SUBMISSION TO STANDING COMMITTEE ON
FINANCE & PUBLIC ADMINISTRATION

INQUIRY INTO BUILDERS WARRANTY INSURANCE

13 January 2010

SUBMISSION FROM
BUILDING ETHICS AUSTRALIA (BEA)
SUITE 3 LEVEL 4 ST KILDA RD
MELBOURNE 3004
Mr Richard Willis  
Council Committees Office  
Department of the Legislative Council  
Parliament House  
East Melbourne, 3002  

Dear Secretary,  

Thankyou for the opportunity to provide this submission concerning Builders Warranty Insurance.  

INTRODUCTION  

BEA is grateful for the opportunity to make this submission. BEA is in a unique position to make comment on the Terms of Reference as a result of our background and the role we play in facilitating the Warranty Insurance Product.  

BACKGROUND  

The directors of BEA have over 40 combined years experience as builders and have experienced first hand the turmoil caused by the collapse of HIH. As a result of this turmoil the concept for BEA was formed and put into operation in early 2004 with the support of Munich American Risk Partners Australia. Initially we operated exclusively in Victoria. In 2005 we expanded our operations into NSW and WA.  

With our building background and six years facilitating builders warranty insurance including dispute resolution and advice relating to warranty claims, we feel we are in a unique position to express a view on the issues relating to warranty insurance.
BEA's OBJECTIVES

BEA's objectives are to:

- minimise homeowners exposure to poor performance by builders
- support builders who operate ethically
- allow builders to structure their businesses according to their professional advisors recommendations
- manage risk and minimise loss to insurers

WHAT WE DO

BEA prequalifies builders to determine if they are financially viable and technically capable. We do this by assessing a summary of a builder's profit and loss and balance sheet. We also investigate a builder's ability by speaking to professionals in the building industry who have worked with the builder and previous clients of the builder. For builders who pass the financial and ability check they can then access the warranty product.

By operating under an Authorised Representative Agreement BEA are able to act as an agent for the insurer. This enables us to provide the builder with eligibility letters, insurance certificates and premium invoices.

Because we are a risk management company we also monitor a builder's progress and performance by conducting inspections at each progress payment stage. This provides peace of mind for the client and provides us with early indications of financial distress and areas where a builder may be deficient.

Due to our neutral role we are also able to assist when a dispute arises. This has proven very effective because we are involved early in the dispute.
INDUSTRY ISSUES

From six years of assessing builders’ performance in all areas it is very clear to us that training in business acumen is urgently needed for a large segment of the industry. The common process for a builder to become a registered practitioner is to start as an apprentice, become a subcontractor and then register as a builder.

The step from subcontractor to builder is significant as it changes the amount of money going through a business dramatically in a short time. A subcontractor will generally retain approximately 90% of his income as it will relate to his own time. Once a building business is established, the outgoings account for approximately 90%, or even more in a financially stressed business.

The importance of understanding building contracts and how to prepare them correctly is also an area requiring urgent attention. We have witnessed poor contract documentation making a dispute significantly worse and more costly. Inadequate contract documentation also contributes to the difficulty of handling a warranty claim after a builder becomes insolvent.

*Better educated builders will benefit consumers and the industry!*

WARRANTY ISSUES

A common and ongoing complaint from builders about Warranty Insurance relates to turnover limits being linked to asset base. Builders resent that they, unlike other businesses have this limitation placed on them as it restricts them from some investment strategies and business growth. Under the Building Ethics program a builder’s turnover is not linked to assets it is based on performance.
Builders and consumers alike have a poor understanding of builders warranty insurance. We believe part of this confusion is attributable to the name which has the effect of it being incorrectly compared to motor vehicle insurance.

CONCLUSION

BEA support last resort warranty insurance. Anything other than last resort diminishes the effectiveness and purpose of a contract and could severely undermine the rights of the two parties covered by the contract.

As builders warranty insurance is effectively a financial guarantee product, a name that reflects this would be strongly recommended.

The education of builders in regard to financial management is a key to minimising consumer exposure to builder failure. BEA believes that part of a builder’s requirement in obtaining a license should be to attend a compulsory approved course during the first year after obtaining a license. It is in this period that we have witnessed builders make their biggest mistakes.

BEA thanks the Standing Committee for the opportunity to make this submission. BEA would be prepared to participate in a public hearing if the Committee so desired.

If you require clarification on any aspect of our submission please contact me on 03 9866 4877.

Yours faithfully,

Tim O’Callaghan
Director