

Chapter 3

Issues raised by builders

3.1 The main issues or claims in submissions from builders were:

- difficulty getting insurance; with a general argument that it is not right that unaccountable private insurers effectively act as gatekeepers on behalf of state licensing authorities;
- alleged oppressive behaviour by insurers such as unreasonable caps on turnover or unreasonable demands for security;
- difficulty getting insurance is encouraging builders to withdraw from the industry, or not enter it, adds to an existing skills shortage;
- the need for insurance encourages working outside compliance, such as with sham owner-builder arrangements.

Claimed difficulty getting insurance

3.2 Some submissions from builders complained about difficulty getting insurance. A closely related complaint is that turnover caps which insurers impose are too restrictive. For example:

The cost of obtaining such insurance for builders is often prohibitive in terms of bank guarantees or personal securities, with a business limited by the constraints imposed by the insurance company. Insurance companies can quite literally cripple a builder's ability to trade, and the constant implied (if not overt) threat of a decreased ceiling means it is extremely difficult to plan strategically.¹

3.3 Some submissions objected to the fact that, as they see it, insurers have become de facto regulators:

The rights of the small to medium builder were assigned to the insurance industry who is now the defacto regulator and decides who will build, when, and to what level.²

3.4 Availability of insurance was certainly a significant problem in the aftermath of the HIH collapse in 2001. However it appears that for most the problem has passed.³ Vero, the largest home warranty insurer, advised that in the years since 2002 it has refused 2-4 per cent of applications for eligibility, and the rate is now about 2

1 Submission 78, confidential.

2 Submission 114, Builders Collective of Australia, p.3

3 For example, see Victorian Competition and Efficiency Commission *Housing Regulation in Victoria - building better outcomes*, October 2005, p.212

per cent.⁴ On the matter of turnover caps, Vero advised that historically utilisation of turnover limits has not exceeded 40 per cent.⁵ Vero told an inquiry in 2005 that time to approve applications for insurance eligibility had reduced greatly, to 25 days, and more than 97 per cent of applicants are accepted for the turnover they request.⁶ Vero told this inquiry that the average time to approve applications for insurance eligibility is now around 1 day.⁷

Bank guarantees and deeds of indemnity

3.5 Submissions from builders complained about insurers' demands for bank guarantees or deeds of indemnity.⁸ The Builders Collective of Australia claimed that 'in all cases the builder must sign an open ended deed of indemnity to obtain insurance eligibility'...

Also in many cases securities must be provided such as open ended Bank guarantees and maintained on an annual basis at a cost of 2.5% of the face value of the guarantee.⁹

3.6 Some submissions complained that having deeds of indemnity still on foot during the statutory warranty period (typically six years) makes it difficult for the builder to shop around for another insurer (a second insurer would be reluctant to deal while the first insurer has a higher priority security). They also complained that insurers retain open-ended bank guarantees even after the statutory warranty period has ended (that is, after the possibility of incurring a claim cost has ended). For example the Master Builders Fidelity Fund (ACT) said:

We had lots of our builders through previous insurance schemes that still have bank guarantees that are not being paid back. This is despite the fact that the statutory warranty period is long past.¹⁰

3.7 The NSW Office of Fair Trading (OFT) advised in late 2006 that there were 640 bank guarantees or securities held by an insurer, which represents 5.2 per cent of NSW builders who have HWI eligibility. In the latest OFT home warranty insurance report, 11 per cent of builder eligibilities were secured, and 'since the June 2006

4 Vero Insurance Ltd, correspondence 13 October 2008.

5 Vero Insurance Ltd, confidential additional information 23 June 2008, p.3

6 Victorian Competition and Efficiency Commission, *Housing Regulation in Victoria - building better outcomes*, October 2005, p.225

7 Vero Insurance Ltd, correspondence 31 October 2008.

8 Deed of indemnity: the signatory indemnifies the insurer directly against costs arising from claims. Bank guarantee: the bank guarantees to pay the insurer up to a certain amount on demand. The bank then recovers from the signatory.

9 Builders Collective of Australia, submission 114, p.3

10 Mr J. Howard, Master Builder Fidelity Fund, *Committee Hansard* 13 June 2008, p.53. Similarly Builders Collective of Australia, submission 114, p.3.

quarter there has been a shift from bank guarantees to indemnities and multiple securities as preferred form of security.¹¹

3.8 The authorities and the industry groups seemed to concede that there may be problems where bank guarantees make it hard for builders to change insurers and/or are being held unreasonably long.¹² Mr McCarthy of the NSW Home Warranty Insurance Scheme Board:

I think there are still some concerns by builders around deeds of indemnity. We are investigating that aspect at the moment to find out where they apply.¹³

3.9 Dr Silberberg of the Housing Industry Association said:

We have, through our broker, made efforts to have guarantees extinguished. We do not condone the practice of holding guarantees after the liability has extinguished.¹⁴

3.10 HIA Insurance Services admitted that 'it is an issue in terms of changing insurance companies. If you have your security issued with one insurance company, that needs to be taken into account as part of your decision to change insurance companies'. And in relation to returning bank guarantees:

A lot of the securities were given post-HIH and so forth, so we really fight hard on behalf of our clients to get those securities back. We will put up our client's financial position to the insurer and say: 'There is no reason for you to keep this security. The builder has enough capital in his business and has a solid enough track record for that to represent reasonable security. Therefore, we don't believe that there's any need for you to continue to hold those securities.' We have been very successful at getting those back, particularly in the competitive environment that we are in, where there are a number of insurers fighting for the business of a builder.¹⁵

11 NSW Office of Fair Trading submission 16a to NSW Legislative Council General Purpose Standing Committee No. 2, inquiry into the operations of the Home Building Service, p.7. NSW Office of Fair Trading, *NSW Home Warranty Insurance Scheme - information on the scheme as at 31 March 2008*, p.5.

12 It appears there are complaints about guarantees being held unreasonably long, and about guarantees being held after the possibility of loss has ended. The second complaint appears to refer to open-ended bank guarantees in which the bank guarantees to pay the insurer unconditionally on demand, then recovers from the signatory. No issue arises with deeds of indemnity which refer specifically to reimbursing claims paid under policies, since the deed becomes irrelevant when the time limit for making claims expires.

13 Mr G. McCarthy (NSW Home Warranty Insurance Scheme Board), *Committee Hansard* 13 June 2008, p.79

14 Dr R. Silberberg (Housing Industry Association), *Committee Hansard* 17 September 2008, p.9.

15 Mr G. Donovan (HIA Insurance Services), *Committee Hansard* 11 August 2008 (in camera), p.17.

3.11 In Queensland the Building Services Authority carries out financial monitoring at licence application, at licence renewal and by audits. Licensees are given turnover limits, and they must meet set liquidity ratios at all times.¹⁶

3.12 Dr Silberberg of the HIA argued that in Queensland every builder has to provide a 'personal guarantee', implying that private insurers' requirements for security are not onerous by comparison. The Queensland Building Services Authority (BSA) replied that the BSA 'does not require personal guarantees'. The HIA clarified that this was a reference to the BSA's statutory power, in all cases, to recover claims payments from directors of a building company 'or any other person through whose fault the claim arose.'¹⁷

Arguments that HWI adds to existing skills shortages

3.13 Some submissions argued that the requirement of home warranty insurance is discouraging builders from entering or staying in the industry, adding to a skills shortage in the building industry.¹⁸

3.14 The Victorian Competition and Efficiency Commission considered the issue in 2005. It noted that the number of registered domestic builders in Victoria hardly changed between 2000 and 2005.¹⁹ At that time Vero said:

During the 2 years between 2001/02 and 2003/04, 'domestic builder unlimited' numbers in Victoria decreased by 5%. Some transferred into the 'domestic builder limited' category and the net reduction was therefore somewhere between 3% and 5%. During the same period, engineers decreased by 3%, commercial builders decreased by 3% and building inspectors decreased by 3%. In the 'domestic builders unlimited' category, it is difficult to detect any significant factors overlaying what appears to be normal industry consolidation of 3%.²⁰

3.15 More recent national statistics on apprenticeships and building employment show no noticeable effect. For example, over the last decade the average annual growth of apprenticeships in construction has been somewhat greater than in most other trade occupations. There was an unusual fall in 2001, presumably related to the HIH collapse and the GST related slump, but numbers have recovered strongly since then:.

16 Queensland Building Services Authority, submission 8, attachment p.2

17 Dr R. Silberberg (HIA), *Committee Hansard* 17 September 2008, p.2. Queensland Building Services Authority, additional information 1 October 2008, p.1. HIA, correspondence 17 October 2008. *Queensland Building Services Authority Act 1991*, s71,111C

18 For example, RDC Constructions, submission 23; Builders Collective of Australia, submission 67, p.3

19 Victorian Competition and Efficiency Commission *Housing Regulation in Victoria - building better outcomes*, October 2005, p.234

20 Vero Insurance Ltd, submission 171 to VCEC Housing Regulation inquiry 2005, p.21

Apprentice and trainee commencements in trade occupations, 1997-2007

ASCO group -	41	42	43	44	45	46	49	total
1997	6,300	7,600	4,900	8,100	6,300	1,400	6,900	41,800
1998	6,500	7,800	5,300	10,300	9,300	1,700	8,100	49,000
1999	6,100	8,800	6,300	12,500	9,800	2,500	9,500	55,700
2000	5,000	8,300	5,700	11,500	9,500	2,800	8,600	51,600
2001	5,300	7,800	5,500	9,600	9,700	3,200	8,200	49,500
2002	6,100	8,100	6,200	12,800	9,700	3,300	8,600	55,100
2003	6,900	10,000	7,400	15,100	10,000	3,000	9,300	61,900
2004	7,900	10,400	9,900	17,700	12,100	3,500	10,400	72,200
2005	9,500	10,400	11,000	17,900	11,600	3,800	10,600	75,000
2006	10,300	10,700	11,900	19,100	12,300	3,300	10,000	77,900
2007	10,600	11,300	12,000	22,100	12,100	3,200	11,300	82,900
annual average growth 1997-2007	5%	4%	9%	11%	7%	9%	5%	7%

ASCO groups:

41 mechanical and fabrication engineering tradespersons

42 automotive tradespersons

43 electrical and electronics tradespersons

44 construction tradespersons

45 food tradespersons

46 skilled agricultural and horticultural workers

49 other tradespersons and related workers

source: National Centre for Vocational Education Research, *Australian Vocational Education and Training Statistics, Apprentices and Trainees*, annual, 2007.

Trade occupations are defined as all tradespersons and related workers (ASCO 2nd edition)

3.16 Similarly, building trades employment showed a decline in 2001 but has recovered strongly since then:

Building and construction industry tradespersons Annual average employment year ending 30 December											
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Aust	295.0	318.4	329.5	341.4	336.3	353.5	380.9	396.6	421.6	448.8	453.9
% ¹		7.9	3.5	3.6	-1.5	5.1	7.7	4.1	6.3	6.4	1.1
NSW	95.8	106.5	113.2	117.7	107.5	117.9	133.8	131.5	128.6	137.7	136.7
% ¹		11.1	6.3	4.0	-8.7	9.7	13.4	-1.7	-2.2	7.1	-0.7
Vic	74.0	86.3	83.4	84.9	88.5	96.1	97.3	101.2	104.7	113.4	112.3
% ¹		16.7	-3.4	1.8	4.2	8.6	1.3	4.0	3.5	8.3	-1.0
Qld	55.3	59.3	64.5	62.3	65.1	66.1	71.7	80.6	98.4	99.8	102.3
% ¹		7.2	8.6	-3.4	4.5	1.5	8.6	12.4	22.1	1.4	2.5
SA	18.9	18.8	18.1	20.9	22.3	23.3	24.8	24.5	25.0	25.9	29.7
% ¹		-0.5	-3.9	15.6	6.6	4.4	6.5	-0.9	2.0	3.6	14.6
WA	36.0	32.8	37.1	39.9	38.5	36.8	37.6	41.8	47.1	53.3	53.0
% ¹		-8.8	13.0	7.6	-3.6	-4.3	2.2	11.1	12.7	13.1	-0.4
Tas	6.2	6.1	6.1	6.2	6.6	6.1	6.8	7.9	7.1	8.5	9.3
% ¹		-2.0	0.4	1.2	6.5	-6.9	10.7	16.3	-10.2	20.9	9.1
NT	3.1	4.3	3.4	3.4	3.1	2.6	3.6	3.5	4.3	4.1	3.7
% ¹		37.1	-19.4	-1.5	-8.9	-17.1	40.2	-3.5	23.9	-3.5	-11.5
ACT	5.7	4.4	3.8	6.1	4.9	4.8	5.5	5.8	6.5	6.0	6.9
% ¹		-23.7	-12.6	60.5	-20.1	-1.5	13.5	5.5	13.0	-7.3	14.9

1. year on year percentage change for the state in the row above.
source: ASB 6291.055.003, Labour Force, Australia, Detailed, Quarterly, Aug 2008

3.17 On the question of whether arrangements discourage new entrants, Vero said in 2005:

BWI does not prevent new suppliers entering the building profession. Since 2003 Vero have offered a product that is available to new builders entering the market... The annual turnover limit and the contract limit for single dwellings are more than sufficient for genuine new entrants. Effectively, new builders need just their vehicle and tools – then they can prove themselves with the first one or two homes they construct... insurers like Vero have recognised the problem and make every attempt to accommodate the genuine, committed builder, no matter their position on the ‘time in industry’ continuum.²¹

Arguments that HWI encourages working outside compliance

3.18 Some submissions argued that the requirement of home warranty insurance encourages builders to work outside compliance - for example, with sham owner-builder arrangements. According to the Builders Collective of Australia:

21 Vero Insurance Ltd, submission 171 to VCEC Housing Regulation inquiry 2005, p.17

All States except Qld are suffering from a non-compliant industry and an enormous increase in owner builder activity. (Qld owner builders under 5%) In Victoria owner builder permits are running at 42% down from 52%, after making it more difficult to obtain one of these permits. These figures are obtained from the Building Commission website, and CAV state more than half the building industry is non-compliant. These facts are repeated in all States and the official figure in NSW in December 2007 show of the 34,000 registered builders only 14,000 hold insurance eligibility.²²

3.19 In reply Vero said:

They [the Builders Collective] use a NSW example of 34,000 licensed builders' compared to 14,000 with HWI eligibility to state that there is systemic non-compliance affecting the competitiveness of compliant builders. They are not comparing 'apples with apples'. There are many licence categories that do not require HWI. NSW is by far the most compliant regime.²³

3.20 The Victorian Competition and Efficiency Commission in 2005 considered owner-builder trend data from 1998 and concluded that the statistics do not support claims that there has been a major shift to owner-builders (in particular, there was no significant change in the trend after the HIH collapse or the 1 July 2002 changes). This was consistent with the findings of the Grellman inquiry in NSW in 2003.²⁴

3.21 Since 2005 owner-builder permits in Victoria have declined greatly, presumably due to new regulations (since 14 June 2005) to limit owner-builder permits to genuine owner-builders (for example a rule that owner-builders are limited to only one home in any three year period).²⁵

3.22 On the other hand, Vero said in February 2008, 'Victoria's "leakage" (of licence fees and HWI premium) from "owner-builder" housing starts has been as high as 45% and, even after a tightening in 2006, remains unacceptably high at 35%'.²⁶ Vero had previously suggested that 'the only permanent solution to this seemingly intractable problem is that all owner-builders, in addition to being subject to the same fee structure as builders, take BWI at the commencement of building - not just if and when they sell the property within the warranty period.'²⁷

22 Builders Collective of Australia, submission 67, p.3

23 Vero Insurance Ltd, correspondence 24 July 2008, p.9

24 Victorian Competition and Efficiency Commission, *Housing Regulation in Victoria - building better outcomes*, October 2005, p.236-8.

25 Owner-builders permits in Victoria in 2004-05: 33,626; in 2006-07: 26,436. Building Commission, annual report 2006-07, p.35

26 Vero Insurance Ltd, confidential additional information 18 June 2008, p.27

27 Vero Insurance Ltd, submission 171 to VCEC Housing Regulation inquiry, 2005.