NEWS

Home Warranty Insurance

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Home warranty insurance is mandatory, but in most states many consumer protection measures have been whittled away over the years.

Home warranty insurance - also known as builders' warranty, building, housing or home indemnity insurance - was originally intended as a consumer safeguard to protect you from financial loss when your builder failed to complete the work or meet certain standards. It's still in place and mandatory.

But in the states where it's privately underwritten (everywhere except Queensland and the NT), so many important protection measures have fallen by the wayside lately that the term 'insurance' seems a misnomer in the way you'd normally understand the word.

The two largest private home warranty insurance schemes (in NSW and Victoria) are broadly similar and account for about 75% of the nation's home warranty insurance market. In both states the government-run schemes were privatised in the mid 1990s.

At the time, FAI, which was later bought by insurance giant HIH, was the major insurer of home warranty risk in Australia. Its collapse in March 2001, together with the attacks of September 11 and a downturn in international share markets, plunged the international insurance market into upheaval and in Australia left a large number of builders looking for insurance cover from a decreasing number of insurers.

To placate insurers and ensure builders could still obtain insurance, the state governments in Victoria and NSW agreed in 2002 to introduce some changes to the home warranty legislation, including making it 'last resort', raising the threshold for compulsory insurance, reducing the period of cover, excluding buildings above three storeys, and limiting maximum insurance payouts and cover.

By the end of 2002, only two companies were left that offered home warranty insurance for residential building work in NSW and Victoria: Vero (a subsidiary of the Promina Group), underwriting around 80% of the Australian market (in May 2004), and Australian International Insurance covering the rest. At the time of writing in May 2004, a new insurer, CGU (a member of the Insurance Australia Group), had just entered the market in NSW and Victoria.

For builders

Many of the builders we spoke to who have small and medium-size businesses experienced a lot of problems during the past years of upheaval on the insurance market. They had to endure long delays while their applications for insurance eligibility were being processed and while this was going on were unable to build and earn a living.

The major insurer, Vero, admitted that there could have been delays after the HIH collapse, but emphasised that at the time of writing waiting periods had been reduced to less than 20 days on average for eligibility applications and less than 48 hours for project insurance once a builder's eligibility had been approved.

Another reason for resentment among the builders we spoke to was the strict financial tests the insurers introduced to establish eligibility for insurance. Under a 'last resort' scheme, an insurer carries very little risk, yet all projects they underwrite have to be backed up by sufficient capital from the builder. This capital is required to help prevent insolvencies, and if they do occur is used to settle the claim. If builders hold insufficient assets in their business, they have to provide a bank guarantee or pledge.

...and home owners

The problems experienced with getting insurance didn't stop there. While waiting for insurance approval, builders' clients had to put their projects on hold, shelve their plans or get new quotes from builders with more assets who already had insurance - and then, possibly, accept more expensive contracts.

Unable to fulfil their insurer's financial tests, some smaller builders had to leave the industry or start working for larger building companies. This waning competition in the home renovation market is one factor that has driven up costs in recent years; higher insurance premiums are yet another.

Home warranty insurance premiums have increased considerably over recent years. But at the time of writing, just before the third insurer entered the NSW and Victorian markets, Vero had introduced premium cuts and discounts of 5-30% and a simplified insurance product for small to medium-size builders.

Some of the exemptions in the mandatory insurance scheme can also spell problems for consumers. High-rise residential buildings (with more than three storeys) are exempt, so if you buy an apartment in a high-rise off-the-plan, check out the reputation of the builder or developer carefully and make sure your deposit is held in trust and only released on completion.

If the high-rise was recently completed, your contract should have defect liability inclusions and include all necessary building certificates and inspection reports. You might also consider having a pre-purchase inspection done to identify possible problems and check out the owners' corporation or body corporate records if it's not brand new.

Owner-builder work, too, is exempt from the insurance requirement, unless the home is sold within six years, in which case owner-builders also need insurance. Builders claim this is being used as a loophole by those who can't get insurance to circumvent the requirement. Beware if a builder suggests you split contracts and take out an owner-builder licence, which means you take on the responsibility for the building or renovation work yourself.

Not even a last resort

The most recent of several government inquiries into home warranty insurance reported late last year that home owners in NSW were dissatisfied with the 'last resort' aspect of the insurance scheme and didn't understand its purpose. We're not surprised. While you (through the builder) have to pay for this compulsory insurance, in most states you can't just make a claim when something goes wrong. The insurance only kicks in when the builder has died, disappeared or become insolvent.

This clause isn't only unexpected and confusing for consumers, it makes a mockery of consumer protection, leaving you without insurance cover when the builder is still around but has failed to work to standard or complete the project. In such a case you're expected to use other avenues to recover your loss - directly from the builder or through the dispute resolution procedures of the NSW Home Building Service or Building Advice and Conciliation Victoria, consumer tribunals and the courts.

So, many consumers are essentially uninsured against what they think they're insured against - incomplete or shoddy work - because of the 'last resort' clause.

Insurance Queensland-style

The problems discussed elsewhere in this report concern those Australian states where home warranty insurance is privately underwritten - everywhere except Queensland and the NT. In the NT, only a limited form of home warranty insurance is mandatory and the Territory government underwrites the risk by default, so to speak, because insurance companies have shown no interest in the small market.

In Queensland, the government underwrites home warranty risk. The Building Services Authority (BSA) regulates the industry and has overall responsibility for licensing, dispute management and home warranty insurance. Unlike in other states, if builders fulfil the licensing requirements in Queensland, they'll automatically be able to get insurance: the BSA's licensing and insurance arms are linked. For the financial soundness test, builders have to provide proof that they have the financial capacity to continue to trade. But they don't have to provide a financial guarantee or pledge their assets, as insurers demand of builders in other states.

In recent years, Queensland's home warranty insurance premiums have been well below those in most other states. Some of the builders we spoke to in NSW and Victoria said the premiums they had to pay (before cuts and discounts were introduced in May) were around two to three times more than they'd be for a similar project in Queensland, where premiums are capped at $1280.

And for the lower premiums they have to pay, Queensland consumers get much more comprehensive insurance than people in other states. It's the only scheme in Australia that compensates for subsidence and settlement, and it's 'first resort' - you have access to the insurance if the builder fails to complete or rectify defective work, even if they're still trading.

The current privatised home warranty scheme as it operates in most Australian states appears to primarily benefit insurers and larger building companies at the expense of consumers and smaller builders. A Queensland-style system offers much higher levels of protection for consumers as well as being easy to access for builders. But if you live outside Queensland, there's very little you can do about this - short of moving to the sunshine state - except to lobby your local member to pressure the government to return to a state-run building services scheme that also underwrites home warranty risk.

How the insurance works

The legislative requirements for home warranty insurance vary from state to state, but are broadly similar in the states where it's privately underwritten (everywhere except in Queensland and the NT). The requirements mentioned below are those that apply in NSW and Victoria, which together account for about 75% of the nation's home warranty insurance market.

Home warranty insurance is compulsory - the builder has to have it and will charge you, perhaps indirectly, for the premium they pay. Builders have to take it out for residential building projects worth $12,000 or more.
Before they commence work, builders must let home owners know the insurance company that'll underwrite home warranty risk - in NSW they must provide the original insurance certificate and in Victoria they have to provide the details in the contract.

The insurance is valid for the construction period and six years afterwards, for structural defects.

In all states except Queensland and the NT, it's a privately underwritten 'last resort' scheme, which means you can only make a claim if the builder has died, disappeared or become insolvent. This is a major disadvantage to the consumer.

The maximum amount you can claim for incomplete work is 20% of the contract value, with a $200,000 limit.

Owner-builder work worth more than $12,000 is exempt from the insurance requirement, unless the home is sold within six years of completion.

Buildings above three storeys are also exempt.
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