

In its supplementary submission to the Inquiry, the Master Builders Association suggested that, given the level of licensing revenue received and remitted to Treasury, the rationale for not establishing an Independent Building Commission could not be argued on the basis of cost.

The Master Builders Association's position in this regard is based upon a common misunderstanding of the revenue collection and funding of the operations of the Office of Fair Trading and Home Building Service.

The Office of Fair Trading (including the Consumer, Trader & Tenancy Tribunal) administers home building related legislation as part of its operational responsibilities. In 2006/2007, it cost \$32m to regulate home building and also provide dispute resolution services to consumers and builders.

In the same period home building licensing fees are expected to generate revenue of \$32m to meet the costs of regulation of the industry, including:

- home building inspectors across the state
- home building investigators across the state
- administration of a licensing regime that covers over 167,000 licensees holding over 250,000 authorities
- Fair Trading Centres to deal with home building complaints and licence applications received
- funding for the Consumer, Trader and Tenancy Tribunal
- the Home Warranty Insurance Scheme Board
- insurance complaint handling.

Revenue received from home building licensing is being fully expended on the regulation and administration of the home building industry in NSW.

6 Conclusion

In a relatively short period of time the Home Building Service has delivered substantial service improvements, particularly in compliance and licensing. It is our submission that

the factual evidence to the Committee, when viewed objectively, reveals that the establishment of the Home Building Service has delivered the service level improvements sought by the Campbell Inquiry in 2002.

The factual evidence as presented to the Committee provides no evidence of systemic failure of either the Home Building Service, the dispute resolution or the home warranty regimes in operation in NSW. Nor does the evidence suggest that there would be an appreciable benefit to the consumers and traders of either introducing an independent building commission or returning to a Government underwritten insurance scheme.

Notwithstanding this, the Office of Fair Trading and Home Building Service acknowledge that more work needs to be done and further improvements made. We know the direction we need to head and remain open, willing and eager to work with stakeholders, including the Building Action Review Group, to improve the building regulatory regime in NSW.