Submission No 130

INQUIRY INTO REGULATION OF BUILDING STANDARDS, BUILDING QUALITY AND BUILDING DISPUTES

Organisation: SecureBuild

Date Received: 1 August 2019

SecureBuild
Build with confidence

31 July 2019

Ms Rebecca Main
Director | Upper House Committees
Legislative Council – Parliament of New South Wales
Macquarie Street,
SYDNEY NSW 2000

SUBMISSION TO PUBLIC ACCOUNTABILITY COMMITTEE

Dear Ms Main,

I write in relation to the Public Accountability Committee's *Inquiry into the regulation of building standards, building quality and building disputes* and to lodge an initial submission to assist the committee with its inquiry into these matters.

I have worked in the building and construction industry in Australia and New Zealand for over fifty years and have spent the last twenty years as a broker of home building compensation (formerly home warranty insurance). Accordingly, I am well placed to provide the committee with information relating to the building industry from both a historical and contemporary perspective.

I am lodging this submission on behalf of SecureBuild Australia (SecureBuild). SecureBuild has developed a new and innovative home building compensation offering that has been designed to:

- Significantly increase consumer protection;
- Provide effective support to builders;
- Produce better building outcomes;
- Significantly reduce defects and overpayments by homeowners;
- Significantly, reduce claims and claims exposures;
- Deliver a profitable and sustainable scheme with lower premium; and
- Ultimately provide cover to the owners of high-rise apartments

Our submission primarily focuses on the adequacy of consumer protection for owners and purchasers of new apartment and dwellings and, in particular, the inadequacy of the current home building compensation scheme. Our submission is enclosed for the committee's attention.

In summary, the level of consumer protection afforded to homeowners by home building compensation has been slowly eroded over the past two decades, firstly in an attempt to keep private insurers in the market and subsequently due to poor management of the scheme.

The purchasers of apartments in building complexes greater than three storeys in rise have been left completely unprotected since 2003. Whilst the NSW Government's Developer Bond Scheme, introduced on 1 July 2018 was intended to address this issue, many in the industry agree that the protection afforded by this arrangement is inadequate.

The building industry has changed significantly over the past three decades and many of the changes have significantly increased in the risk profile of the industry from an insurance perspective. However, the approach to providing consumer protection via the use of home building compensation has, unfortunately, changed very little in that time resulting in significant scheme deficits that now require the support of taxpayers.

Up until the late 1980's and early 1990's the operating risks associated with the building and construction industry and its risk profile were low and confidence in the building and construction industry was strong.

In this era builders built predominately low-rise, non-complex, single dwellings; to prescriptive building codes and standards; utilising trades contractors who had come through robust apprenticeship and vocational training processes; and utilised standardised building methods and products.

Their projects were overseen by independent (Clerk of Works) council building inspectors in addition to inspections from quantity surveyors from banks and financial institutions, which provided a robust quality assurance mechanism ensuring optimal building outcomes whereby defects were identified early and remedied prior to completion.

There was also a strong, effective and independent regulator (the Building Services Corporation) focused on ensuring industry compliance with licensing, contracting and statutory warranty requirements in addition to administering the then home warranty insurance scheme. Financial institutions also played a role in ensuring quality assurance was a key component of the building process.

Within this setting, building defects and disputation was low and consumer protection included the provision of home warranty insurance for all residential building work, including high-rise projects.

Today, builders now build significantly more complex, medium and high-rise projects; to performance-based alternative solutions; utilising trade contractors who, due to skill shortages, rely heavily upon employees or subcontractors who have not come through Australia's vocational training system whereby they have not been education in relation to the NCC and applicable standards; and, are using increasingly changing and innovative building methods and products.

Their projects are overseen predominantly by Private Certifying Authorities (PCA's) who have questionable independence from developers; are not well supported in their task by regulatory authorities and are not appropriately remunerated to undertake the quality assurance role required of them in order to provide an effective quality assurance process. Additionally, banks and financial institutions have curtailed their oversight of building projects.

As a result of failing to adjust to the significant changes in the building and construction industry the home building compensation scheme sustained significant deficits leading to the NSW Government's attempts to reform the scheme in 2016.

As mentioned previously, SecureBuild developed a home building compensation product that significantly increases consumer protection and ultimately could be made available to the purchasers of apartments in high-rise buildings. However, our product will not be made available to consumers as the NSW Government was not able to convince the Australia Prudential Regulatory Authority (APRA) to allow non-insurers to provide home building compensation products as intended via the amendments made to the *Home Building Act 1989* in June 2017.

Given the present situation the NSW Government has a number of alternatives available to it to improve the protection HBC affords to homeowners, these include:

- Fully implementing its original reforms for the scheme by seeking an amendment to Schedule 2 of the Commonwealth *Insurance Regulations 2002*; or
- Enhancing the provision of HBC by iCare by requiring it adopt new and innovative approaches to the management of risk; and
- Enhancements to the Developer Bond Scheme administered under the *Strata Schemes Management Act 2015*

The risk profile of the building and construction industry would also benefit significantly from:

- Implementation of higher qualifications for builders of medium density and high-rise building (similar to the tiered approached to licensing in Victoria and Queensland);
- Greater use of industry data to target Continual Professional Development (CPD) courses for all building practitioners;
- Regulator focus on sub-contractor accountability and capability;
- A 'one-stop-shop' approach to regulation with a single industry regulator;
- Greater accountability of building professionals (building designers and engineers) as proposed by the NSW Government and Shergold Weir report;
- A central register of all building work undertaken in NSW which retains building plans and all declarations made by relevant building practitioners for future access by owner's corporations and home purchasers;
- Implementing a framework whereby PCA's are supported by the industry regulator; and
- Introduction of a PCA allocation scheme for developer projects as a means of eliminating conflict of interest issues.

I would be more than happy to attend the Committee's hearing to provide further detail. Please feel free to contact me regarding any aspect on my submission.

Yours sincerely,

Mr Philip Randall Sim
Executive Director

SUBMISSION

New South Wales Legislative Council

Public Accountability Committee

Inquiry into

Regulation of building standards, building quality and building disputes

July 2019

1 HISTORY OF BUILDING REGULATION IN NSW

The building and construction industry in New South Wales has been regulated by Government since the early 1970's. A brief chronology of building regulation in New South Wales is enclosed at **attachment 1**.

Up until the late 1980's and early 1990's the operating risks associated with the building and construction industry and its risk profile were low and confidence in the building and construction industry was high.

In this era builders built:

- predominately low-rise, non-complex, single dwellings;
- to prescriptive building codes and standards;
- utilised trade contractors who had come through robust apprenticeship and vocational training processes; and
- using standardised building methods and products.

Their projects were overseen by independent (Clerk of Works) council building inspectors in addition to inspections from quantity surveyors from banks and financial institutions, which provided a robust quality assurance mechanism ensuring optimal building outcomes. Within this quality assurance framework defects were identified early and remedied prior to completion.

There was also a strong, effective and independent regulator (the Building Services Corporation) focused on ensuring industry compliance with licensing, contracting and statutory warranty requirements in addition to administering the then home warranty insurance scheme.

Within this setting, building defects and disputation was low and consumer protection included the provision of home warranty insurance for all residential building work, including high-rise projects.

Today, builders now build:

- significantly more complex, medium and high-rise projects;
- to performance-based alternative solutions;
- utilising trade contractors who, due to skill shortages, rely heavily upon employees or subcontractors who have not come through Australia's vocational training system whereby they have not been education in relation to the NCC and applicable standards; and
- are using rapidly changing and innovative building methods and products.

Their projects are overseen predominantly by Private Certifying Authorities (PCA's) who:

- have questionable independence from developers;
- are not well supported in their task by regulatory authorities; and
- are not appropriately remunerated to undertake the quality assurance role expected of them by consumers and regulators.

Additionally, banks and financial institutions have significantly curtailed their oversight of building projects.

While the building industry has changed significantly over the past three decades, the approach to providing consumer protection via the use of home building compensation has changed very little and, despite repeated inquiries and reviews, regulatory frameworks have diminished.

As was the case around the world, during the late 1990's National Competition Policy ushered in an era of deregulation of many market sectors in Australia and the building and construction industry was not immune from this pervasive wave of policy reform.

Additionally, the strong and pervasive aspiration for home ownership by Australians saw all political parties support deregulation policies under the guise of 'red tape' and 'regulatory burden' reduction.

The changing nature of industry and its workforce, as outlined above, together with this deregulatory cycle combined to create a 'perfect storm' resulting in the unacceptably high risk profile of the industry that we see today.

The unwillingness of insurance underwriters to re-enter the home building compensation market in NSW and their withdrawal from providing professional indemnity insurance for building professionals are clear indications that the industry's risk profile has reached a level requiring the Government to take corrective action to address distortions leading to market failure.

2 HOME BUILDING COMPENSATION IN NSW

As outlined above, the risk assessment of the industry carried out by insurance underwriters provides an excellent barometer of the health of the building and construction industry. Accordingly, the withdrawal of all private insurers from the then home warranty insurance market in 2010 should have acted as a warning as to the need for strengthening the regulatory framework of the building and construction industry in New South Wales.

The protection of homeowners from the financial losses that can occur as a result of building or buying a home has been around almost as long as regulation of the industry.

Home Building Compensation (HBC), formerly known as home warranty insurance, has had a vexed and challenging history. A brief historical chronology on HBC is enclosed to this submission as **attachment 2.**

Over the past twenty years, successive Governments have introduced reforms to HBC largely designed to keep private insurers in the HBC market. Notwithstanding the objective, each reform has resulted in an erosion of the consumer protection provided to homeowners in NSW.

Following the collapse of FAI/HIH in 2001, the NSW Government introduced the most significant of the reforms to HBC when amendments were made to the *Home Building Act 1989* in 2002 which included:

- moving from a "first resort" to "last resort" scheme;
- cover only being provided in the event of the death, insolvency or disappearance of the builder; and
- the period of cover was reduced from seven years to six years after completion of construction.

In December 2003, the requirement for HBC insurers to provide cover to owners of apartments in buildings higher than three storeys in rise was introduced.

These reforms were successful in enticing five private insurance underwriters to enter the HBC market.

In May 2009, HBC protection was strengthened by allowing a claim to be made in circumstances where NSW Fair Trading had suspended the licence of a builder who had failed to pay a court or tribunal money order.

As a result of strong competition amongst insurance underwriters for a greater share of the market, between 2005 and 2008 HBC premiums fell significantly to unsustainable levels. A combination of unsustainable premium levels and the global financial crisis saw private insurance underwriters exit the market in 2010 with the NSW Government's Self Insurance Corporation commencing to underwrite the provision of HBC.

From 2010 to 2017 the Self Insurance Corporation (and its successor iCare) failed to lift premiums to sustainable levels. As a result of failing to adjust premium levels and employ greater levels of risk mitigation, the home building compensation scheme sustained significant deficits.

In July 2014, the name of the product was changed from home warranty insurance to home building compensation HBC and cover for dwellings constructed by owner builders was removed from the scheme.

3 HBC SCHEME PERFORMANCE

In developing its new and innovative approach to providing HBC, SecureBuild and its actuary completed a comparative analysis of the HBC schemes operating in NSW, Victoria and Queensland. The outcome of that analysis is outlined below.

When compared to the HBC schemes operating in Victoria and Queensland, the HBC scheme in NSW is performing poorly. The number of HBC claims, average claim costs and claims costs per 1000 homes constructed in NSW, Victoria and Queensland since 2002 are set out in Table 1 below.

	Victoria				NSW				QLD			
	Claims	%	Ave cost per claim	Cost per 1000 homes	Claims	%	Ave cost per claim	Cost per 1000 homes	Claims	%	Ave cost per claim	Cost per 1000 homes
Failure to commence	189	2.30%	$18,460	$4.49	248	3.89%	$23,310	$9				
Failure to complete	1,918	25.20%	$60,806	$150	1700	26.65%	$83,699	$227	4,722	20.76%	$22,989	$187
Structural defect	3,117	52.70%	$40,085	$161	3333	52.25%	$101,001	$536	11456	79.24%	$21,336	$336
Other (non-structural) defect	1,169	19.30%	$26,795	$40	424	6.65%	$52,073	$35	6562			
Total	**6,393**	**100.00%**	**$43,232**	**$356**	**5705**	**100.00%**	**$88,831**	**$807**	**22740**	**100%**	**$13,342**	**$523**

Table 1 Claims outcome data for NSW, Vic and Qld 2002-18

First resort HBC scheme

Due to existence of a 'first resort' scheme in Queensland the number of HBC claims in that State is much higher than NSW and Victoria. However, the average claims costs in both Victoria and Queensland are significantly lower than NSW.

The average cost of claims in Victoria is more than 50% lower than NSW and Queensland's cost of HBC claims is 150% lower than NSW.

NSW	VIC	QLD
$88,831	$43,232	$13,342
	-48%	-150%

Table 2 Home Building Compensation average claim size 2002-19

When construction volumes are taken into account, the HBC claims cost per 1000 homes in NSW is significantly higher than Queensland's 'first resort' scheme outcomes. The difference between the HBC claims cost outcomes in NSW in comparison with a more similar HBC scheme, such as Victoria is even more significant (see figure 1 below).

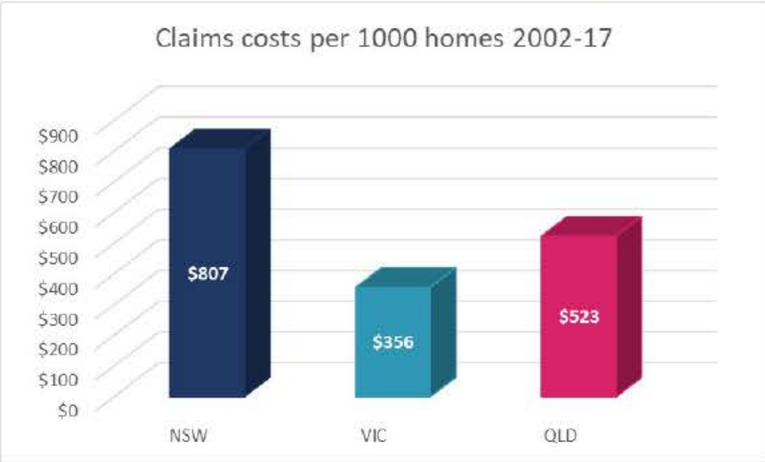

Figure 1 HBC claims in Victoria, NSW and Queensland 2002 to 2017.

Perhaps most significantly, the HBC claims data reveals a much higher level of claims attributable to 'major defects' in NSW when compared to Victoria and Queensland (see figure 2 below).

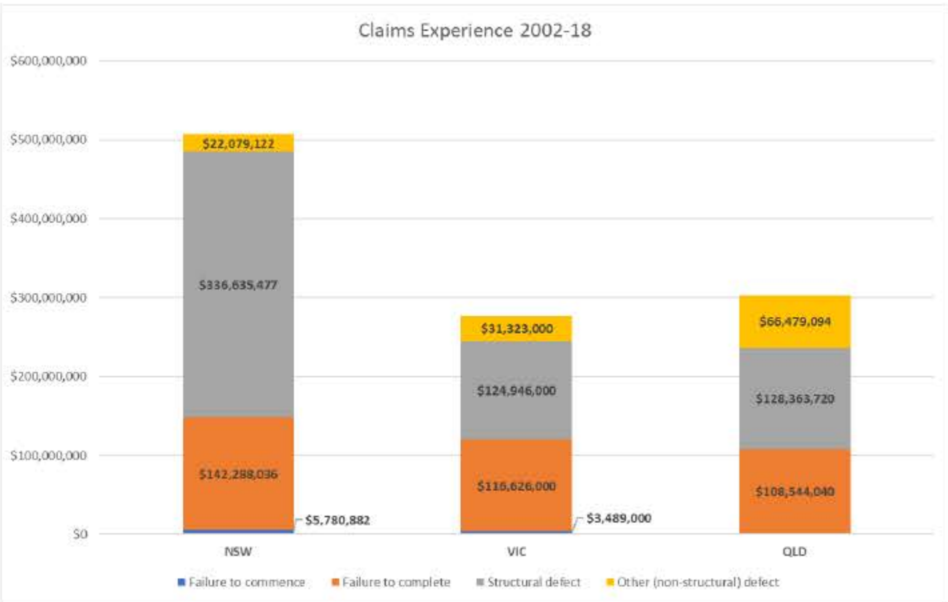

Figure 2 Total HBC claims cost comparison breakdown NSW, Victoria and Queensland (2003-04 to 2016-17).

As a result of the scheme comparatively poorer performance, the HBC premiums for consumers in NSW are substantially higher than in Victoria and Queensland (see table 3 below).

Jurisdiction	Premium for $500,00 single dwelling (2019)	% Difference
NSW	$5,695.25	
Victoria	$3,158	-44.5%
Queensland	$4,883.25	-14.3%

Table 3 HBC premium comparison

HBC premiums in NSW now represent over 1% of the contract price for a single dwelling and in excess of 3% for multi-dwellings. Premiums have risen by 60% over the past two years with iCare indicating that a further premium increase will occur by the end of the 2018-19 financial year.

Further detail setting out the rationale for substantially reforming the HBC in New South Wales is set out within **attachment 3**

4 ATTEMPTS TO REFORM HOME BUILDING COMPENSATION

In 2015 the NSW Government indicated that the HBC scheme's deficit had reached $398m, and to its credit, commenced a consultation process seeking ideas on how to reform the scheme.

Our company, SecureBuild, lodged a submission as part of the consultation process indicating that, given the vexed history of the scheme and its failure to adequately protect consumers, new and innovative approaches to the provision of HBC were required. More specifically, our submission indicated that providers needed to provide HBC products that mitigated the significant risk of defects and prepayments in the industry.

In November 2016, the NSW Government announced a range of reforms to the HBC scheme, including:

- Splitting HBC into to separate contracts of cover (one covering the 'construction period' and the other covering the post construction 'warranty' period); and
- Allowing private insurance underwriters and non-insurers to enter the market to provide innovative HBC products.

In June 2017 the NSW Parliament passed amendments to the *Home Building Act 1989* allow for private providers (including alternative indemnity providers) to enter the HBC market.

In December 2017 the *Home Building Regulation 2014* is amended, and guidelines are published by the NSW State Insurance Regulatory Authority (SIRA) allowing for the commencement of the reforms to HBC on 1 January 2018.

In February 2018 the Australian Prudential Regulatory Authority (APRA) indicates that, despite the amendments made to *Home Building Act 1989* by the NSW Government, "Alternative Indemnity Providers" were captured by the Commonwealth's *Insurance Act 1973* and deemed insurance businesses thereby subject to regulation by APRA.

APRA's position effectively meant that, unless:

- The NSW Government sought an amendment to Schedule 2 of the Commonwealth *Insurance Regulation 2002*; or
- Individual exemptions are granted to HBC Alternative Indemnity Providers,

only insurance underwriters licensed by them could enter the HBC market in NSW. This is despite similar arrangements operating in the Northern Territory and the Australia Capital Territory.

SecureBuild lodged an exemption application with APRA in October 2018 and they indicated that they will not provide Alternative Indemnity Providers with an exemption from the *Insurance Act 1973* as, in their view, the prudential framework established by the NSW State Insurance Regulatory Authority (SIRA) was not adequate to protection policy HBC holders.

Our view is that APRA did not fully understand SIRA's prudential requirements, which actually mirrored theirs.

Unless the dual regulatory issue with APRA is resolved:

- there will be no new entrants into the HBC market in NSW;
- homeowners will not be given the opportunity of experience superior consumer protection;
- scheme performance will not improve; and
- premiums will continue to increase.

5 SECUREBUILD'S APPROACH TO THE PROVISION OF HBC TO CONSUMERS

SecureBuild has developed a new and innovative home building compensation offering that has been designed to:

- Significantly increase consumer protection;
- Provide effective support to builders;
- Produce better building outcomes;
- Significantly reduce defects and overpayments by homeowners;
- Significantly, reduce claims and claims exposures;
- Deliver a profitable and sustainable scheme with lower premium; and
- Ultimately provide cover to the owners of high-rise apartments

Whereas the failure of the current approach to providing HBC comes from solely focusing on a builder's financial status (that can change at any time), SecureBuild's approach to providing HBC products was designed to mitigate the risk of a homeowners sustaining a loss as a result of building defects, overpaying or prepaying their builder.

In summary, SecureBuild's HBC product offering involved the following elements:

- Allocating a build inspector to each building project to support the homeowner and provide feedback to their builder;
- The building inspectors would conduct inspection at critical stages and, should the building work by complete and free of defects, they would notify the homeowner to pay their builder's progress claim payment;
- Where defects or incomplete building work was detected, the building inspector would advise the homeowner not to pay their builder's progress claim payment and provide the builder with a defects list;
- Once defects/incomplete work had been remedied the building inspector would reinspect;

- Building inspectors would also assist in quickly resolving and misunderstanding or dispute between the builder and the homeowner; and
- SecureBuild's building inspectors would ensure that trade contractors where aware of and had an up-to-date understanding of the National Construction Code and Australian Standards that were applicable.

Research by its actuary supported the proposition that SecureBuild's approach could reduce defect and claims costs by at least 40%.

Further details regarding SecureBuild's proposed innovative HBC product offering is set out within **attachment 4.**

6 THE WAY FORWARD FOR HOME BUILDING COMPENSATION

Given the present situation the NSW Government has a number of alternatives available to it to improve the protection HBC affords to homeowners, these include:

- Fully implementing its original reforms for the scheme by seeking an amendment to Schedule 2 of the Commonwealth *Insurance Regulations 2002*; or
- Enhancing the provision of HBC by iCare by requiring it adopt new and innovative approaches to the management of risk; and
- Enhancements to the Developer Bond Scheme administered under the *Strata Schemes Management Act 2015*.

7 PROPOSED REFROMS TO REDUCE RISK AND IMPROVE OUTCOMES

The risk profile of the building and construction industry would also benefit significantly from:

- Implementation of higher qualifications for builders of medium density and high-rise building (similar to the tiered approached to licensing in Victoria and Queensland);
- Greater use of industry data to target Continual Professional Development (CPD) courses for all building practitioners;
- Regulator focus on sub-contractor accountability and capability;
- A 'one-stop-shop' approach to regulation with a single industry regulator;
- Greater accountability of building professionals (building designers and engineers as proposed by the NSW Government and Shergold Weir report);
- A central register of all building work undertaken in NSW which retains building plans and all declarations made by relevant building practitioners for future access by owner's corporations and home purchasers (similar to the reporting framework proposed by the NSW Government and Shergold Weir report);
- Implementing a framework whereby PCA's are supported by the industry regulator; and
- Introduction of a PCA allocation scheme for developer projects as a means of eliminating conflict of interest issues.