

Home Warranty Insurance – Why is it such a mess?

Presenter David Bannerman

10 February 2015

T (02) 9929 0226 **F** (02) 8920 2427

M 0403 738 996 **E** dbannerman@bannermans.com.au

A Suite 702, 2 Elizabeth Plaza, North Sydney, NSW 2060

PO Box 514, North Sydney, NSW 2059



Topics to be covered

1. Home warranty insurance a brief history
2. Statutory warranties implied by the Act
3. Statutory warranty time periods
4. First resort insurance from 1 May 1997 to 30 June 2002
5. Last resort insurance from 1 July 2002
6. Time limits for notice of loss or damage
7. Case law on statutory warranty and insurance time limits
8. Completion of Works Provisions
9. Multi-Storey building insurance exemption
10. Recent trends in insurance claims

Introduction

Introductory Comments on the warranty system in NSW:

- Amendments since the warranty system was first introduced in 1997 have progressively written down the exposure of home warranty insurers
- On 20 June 2014, Fair Trading NSW announced that the Government plans to review the warranty systems, with the terms of reference not announced it remains to be seen whether the Government will seek to reduce insurance exposure such through limiting liability for development work

Insurance Fundamentals Spur Reforms

- October 2014, the Fair Trading Minister advised home warranty insurance was costing the NSW Government \$1.5M per week
- Underwriting loss for 2013 was \$58,672,000 and the underwriting loss for 2014 was \$29,591,000
- Recent reforms by the NSW Government appears to be aimed at limiting exposure to claims by retrospectively reducing coverage for building defects
- The NSW Government hasn't used other levers to improve the insurance fundamentals such as by:
 - improving building quality through licensing
 - increasing premiums,
 - addressing poor recoveries which in 2014 were 0.1% of claims paid, or
 - reducing operating costs.

Home Building Compensation Fund

'Home Warranty Insurance Scheme' name changed to **'Home Building Compensation Fund'** from 15 January 2015, under changes to the *Home Building Act 1989*

Government's view was that it needed to correct a perception that the scheme operated in a similar fashion to home or car insurance rather than as a financial safety net.

Building Insurance - History

A brief history of Building Insurance in NSW *

- **1972 to 30 April 1992, Government administered insurance scheme.** Cover for defects was set at \$40K and increased to \$100K in March 1990. Incomplete work was capped at \$25K.
- **1993 Dodd Inquiry.** Recommended to move away from Government monopoly to private insurers. Avoidance of conflict claims with the Government acting as both insurer and arbiter on disputes.
- **Privatised from 1 May 1997.** Minimum cover was \$200K, increased to \$300K on 1 March 2007 and \$340K on 1 February 2012.
- **In 2001, HIH Casualty and General Insurance Limited and FAI General Insurance Company Limited went into liquidation.** They held approximately 40% of home warranty insurance book.

* Based upon Fair Trading NSW Factsheet January 2014

Building Insurance – History (cont)

A brief history of Building Insurance in NSW (cont)*

- **From 1 July 2002, NSW shifted from a ‘first resort’ scheme to a ‘last resort’ scheme**, i.e. the scheme provided cover in the event of the death, insolvency or disappearance of the builder.
- **From 1 July 2002**, with the shift to a ‘last resort’ scheme, insurance liability reduced to **6 years for a loss arising from a ‘structural’ defect** or **2 years for loss arising from a ‘non-structural’ defect**.
- **From 1 July 2010**, the NSW Government through SICorp (the NSW Self Insurance Corporation), became the sole home warranty insurance agent.

* Based upon Fair Trading NSW Factsheet January 2014

Building Insurance – History (cont)

A brief history of Building Insurance in NSW (cont)*

- **From 25 October 2011**, for first resort insurance claims needed to have been made during the period of cover. Owners were unable to notify and claim after period of cover as previously permitted. A grace period was given to allow matters notified during cover to be claimed before 25 April 2012.
- **From 25 October 2011**, for last resort insurance, claims need to have been made during the period of cover (or during 6 month extension period if the loss occurs in the last 6 months of the period of insurance) if the builder dies, disappears or becomes insolvent during the period of insurance (or the 6 month extension period). Owners lost the right to make a claim outside the period of cover, subject to the below point.

* Based upon Fair Trading NSW Factsheet January 2014

Building Insurance – History (cont)

A brief history of Building Insurance in NSW (cont)*

- **From 25 October 2011**, for last resort insurance, if the builder does not die, disappear or become insolvent within the insurance period, and the loss was properly notified, owners can make a claim later but will not be entitled to indemnity unless they ‘diligently pursued’ enforcement of statutory warranties.
- **From 25 October 2011**, owners unable to make insurance claims more than 10 years after completion of works.

* Based upon Fair Trading NSW Factsheet January 2014

Statutory Warranties

Home Building Act 1989

18B Warranties as to residential building work

- (1) The following warranties by the holder of a contractor licence, or a person required to hold a contractor licence before entering into a contract, are implied in every contract to do residential building work:
 - (a) a warranty that the work will be performed in a proper and workmanlike manner (**will be changed to “done with due care and skill” from 1 March 2015**) and in accordance with the plans and specifications set out in the contract,
 - (b) a warranty that all materials supplied by the holder or person will be good and suitable for the purpose for which they are used and that, unless otherwise stated in the contract, those materials will be new,
 - (c) a warranty that the work will be done in accordance with, and will comply with, this or any other law,
 - (d) a warranty that the work will be done with due diligence and within the time stipulated in the contract, or if no time is stipulated, within a reasonable time,

Statutory Warranties

Home Building Act 1989

18B Warranties as to residential building work (cont)

- (e) a warranty that, if the work consists of the construction of a dwelling, the making of alterations or additions to a dwelling or the repairing, renovation, decoration or protective treatment of a dwelling, the work will result, to the extent of the work conducted, in a dwelling that is reasonably fit for occupation as a dwelling,
- (f) a warranty that the work and any materials used in doing the work will be reasonably fit for the specified purpose or result, if the person for whom the work is done expressly makes known to the holder of the contractor licence or person required to hold a contractor licence, or another person with express or apparent authority to enter into or vary contractual arrangements on behalf of the holder or person, the particular purpose for which the work is required or the result that the owner desires the work to achieve, so as to show that the owner relies on the holder's or person's skill and judgment.

Statutory Warranties

Home Building Act 1989

18B Warranties as to residential building work (cont)

[from 1 March 2015]

(2) The statutory warranties implied by this section are not limited to a contract to do residential building work for an owner of land and are also implied in a contract under which a person (the ***principal contractor***) who has contracted to do residential building work contracts with another person (a ***subcontractor*** to the principal contractor) for the subcontractor to do the work (or any part of the work) for the principal contractor.]

Statutory warranty time limits prior to 1 February 2012

Home Building Act 1989

Former 18E Proceedings for breach of warranties

- (1) Proceedings for a breach of a statutory warranty must be commenced within **7 years** after:
 - (a) the completion of the work to which it relates, or
 - (b) if the work is not completed:
 - (i) the date for completion of the work specified or determined in accordance with the contract, or
 - (ii) if there is no such date, the date of the contract

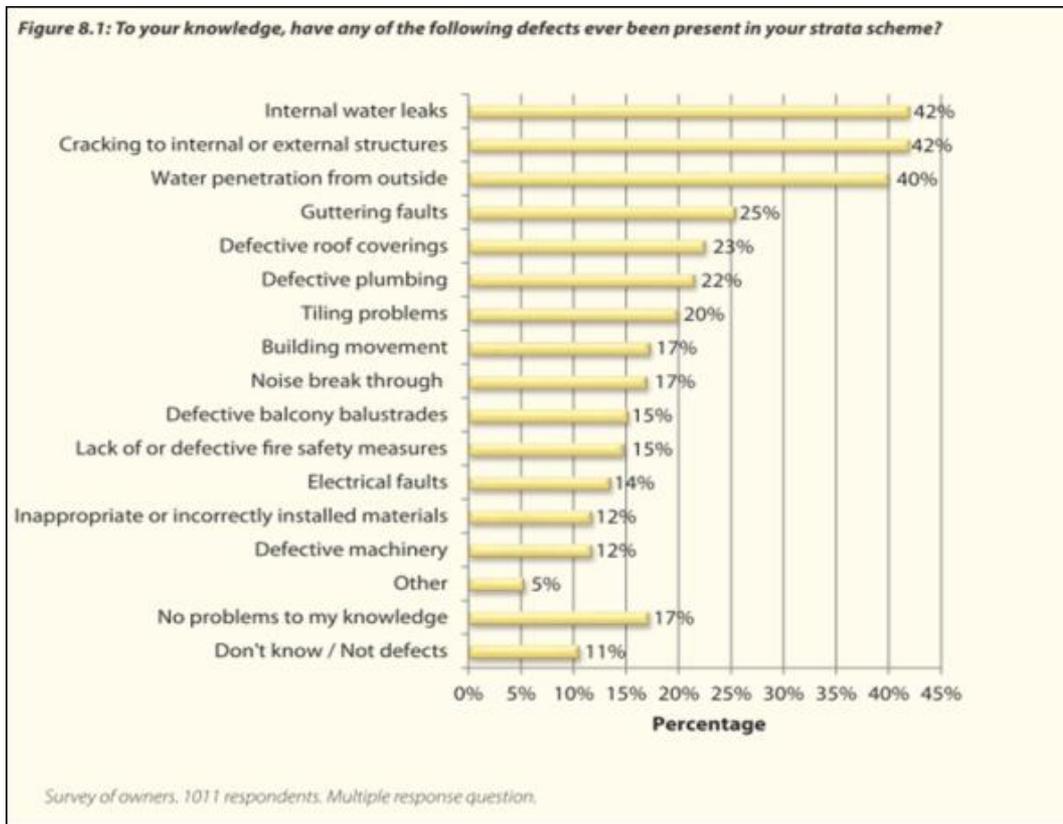
Amendment to period to commence statutory warranty claim made in 1 February 2012

- **Effective from 1 February 2012** section 18E was amended to reduce the period to make a claim against builders/developers from 7 years to **6 years for a structural defect or 2 years for any defect** for any works performed under a contract entered into from 1 February 2012
- The **period to make a claim** was **extended for 6 months** where a warranty breach **becomes apparent within the last 6 years of a warranty period**, that is when any person entitled to the benefit of the warranty:
 - First becomes aware of the breach, or
 - Ought reasonably to have become aware of the breach

Amendment to period to commence statutory warranty claim made in 1 February 2012

- **‘Structural Defect’** was defined in former regulation 71 of the *Home Building Regulations 2004* as a defect in a **‘Structural Element’** that:
 - Results in, the building or part of the building being closed;
 - Prevents, or is likely to prevent, the practical use of the building or part of the building;
 - Results in, or is likely to result in, the destruction or **physical damage** to the building;
 - Results in, or is likely to result in, threat of imminent collapse

UNSW Research - Common Strata Building Defects



Extracted from Easthope, H., Randolph, B., & Judd, S. (2012) Governing the Compact City: The role and effectiveness of strata management . Sydney: City Futures Research Centre”

Amendment to period to commence statutory warranty claim made in 15 January 2015

- On 15 January 2015, 6 year statutory warranties change from “Structural Defect” to a 2 Element Test “Major Defect” in a “Major Element”.
- Generally applies **retrospectively** to:-
 - Building contracts entered into from **1 February 2012**
 - Insurance contracts entered into from **1 July 2002**
- Arguably the presumption against retrospectively may mean that the changes to insurance contracts only apply for new contracts from 15 January 2015, our view is that the changes are retrospective.

Amendment to period to commence statutory warranty claim made in 15 January 2015

- **First Element of 6 year Statutory Warranties – “Major Defect”** in a “Major Element” causing, or likely to cause:-
 - An inability to inhabit or use any part of the building for its intended purpose; or
 - The destruction of any part of the building; or
 - A threat of collapse of any part of the building; or
 - A defect prescribed by the regulations (currently none are prescribed).
- **“results in, or is likely to result in physical damage to the building or any part of the building”** present in the definition of **“Structural Defect”** is not included in the definition of **“Major Defect”**

Amendment to period to commence statutory warranty claim made in 15 January 2015

- **Second Element of 6 year Statutory Warranties – Major Element:-**
 - Load bearing components essential to the stability of the building (e.g. foundations, floors, walls, roofs, columns, beams); or
 - A fire safety system; or
 - Waterproofing; or
 - Other elements prescribed by the regulations (currently none are prescribed)

Statutory warranty time limits pre 25 October 2011 – First Resort

First resort insurance – effective 01/05/97 to 30/06/02

Home Building Act 1989

Former 103B Period of cover

- (1) A contract of insurance must provide insurance cover for loss arising from non-completion of the work for a period of not less than 12 months after the failure to commence, or cessation of, the work the subject of the cover.
- (2) A contract of insurance must provide insurance cover for other loss insured in accordance with this Act for a period of not less than 7 years after the completion of the work or the supply of the kit home, or the end of the contract relating to the work or supply, whichever is the later.

Statutory warranty time limits post 25 October 2011 – First Resort

First resort insurance – effective 01/05/97 to 30/06/02

Home Building Act 1989

103BA Period of cover

- Contract of insurance provides cover only if a claim is made during the period of insurance
- Owners lost the right to notify within the period of insurance and then make a claim after the period of insurance
- Owners that had notified during the period of insurance were given a grace period to make insurance claims before 25 April 2012 (6 month grace period)

Statutory warranty time limits pre 25 October 2011 – Last Resort

Last resort insurance – effective from 01/07/02

Home Building Act 1989

Former 103B Period of cover

- Non-completion insurance cover for 12 months after the failure to commence, or cessation of, the work the subject of the cover.
- Defects insurance cover where a builder dies, disappears or becomes insolvent for a period of not less than:
 - (a) structural defect—6 years after the completion of the work, or
 - (b) non-structural defect—2 years after the completion of the work.

Statutory warranty time limits pre 25 October 2011 – Last Resort

Home Building Regulation 2004

Former 61 Period of cover

- (1) For the purposes of determining the period of cover to be provided by an insurance contract in relation to residential building work, work is taken to be complete:
 - (a) on the date that the work is completed within the meaning of the contract under which the work was done, or
 - (b) if the contract does not provide for when work is completed or there is no contract, on the date of the final inspection of the work by the applicable principal certifying authority, or
 - (c) in any other case, on the latest date that the contractor attends the site to complete the work or hand over possession to the owner or if the contractor does not do so, on the latest date the contractor attends the site to carry out work.

Statutory warranty time limits pre 25 October 2011 – Last Resort

Home Building Act 1989

Former 103BA Limitations on policy coverage—claims made and notified policy

- (1) A contract of insurance provides insurance cover in respect of loss only if:
 - (a) in the case of cover for loss arising from non-completion of work—the loss becomes apparent and is notified to the insurer within the period of insurance, or
 - (b) in any other case:
 - (i) the loss becomes apparent and is notified to the insurer within the period of insurance, or
 - (ii) the loss becomes apparent during the last 6 months of the period of insurance and is notified to the insurer within 6 months after the loss becomes apparent.

(2) A loss **becomes apparent** when a beneficiary under the contract first becomes aware (or ought reasonably have become aware) of the loss.

(3) In this section:

loss means loss indemnified by a contract of insurance.

period of insurance means the period for which a contract of insurance provides cover.

Statutory warranty time limits post 25 October 2011 – Last Resort

Home Building Act 1989

103BB Time limits for policies issued from 1 July 2002

- (1) A contract of home warranty insurance entered into on or after 1 July 2002 provides insurance cover in respect of loss only if a claim in respect of the loss is made to the insurer during the period of insurance.
- (2) A loss that becomes apparent in the last 6 months of the period of insurance has an ***extended claim period***, which permits a claim in respect of the loss to be made within 6 months after the loss becomes apparent. There is no extended claim period for a loss that arises from non-completion of work.

Statutory warranty time limits post 25 October 2011 – Last Resort

Home Building Act 1989

103BB Time limits for policies issued from 1 July 2002 (cont)

- (3) When a loss becomes apparent during the period of insurance but a claim cannot be made during that period because an insured event has not occurred, a claim can be made after the period of insurance (as a ***delayed claim***) but only if:
 - (a) the loss was properly notified to the insurer during the period of insurance (or within 6 months after the loss became apparent in the case of a loss that became apparent in the last 6 months of the period of insurance), and
 - (b) The beneficiary under the contract of insurance making the claim diligently pursued the enforcement of the statutory warranty concerned after the loss became apparent.
- (4) A delayed claim can also be made when the insured event occurs in the last 6 months of the period of insurance (as if the insured event did not occur until after the period of insurance) subject to compliance with the other requirements of this section for a delayed claim.

Statutory warranty time limits post 25 October 2011 – Last Resort

Home Building Act 1989

103BB Time limits for policies issued from 1 July 2002 (cont)

- (5) A delayed claim cannot be made for a loss that arises from non-completion of work.
- (6) The regulations can make provision for or with respect to what constitutes or does not constitute diligent pursuit of the enforcement of a statutory warranty for the purposes of this section.
- (7) A loss is ***properly notified*** to an insurer only if the insurer has been given notice in writing of the loss and the notice provides such information as may be reasonably necessary to put the insurer on notice as to the nature and circumstances of the loss. The regulations can make provision for or with respect to the form and content of such a notice.

Statutory warranty time limits post 25 October 2011 – Last Resort

- **Non-completion of work period of cover is 12 months from failure to commence or cessation of work.** Claims need to be made during the period of cover if the builder dies, disappears or becomes insolvent during the period of insurance.
- **Major defects period of cover is 6 years from date of completion, non-major defects period of cover is 2 years from date of completion.**
- For a defects loss there is a **6 month extended claim** period if the loss becomes **apparent in the last 6 months of the period of insurance.**
- If a builder doesn't die, disappear or become insolvent during the period of insurance a delayed claim can be made if:
 - The **loss was notified during the period of insurance or applicable extended claim period;** and
 - The claim was **diligently pursued.**

Statutory warranty time limits post 25 October 2011 – Last Resort

The opportunity to define **diligently pursue** was passed up in the last round of amendments but diligently pursuit probably includes:

- promptly investigating, seeking advice upon and pursuing defects as soon as they become apparent;
- actively pursue defects by commencing proceedings and efficiently putting on all of your evidence against builders and/or developers;
- complying with Tribunal or Court timetables where reasonably practicable;
- obtaining evidence in reply and pressing matters to settlement or hearing in a timely manner; and
- address any issues that arise during proceedings in a diligent and timely manner.

Time Limits for Notice of Loss or Damage

Regulation 47 (formerly Regulation 63)

- Insurance contracts are taken to contain a provision that the insurer may not reduce its liability because of a delay in a claim being notified if the claim is notified:
 - a) Within 6 months of the beneficiary becoming aware, or ought reasonably have become aware, of the fact or circumstance under which the claim arises; or
 - b) For incomplete work within the later of 12 months after –
 - i. the contract date, or
 - ii. The date provided in the contract for commencement of the work, or
 - iii. The date work ceased
- An insurance contract may contain provisions extending time for giving notice or allowing an insurer to waive the time within notice may be given.
- If a beneficiary has given notice of loss to the insurer the beneficiary is taken to have given for the purpose of an insurance contract provision pursuant to regulation 47 notice of all related losses
- Notice of loss isn't notice of related losses for the purpose of the time periods in section 103BA to 103BC of the Act

Case law on statutory warranty and HOW Insurance time limits

➤ SP61404 (CTTT - May 2008)

- Insurance case
- No contract, therefore clause 61(1)(a) HBR (previously s48(a)) does not apply
- Inspection under clause 61(1)(b) HBR (previously s48(b)) means physical inspection

Case law on statutory warranty and HOW Insurance time limits

➤ **Abrahams & Anor v Degan (DC – 2009)**

- Owner builder
- Completion is as per regulation for determining period of cover (clause 61 HBR (previously clause 48 HBR))
- Contrary to earlier cases about physical completion of the works and contrary to our opinion
- Held that date of completion was the date of inspection by certifier for final occupation certificate for s18E

Case law on statutory warranty and HOW Insurance time limits

- **Owners Corporation Strata Plan 64757 v MJA Group Pty Ltd [2011] NSWCA 236**
 - Overturned *Abrahams & Anor v Degan* (DC – 2009)
 - Highlighted problems for successors in title to determine completion
 - Completion is a case by case basis

Date of Completion of Residential Building Work

Date of Completion of residential building work that is not new buildings in strata schemes – section 3B

- Completion is when work is complete within the meaning of the contract;
- If the Contract doesn't define completion, when the work reaches **practical completion** = completed except for omissions or defects that do not prevent the work from being reasonably capable of being used for its intended purpose;
- Practical completion presumed (unless an earlier date is established) on the earlier of:
 1. Hand over of possession;
 2. Last attendance onsite to carry out work (other than to remedy defect that doesn't affect practical completion);
 3. Issuance of occupation certificate that authorises commencement of use of occupation of the work
- Where 2 or more individual buildings that are reasonably capable of being used and occupied separately are constructed practical completion can occur at different times.

Date of Completion of New Buildings in Strata Schemes

- **Date of Completion of New Buildings in Strata Schemes – section 3C** (commenced 15 January 2015 with retrospective effect)
- Completion occurs on:
 1. Date of issue of an occupation certificate that authorises the occupation and use of the whole of the building;
 2. The occurrence of an event prescribed in the regulations (currently none prescribed)

Exemption for multi-storey buildings

- Multi-storey buildings that:
 1. Contain a rise in storeys of more than 3, and
 2. Contain 2 or more separate dwellings,are exempt from requiring insurance.
- With effect from 15 January 2015, the definition of **storey** in the Act was aligned with the BCA

Exemption for multi-storey buildings



Photograph of 228-232 Condamine Street, Manly Vale, Strata Plan 75903.

Exemption for multi-storey buildings

The Owners SP 75903 v Dix [2011] NSWSC 245

- Dispute concerning a certifier's advice to a developer that a building qualified for multi-storey insurance exemption
- Dispute over whether a lower ground level that contained both designated carspaces and residential accommodation was a storey
- Certifier had interpreted that level would not be categorised as a storey only if it exclusively contained carspaces
- Statutory interpretation of '**storey**' found that level with both designated carspaces and accommodation was not a '**storey**'.

Exemption for multi-storey buildings

BCA definition of storey

Storey means a space within a building which is situated between one floor level and the floor level next above, or if there is no floor above, the ceiling or roof above, but not –

(a) a space that contains only –

(i) a lift shaft, stairway or meter room; or

(ii) a bathroom, shower room, laundry, water closet, or other sanitary compartments; or

(iii) accommodation intended for not more than 3 vehicles; or

(iv) a combination of the above; or

(b) a mezzanine



BANNERMANS
LAWYERS

Exemption for multi-storey buildings

- **For pre 15 January 2015 contracts storey is defined as –**
storey does not include a space within a building if the space includes accommodation only intended for vehicles
- **For post 15 January 2015 contracts the a greater number buildings will be eligible for the multi-storey building insurance exemption**

Owner Builder Insurance

- **From 15 January 2015** owner builder work is not subject to home warranty insurance
- Owner builder work must not contain notice in contract of sale that it is not subject to home warranty insurance

Building Insurance Trends – Underwriting Performance

	2012 \$'000	2013 \$'000	2014 \$'000
Gross Written Premium	47,588	53,156	66,667
Movement in unearned premium	(37,414)	(35,896)	(40,868)
Net Premium Revenue	10,174	17,260	25,799
Recoveries	-	-	30
Movement in outstanding claims provision	(34,679)	(15,140)	(796)
Claims paid	(16,815)	(24,680)	(23,677)
Acquisition costs	(29,651)	(22,609)	(28,383)
Unexpired risk liability	(32,209)	(13,503)	(2,564)
Total underwriting loss	(103,180)	(58,672)	(29,591)

Source – NSW Home Warranty Insurance Fund Financial Statements for years ended 30 June 2013 and 30 June 2014

Building Insurance Trends

Claims received (by year project certificate issued) as at 31 August 2014

	2010/11	2011/12	2012/13	2013/14	2014/15	Total
Claims Received	576	400	110	4	0	1,090
Notifications Received	256	189	84	20	0	549

Source – Home Warranty Insurance Fund – Report as at 31 August 2014

Building Insurance Trends (cont)

Claim payments (by year project certificate issued) as at 31 August 2014

Year	Payment to Claimants & 3 rd Parties (\$)	Outstanding Estimate (\$)	Estimated Total Cost (\$)	Average Cost (\$)
2010/11	35,632,083	6,477,293	42,109,377	73,107
2011/12	23,379,863	2,433,054	25,812,976	64,532
2012/13	5,716,656	1,856,833	7,573,489	68,851
2013/14	5,231	214,156	219,397	54,847
2014/15	0	0	0	0
TOTALS	64,733,833	10,981,336	75,715,239	65,334

Source – Home Warranty Insurance Fund – Report as at 31 August 2014

Building Insurance Trends (cont)

Status of claims as at 31 August 2014

Claims Settled	882
Claims Declined	113
Claims Open	256

Source – Home Warranty Insurance Fund – Report as at 31 August 2014

Further Reforms?

- Address risks of manufacturing off-site fabricated building elements overseas
- Improve builder's skills through continuing professional development
- Strata Package Reforms which were to be implemented with Home Building Act reforms have been shelved until 2016, key reforms included:-
 - Inclusion of defects and rectification as a compulsory agenda item for discussion at each AGM until the expiry of the statutory warranty periods
 - Provision of an independent defects report for the owners corporation within 12 – 18 months after the building is completed
 - High-rise strata developers to pay bond of 2% construction costs held in trust until independent inspector agrees any identified defects are fixed
 - Developer not able to vote on matters relating to building defects
- Improve certifier practices

Disclaimer

- This is not a legal advice and you should seek legal advice regarding any time limits or issues referred to.
- This area of law is regularly amended or new cases decided, requiring updated information.
- This presentation does not include:
 - claims for incomplete works;
 - Fair Trading Administration Insurance Scheme claims;
 - claims where the insurance contract was entered into before 1 May 1997; and
 - all possible steps, remedies, defences and time limitations.

Thank you

T (02) 9929 0226 **F** (02) 8920 2427

M 0403 738 996 **E** dbannerman@bannermans.com.au

A Suite 702, 2 Elizabeth Plaza, North Sydney, NSW 2060

PO Box 514, North Sydney, NSW 2059

