

Review of the Home Building Compensation Fund

Supporting Information

The NSW Government is implementing its election commitment to review the State's home building compensation scheme (HBC).

The Review will be informed by public and industry consultations, including through a specially formed Advisory Panel.

This document brings together the supporting information published on the Review's "Have Your Say" webpage.

Introduction

When is HBC insurance required?

HBC insurance is required for home building work which is valued at \$20,000 or more.

HBC insurance is required for the construction of new homes, swimming pools associated with a home and for renovations or alteration to homes.

A home includes a single dwelling, townhouse or apartment building.

However, HBC insurance is not required for new apartment buildings that are more than 3 storeys or for parts of apartment buildings that are not homes (like shops or offices within an apartment building that is 3 storeys or less).

Even though HBC insurance is not required for new apartment buildings over 3 storeys, it is required if there are renovations, alterations or remedial works undertaken to an existing apartment building valued at more than \$20,000, regardless of the number of storeys.

There are also some other exemptions that apply to specific types of building work.

What does HBC insurance cover?

The HBC Scheme provides homeowners with important but limited protections.

Where home building work is defective or is not completed by the building business, the HBC fund will compensate homeowners to help them get their building work completed or fixed.

There are limits on the types of defects that are covered, the timeframes within which a claim can be made and the amount of compensation that will be paid if a claim is made.

A claim can only be made where the builder dies, disappears, becomes insolvent or has their licence suspended because they have not paid money ordered by a Court or Tribunal. 87% of claims are triggered because of builder insolvency.

Insolvency

The Review is looking into the prevalence and nature of home building business insolvencies in NSW relevant to the HBC scheme.

Supporting information

The most common event that triggers HBC insurance is when a building business becomes insolvent. Therefore, if insolvency rates are increasing, there will be more claims on the HBC fund.

According to data from ASIC, there were 1372 construction companies which entered into external administration for the first time in 2023-24 compared to 981 in 2022-23, and 513 in 2021-22. Construction industry insolvencies in NSW increased by 40% in 2023-24.

Whilst the ASIC data is very useful, the numbers relate to the whole of the construction industry which includes many businesses that are not involved in home building work. The ASIC data also looks at companies, whereas around 30% of building businesses eligible for HBC insurance are sole traders or partnerships.

The Review will undertake research to explore the rates of insolvency for eligible home building businesses and common reasons for these insolvencies. The Review will also look at whether publishing information about building businesses that have become insolvent could provide greater transparency to consumers when selecting their builder.

We know that in 2022-23, 137 eligible building companies became insolvent. This number represents 0.6% of the total number of eligible building businesses. That same year, a further 87 building companies went into insolvency after their eligibility was suspended by icare.

To be eligible to purchase insurance, a building business must be licensed by the Building Commission. A licenced applicant must meet various criteria including being a fit and proper person not having an unreasonable number of insurance claims paid. The Building Commission may also refuse or cancel a building business's licence due to bankruptcy or involvement in corporate insolvencies.

One way that icare seeks to reduce the risk of insolvency is to regulate the eligibility of building businesses to purchase insurance by:

- limiting the value and number of individual projects that the building business can have under construction at any time ('open job limit')
- screening unstable or unreliable businesses from the scheme
- limiting the maximum contract value for any individual project, and
- imposing conditions, such as the injection of additional capital into their business

However, the conditions of eligibility may limit the number and nature of home building projects that can be undertaken by eligible businesses which could impact on the timing and cost of home building work for all. This is a sensitive issue given the housing supply issues and the policy priority for government which is to increase the rate of home building.

Your comment

Some matters you might like to address below include:

- concerns about insolvency of eligible building businesses in NSW;
- actions to reduce insolvency risk;
- ways to provide greater transparency about insolvent building businesses;
- obstacles, if any, to reducing insolvency risks; or
- value in publishing and monitoring insolvency data specific to HBC Scheme.

Cover amount

Issue 1: Maximum cover for completed work - \$340,000

The Review is looking at the adequacy of the HBC insurance cover amount. It will also consider any future adjustments to it and the impact on premiums.

There are two components to the maximum cover amount. First, there is cover for home building work which has not commenced or been completed. Second, there is cover for completed home building work.

Supporting Information

The Review is looking at the insurance cover amount and the options to adjust the cover amount in the future, as well as the impact on premiums.

The minimum amount of cover insurers must offer under a contract of insurance has not changed since 2012. It is currently \$340,000. Home building costs have increased by 60% since the cover amount was set in 2012. We know this based on data that building businesses provide when applying for insurance. It is also consistent with the Australian Bureau of Statistics' data about changes in the cost of building work (the Producer Price Index). The average price of building a new house was \$320,000 in 2012 and \$483,000 in 2023.

The cover amount was changed in 1997, 2007 and 2012 by legislation. There is no mechanism for the cover amount to be adjusted automatically. A 60% increase in the cover amount, to reflect changes in home building costs, would bring it to \$540,000.

Table 1 below shows the predicted impacts of increasing the maximum cover for new home building (which is approximately 55% of the premium collected by the HBC Fund). This is based on premium written in FY 2024.

	% of claims that exceed the completed work limit	Average cost of HBC insurance
Current limit of \$340,000	10%	\$4,400
Increase limit to \$440,000	Estimate 7.8%	Estimate \$4,790
Increase limit to \$540,000	Estimate 6.6%	Estimate \$5,130

% of claims that exceed the completed work limit. Based on policies underwritten between 2013 to 2021. Claims have been considered on a single claim per policy basis.

Average cost of HBC insurance. Average cost is the average cost per policy and is dependent on the contract value.

Table 2 below shows the predicted impacts of increasing the maximum cover for a renovation or alteration of an existing single dwelling home (which is approximately 22% of the premium collected by the HBC Fund). This is based on premium written in FY 2024.

	% of claims that exceed the completed work limit	Average cost of HBC insurance
Current limit of \$340,000	16%	\$1,300
Increase limit to \$440,000	Estimate 8.7%	Estimate \$1,450
Increase limit to \$540,000	Estimate 2.8%	Estimate \$1,550

↳ .of.claims.that.exceed.the.completed.work.limit *Based on policies underwritten between 2013 to 2021. Claims have been considered on a single claim per policy basis.*

Average.cost.of.HBC.insurance.Average cost is the average cost per policy and is dependent on the contract value.

Over the 2013 to 2021 underwriting years, almost no defect claims made by apartment owners of newly constructed buildings that are 3 storeys or less were covered by the current maximum.

Over that same period, on average only 2% of defect claims relating to renovations to existing apartments and swimming pool construction have exceeded the maximum claim amount.

Your comment

Some matters you might like to address below include:

- the appropriate cover amount;
- whether the cover amount should keep pace with building costs;
- whether the cover amount should differ for different types of home building work;
- the basis for the adjustment of the cover amount (for example, HBC data about building costs or the Producer Price Index);
- how often the cover amount should be adjusted; or
- the premium impact and value of increasing the cover amount to \$540,000.

Issue 2: Maximum cover for incomplete work - 20% of the contract price

Where a claim relates to incomplete work, the insurance cover is currently up to 20% of the contract price plus an amount for defect rectification if there are defects.

Supporting Information

1. Where home building work is incomplete, there are 2 components to the cover:
2. HBC insurance will pay up to 20% of the value of the contract for non-completion; and
3. If there are also defects in the incomplete work, the HBC insurance will pay for defect rectification.

The maximum total payout for the two components is \$340,000.

The 20% limit was introduced in 2002 in a package of legislative reforms to address financial risks for private insurers at that time. The risk of some homeowners having an uninsured loss due to this cap was raised in the Parliament's debate about the legislation. The 2012 'Reform of the Home Building Act 1989 Issues Paper' said the intention of the cap was to limit the exposure of insurers to the costs of completing insured homes, and again noted the risk of some

homeowners experiencing uninsured loss. The 2012 Issues paper asked stakeholders about whether the cap should be increased to 40%. This was not adopted.

An alternative proposal was made to cap builder progress payments aligned to the 20% cap, but this was not implemented in the resulting legislative reforms in 2014. This risk to homeowners has been greater in recent years, because of the rapid increase in building costs. The costs to complete are often much greater than 20% of the original contract price.

The table below shows the predicted impacts of increasing the 20% limit for non-completion for new home building (which is approximately 55% of the premium collected by the HBC Fund). This is based on premium written in FY 2024.

	% of claims that exceed the non-completion limit	Average cost of HBC insurance
Current limit of 20%	25%	\$4,400
Increase limit to 30%	Estimate 15.4%	Estimate \$4,580
Increase limit to 40%	Estimate 9.3%	Estimate \$4,690

↳ .of.claims.that.exceed.the.non_completion.limit. Based on policies underwritten between 2013 and 2023 and includes an adjustment for contract variations.

Average.cost.of.HBC.insurance. Average cost is the average cost per policy and is dependent on the contract value.

The table below shows the predicted impacts of increasing the 20% limit for non-completion for a renovation or alteration to an existing single dwelling house (which is approximately 22% of the premium collected by the HBC Fund).

	% of claims that exceed the non-completion limit	Average cost of HBC insurance
Current limit of 20%	15%	\$1,300
Increase limit to 30%	Estimate 10.2%	Estimate \$1,320
Increase limit to 40%	Estimate 7.5%	Estimate \$1,330

↳ .of.claims.that.exceed.the.non_completion.limit Based on policies underwritten between 2013 and 2023 and includes an adjustment for contract variations.

Average.cost.of.HBC.insurance Average cost is the average cost per policy and is dependent on the contract value.

Over the past 9 years 1% of non-completion claims made by apartment owners of newly constructed buildings that are 3 storeys or less are not covered by the current 20% limit.

Over that same period, on average only 4% of non-completion claims relating to renovations to existing apartments and 31% relating to swimming pool construction have exceeded the current 20% amount.

Your comment

- Some matters you might like to address below include:
- the complexity of the conditions of insurance for incomplete works;
- the appropriateness of the conditions for the calculation of compensation of claims for incomplete works;
- the adequacy and impact of the 20% limit for incomplete works;
- whether the limit should be increase (for example to 30 or 40%);
- whether the 20% limit should be increased for only some types of home building work; or
- the value of the potential premium impact if the 20% limit were increased.

Awareness

The Review is looking into the level of awareness and understanding of the HBC Scheme amongst building businesses and homeowners.

Supporting information

It is mandatory for home building work of \$20,000 or more to be insured. But sometimes a policy is not taken out.

Awareness of the scheme could help to decrease the likelihood of home building work being carried out without HBC insurance. Building businesses are more likely to comply if they are aware of the insurance requirements. If homeowners are more aware they are more likely to ask their builder about insurance and check that insurance is in place. Awareness also creates greater confidence for homeowners to engage building businesses because they know there is protection if their building business goes bust.

Information about the scheme is widely available. However, anecdotally, awareness of the scheme is low. Even some people who are aware of the scheme do not understand how it works. There is no mechanism in place to measure awareness and understanding. There is also no strategy about how to improve awareness.

Information published about the HBC Scheme is available online but understanding it requires a good understanding of English. The information is not the same across websites. For example, some websites still call it 'home warranty insurance', which is an old name for the scheme. icare, Building Commission and SIRA are currently updating their websites. These updates provide an opportunity to improve awareness of the HBC Scheme.

Your comment

Some matters you might like to address below include:

- the level of awareness and understanding of the HBC Scheme;
- the adequacy, and ease of locating, information on the HBC Scheme;
- the ways in which information on the HBC Scheme is best provided; or
- the best ways to measure awareness of HBC Scheme.

Compliance

The Review is looking at building businesses' compliance with HBC insurance. It is also looking at options to help homeowners whose homebuilding work is uninsured.

Supporting information

The law requires HBC insurance for all home building work over \$20,000 (unless exempt). A building business that is a principal contractor for the work, must buy the insurance before starting the work or taking any money from the homeowner. Only building businesses that have been assessed as 'eligible' to hold insurance may purchase the insurance. If a building business is not eligible, it cannot be a principal contractor for work that must be insured.

The scheme does not cover homeowners if the building business that worked on their home did not take out the insurance, even if the building business charged the homeowner for the cost of buying insurance. This has resulted in some homeowners being left without help to complete or fix their home.

There are a range of ways that non-compliance can occur, such as:

- non-insurance – where the building business does not take out insurance;
- fake insurance – where the building business or insurance broker pretends to have taken out insurance, and provides a fake certificate of insurance;
- under-insurance – where the building business takes out insurance to cover a lower value of the home building work than the contract price, resulting in underpayment of the insurance premium; or
- delayed insurance – where the building business accepts a deposit but does not obtain the HBC insurance for some weeks or months.

A related issue is the use of 'preliminary services agreements' – where the building business charges owners for 'pre-contract services' such as preparing designs, obtaining reports, negotiating the contract price or design changes.

The homeowner has no insurance cover for these services. SIRA has observed cases where large sums of money are taken under these agreements that are later credited towards a building contract. This raises questions about whether the intent or effect is to circumvent the regulation and insurance of deposits. This issue is also being separately considered as part of separate reform processes by Building Commission NSW.

Why do building businesses fail to comply?

Building businesses operate illegally without insurance for a range of reasons:

- they are unaware of the insurance requirements. For example, there is evidence suggestive of higher rates of non-compliance in relation to renovations, alterations and remedial work to apartments. One reason could be a common misunderstanding that HBC insurance only applies to apartments in buildings that are 3 storeys or less. 'Owner-builder' projects also risk confusion for trades contractors, who ordinarily do not need insurance when sub-contracting work from a building business;
- they are not eligible to purchase insurance, possibly because their financial circumstances are not acceptable to icare; or

- they do not have sufficient eligibility at the time they contract for the work so they delay taking out the insurance until they complete existing jobs, or they undervalue the work they have contracted for when taking out insurance.

Mechanisms to prevent non-compliance

In an effort to ensure that HBC insurance is taken out when required, the government has introduced two mechanisms:

1. Checking by the building certifier - If the home building work requires a development consent or a complying development certificate, a certifier is required to confirm that insurance is in place before the work commences.
2. Checking by the homeowner - when the homeowner and the builder are signing their contract, the builder is required to give the homeowner a Consumer Building Guide which has information about insurance. Homeowners are also required to complete a checklist certifying that the homeowner has been provided with evidence of insurance before they pay their deposit.

The government also provides a [public register of insurance](#), which enables any person to check if a certificate of HBC insurance is real or fake.

These checks do not always work. Not all home building works require a certifier to be involved. In those cases, there is no one to check that insurance is in place. Sometimes homeowners sign the contract and pay the deposit even though they have not seen evidence of insurance. There is also evidence that to save money, some homeowners agree with the building business not to take out insurance or that they should take out insurance for a lower amount than the actual cost of the home building work.

What is the government doing to enforce compliance?

As a mandatory form of insurance, there are penalties for building businesses who do not comply with the insurance requirements. Between 1 January 2018 and 30 June 2023, 1,461 penalty notices were issued by NSW Fair Trading to building businesses for failing to insure their work under.

Recent findings from an audit of building businesses by SIRA, revealed that about half of the 56 businesses audited took money from consumers for their building project without having insurance in place. The audit is ongoing.

Work is currently underway to increase the penalties for non-compliance and improve information sharing mechanisms between the Building Commission, SIRA and icare.

The Building Commission has been working with strata communities and the apartment remediation industry to educate them about the need to take out HBC insurance for renovations, alterations or remedial works to existing apartments, regardless of the number of storeys of these buildings.

The Review will be considering the roles of the Building Commission, SIRA and icare in ensuring compliance and enforcement activities are effective.

How could government help homeowners who are unlawfully uninsured?

Potential ways that the scheme or the government could compensate homeowners who find themselves without mandatory insurance would be:

- To set up a scheme whereby every homeowner that should be covered by the HBC Scheme is covered, regardless of whether insurance has been taken out

- To set up a limited scheme where cover is only given in some cases, for example to only cover the homeowner:
 - for the return of deposits where the building business becomes insolvent after a deposit is taken but before works commence; or
 - where fake certificates have been provided; or
 - where the builder was eligible but did not take out insurance;
 - where insurance was paid for but was not taken out by the building business.
- To provide homeowners with a nominal amount of compensation instead of full cover, for example up to \$100,000.

Any of the above ways to help uninsured homeowners would have to be supported by funding of some kind, such as a levy on premiums, building licences or home building work, or from government's general taxpayer revenues.

Your comment

Some matters you might like to address below include:

- how easy, or hard, is it comply with the insurance requirements;
- should homeowners that don't have insurance be compensated (if so how) and what if any limits should apply;
- ways that compliance could be improved;
- obstacles to compliance; or
- the impact of full compliance on the total premium pool and the premiums charged.

Multi-insurer market

The Review is looking into the feasibility and desirability of a multi-insurer market for the HBC Scheme.

Supporting information

HBC Scheme reforms in 2018 made changes to permit SIRA to licence and regulate multiple insurers and alternative indemnity product (AIP) providers. This was done to encourage the private sector to offer products to the market. Despite the reforms, icare has continued to be the sole provider of home building insurance since 2010.

The 2018 reforms were one of multiple attempts by government to achieve and sustain a competitive, private sector underwritten scheme since 1996, none of which have been successful. This aligns to experience in other Australian states and territories, where insurers have been unwilling to insure the market except where the Government provides underwriting support or where Government is the primary insurer for most of the market with a small number of private insurers issuing less than 10% of policies as niche players.

There are consequences of having legislation which holds the door open for private sector insurers to enter the market including:

- The premiums charged by icare are higher than they would be if it was the sole insurer. This provides 'competitive neutrality'. In other words, icare must operate at a profit, just like a private insurer would. If icare did not do this, private insurers would not be willing to enter the market. In its 2022 submission to IPART, icare estimated that 9% of the 15% profit margin is charged on public policy grounds of not disadvantaging competition.

- The risk that private insurers will insure only the least risky building businesses or projects. This would leave the State insurer with responsibility for insuring the higher risk projects with a concomitant impact on premiums.
- Brokers assist building businesses to apply for or renew their eligibility and to purchase insurance. Currently brokerage services are required because of icare's operating model, however, icare is transitioning to a model where businesses will be able to interact directly with icare. Without provision for a multi-insurance market the case for retaining brokers further diminished. In its 2022 submission to IPART, icare estimated that the annual cost of brokerage fees (which are in addition to premium costs) was \$20 million.
- Additional complexity and regulation to provide for private sector insurers.

Your comment

Some matters you might like to address below include:

- the commercial viability of a multi-insurer market;
- the value and savings from a legislated sole insurer of HBC;
- the appropriateness of brokerage if there is only one insurer; or
- possible reforms to encourage new entrants.

Conversely, considerations in favour of a multi-insurer market are increased choice and competition which could reduce premiums and reduced risk for Government.