MBA SUBMISSION – IPART NSW HBCF ISSUES PAPER
5 June 2020

1. INTRODUCTION

These submissions are made by the Master Builders Association of New South Wales (MBANSW).

MBANSW is the oldest industry association in Australia, having been founded in Sydney in 1873. MBANSW is the only industry body representing the key building construction sectors: residential, commercial, engineering and civil construction.

MBANSW has a robust and active membership which is organised into a divisional structure, encompassing 11 regional areas and a total of 28 divisions. Each active division conducts regular meetings and has an elected President (honorary) and an Executive Committee to represent the interests of their local members to the Associations' Council of Management. This structure provides a truly democratic process in terms of representing the views and forming the policy of a diverse group of building and construction industry professionals.

MBANSW currently represents some 8,000 members in NSW.

MBANSW Head Office is located at Forest Lodge, Sydney, with dedicated regional offices in Newcastle, Port Macquarie, Albury, Gosford, Ballina and Ulladulla.

2. IPART HIGHLIGHTED QUESTIONS

Listed below are the MBANSW responses to the specific questions posed in the Issue Paper:

1. What changes to the scheme would encourage the supply of new, innovative products – both different types of insurance and non-insurance products?

No comments.

2. Should private providers be allowed to mitigate risk by limiting insurance to high risk, or other methods?

No. This will polarize the market and carry the risk that the State will have to carry the balance of that market. Whilst there should be incentives for good builders with appropriate experience and track records, the market should retain the ability to spread the risk to a certain extent to enable a more even distribution of premium amounts that might otherwise be too spread out and overly penalize new builders. MBANSW prefers the current SIRA holistic approach.

3. To what extent do the requirements of the Home Building Act 1989 duplicate the Insurance Act 1973 and increase costs of entry for private insurers?

No comments.

4. What additional information would be helpful to homeowners on selecting a builder?

Notification of the builder's membership of an appropriate industry body would inform the homeowner that the builder is informed and has access to the appropriate information needed to keep them current in technical and compliance aspects.

5. *How could the claims process be made more efficient*?

No comments.

6. *What incentives should the scheme have for builders to undertake good risk management and encourage good business practices?*

Incentives should always be provided. The principal incentives should be primarily eligibility (see response to question 9) and premiums.

7*. How could enhanced information collection be used to further mitigate builders' insolvency risk?*

In the residential building industry a primary source of insolvency is non-payment by a homeowner. MBANSW is skeptical that enhanced information collection would result in any significant mitigation of the insolvency risk.

Further, builder insolvency can occur very quickly such that collection of information would not help. A single significant non-payment of monies due to quickly move a builder from solvency to insolvency.

MBANSW is of the view that an expansion of the Security of Payment legislation to encompass homeowners would have a significant positive impact on the solvency of average residential builders.

8. *Is an efficiency study of icare's economic costs necessary?*

Yes, given the cost of icare's management of the scheme compared to the overall cost gives an incentive to have an efficiency study that would be worthwhile provided that it is conducted by an appropriate entity with the expertise to understand the industry and the product.

9. ***Do you consider the current eligibility assessment process should be simplified?***

The inflexible approach to eligibility assessments restricts a builder's ability to plan workflow over a medium to long term basis and can also prevent them from taking advantage of business opportunities as they arise.

Attached is the MBANSW Reform of NSW Home Owners Warranty Eligibility Criteria prepared in July 2017 which sets out propose changes to eligibility assessments to improve outcomes.

10. ***Could this be done without subjecting the Home building compensation fund to greater risk?***

Yes. MBANSW is of the view that the recommendations set out in the attached NSW Home Owners Warranty Eligibility Criteria will not subject the fund to greater risk.

11. ***Are there any other unnecessary regulatory or administrative burdens and barriers to entry for builders that should be reviewed?***

The building contract review program is of limited to no value to most builders on which it is imposed. Feedback is that that it is confusing and used as a punishment tool rather than for guidance. The program appears to be unprofitable if run properly which encourages shortcuts and affects the quality.

Yours faithfully

Robert Collings
General Counsel
Master Builders Association of New South Wales

MASTER BUILDERS ASSOCIATION OF NEW SOUTH WALES

Reform of NSW Home Owners Warranty Eligibility Criteria

Proposed changes to eligibility assessments to improve outcomes

MBANSW

5 July 2017

Executive Summary

The current Builder's Warranty Insurance Scheme ('Scheme') eligibility process for builders is time consuming, complicated and inhibits their ability to manage their business in an effective manner.

The inflexible approach taken to eligibility assessments restricts a builder's ability to plan their workflow over a medium to long term basis and can also prevent them from taking advantage of business opportunities as they arise.

The Master Builders Association of NSW ('Master Builders') is ideally placed to advocate for changes to the eligibility process given its long history since being founded in 1873 and its member base of some 8,000 that span the key building construction sectors.

Master Builders recognises the importance of balancing the aims of the Scheme and the impact on builders because a strong and stable residential construction industry is in the best interests of all stakeholders.

The primary aim of the Scheme is to protect homeowner's in the event that the homeowner's builder dies, disappears, becomes insolvent or has their builder's licence cancelled due to non-compliance with a court order. Claims arise broadly as a result of either non completion of works or defects in the building work performed.

Of all claims paid out pursuant to the Scheme, 88% by number are as a result of insolvency. Accordingly, the eligibility guidelines that are used to assess the financial health of a business focus primarily on the solvency.

In order to improve outcomes for all involved, Master Builders has made a number of recommendations for improvements to the Scheme. Some of these recommendations include increasing the eligibility limit applicable for each builder segment classification and utilising a standard net asset position (excluding intangible assets) based on a going concern assumption rather than what is effectively a liquidation scenario.

In addition to the recommendations around financial analysis, it is recommended that an entity's growth is managed over a 24 to 36 month period to allow greater flexibility and reduce the impact on builders and the Scheme of conducting a high frequency of reviews. Master Builders wishes to reward builders who are demonstrably a lower risk; this in turn incentivises other builders to be better.

Improvements in the flexibility of the application of job profile limits will enable builder' ability to take advantage of business opportunities as they arise.

It is also proposed to incentivise builders by reducing review requirements for those builders that have continually and successfully traded in the Scheme for ten years or more.

In recognition of the fact that 75% of total claims (by number) are paid out due to defects, it is proposed to increase the weighting given to non-financial factors in the eligibility assessment. It is suggested that one way that non-financial factors may be measured objectively is to tie it to continuing education, particularly in those areas deemed to be high risk such as waterproofing. An increase in accreditation requirements to undertake trade work that is in aggregate adversely affecting the Scheme seems to be a logical solution.

An additional non-financial indicator could be independent inspection of works completed, for instance waterproofing of wet areas that verifies work has been completed to a best practice standard. In this way, build quality and skill can be assessed and incorporated into the eligibility review process.

It is proposed that new builders progressively grow their eligibility limit and are provided stronger guidance around site-management, not just instruction on better administration that the current support system offers. This enhanced builder assistance system may also provide a “safe harbour” for experienced builders that may be in financial difficulty; this system may be able to guide builders away from troubled financial waters and avoid insolvency.

Master Builders believes that by incorporating the recommendations detailed in this report, eligibility assessment outcomes can be improved not only for builders but for the residential construction industry as a whole.

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Introduction

Discussions between the Master Builders and the State Insurance Regulatory Authority ('SIRA') have been ongoing with respect to the Scheme and the eligibility assessment process in particular. As a result of these discussions, Master Builders has been invited to make a submission with respect to suggested improvements to eligibility criteria and the application of same in order to improve outcomes for builders and the Scheme.

As part of the consultation process for this submission, Master Builders has sought input from various stakeholders including its members and MBA Insurance Services. Master Builders has consulted widely with its membership through member meetings to invite feedback on the Scheme as it relates to eligibility and sought suggestions for improvements that could be made.

Members' views were sought at Division meetings held at Manly, Castle Hill, Newcastle <Craig>[A1] and Goulburn. Over the past months, at least 200[A2] members provided feedback on the Scheme in general and the application of the eligibility criteria in particular.

During the consultation process, views were sought from stakeholders about what aspects of the Scheme worked, which could be improved and how improvements might be achieved.

In order to provide context for the changes to the eligibility guidelines proposed by Master Builders, the report first provides a brief overview of the current eligibility guidelines as they are relevant to this submission. Following on from the overview is commentary about the shortfalls of the current eligibility process before concluding with the suggested ways in which the eligibility process can be improved.

Special Note:

Due to the narrow scope of this Report it does not contemplate changes to the Scheme in general. Notwithstanding this, Master Builders believes it is in the best interests of the Scheme and the residential construction industry in general that fundamental changes are made.

For instance, in an effort to minimise phoenixing behaviour, licencing could be linked to the building entity, that is, a company must have an appropriately licenced builder as a director. This would make it easier to identify the small number of builders that engage in phoenix behaviour. This approach would also need the involvement of NSW Fair Trading to be most effective.

Additionally, there should be greater barriers to licencing. If the requirements that need to be met prior to obtaining a builders licence are increased (in an appropriate way) this would result in better building outcomes for consumers and reduce the burden on the Scheme due to defects. Additional licencing prerequisites could include greater experience requirements, increased training requirements around high risk areas such as waterproofing and basic business and financial literacy skills.

Suggested improvements and changes to the Scheme will be canvassed further in a separate report that Master Builders has commissioned.

About the MBA

The Master Builders Association of NSW is the oldest industry association in Australia, founded in Sydney in 1873.

Master Builders has approximately 8,000 members and is the only industry body representing the key building construction sectors - residential, commercial, engineering and civil construction.

Master Builders' membership is active and comprehensively covers the regional and metropolitan building and construction industry areas.

The membership is organised into 28 Divisions throughout New South Wales; each Division has an elected President and Executive Committee who facilitate regular local member meetings to inform members about the latest building materials, trends and regulatory changes.

Further, the views and interests of local members that are formulated at Division meetings are communicated to the Association's peak decision making body, the Council of Management.

Master Builders Head Office is located at Forest Lodge, Sydney and its Education Centre is located in Norwest Business Park, Baulkham Hills.

Master Builders has regional offices in Ballina, Port Macquarie, Newcastle, Gosford, Wollongong, Ulladulla, Albury and Orange.

Current Eligibility Guidelines

Overview

The current Underwriting Guidelines Version 5.1 (‘Guidelines’) as published on the Home Building Compensation Fund (‘HBCF’) website was effective from 1 December 2013. The Guidelines were updated in 2015 however the updated guidelines have not been published or made available to brokers and builders.

It is understood that the Guidelines have not materially changed with respect to the financial assessment of builders. The bulk of the changes appear to relate to the introduction of the combined open job value and open job limit however this can’t be confirmed without a copy of the current Guidelines being made available by HBCF.

For the purposes of this paper, any reference to the Guidelines is to be taken as a reference to Version 5.1 of the Guidelines.

The Guidelines prescribe an eligibility decision framework consisting of an objective financial assessment and a subjective qualitative assessment. Of these two aspects, the financial assessment is given the most weight.

According to the HBCF Claims Data (‘Claims Data’) covering the FY06 to FY16 financial years, claims paid out as a result of insolvency account for approximately 88% of claims paid by number. Given insolvency events account for the vast majority of claims it is reasonable that the financial assessment has priority.

The Claims Data also reveals that 75% of total claims (by number) are paid out as a result of defects, rather than non-completion. Defects are a fact of building life which builders are expected to rectify as part of their responsibilities. If a builder is no longer able to rectify the defects due to death, disappearance, insolvency or the building licence has been suspended due to non-compliance with a court order, the burden of rectification falls to the homeowner and the HBCF.

Ensuring a builder remains financially viable and therefore continues to operate is one way in which the Guidelines can attempt to minimise future defect claims. The Guidelines, as part of the qualitative assessment, provides a framework to assess a builders qualifications and work experience in an attempt to ensure the builder has the necessary skills to complete the work for which they are seeking eligibility.

Essentially, the eligibility criteria are focussed on attempting to determine the likelihood of a builder becoming insolvent or bankrupt. The criteria prescribed by the Guidelines are broadly designed to analyse the financial position of a business, determine its ability to withstand business shocks and ensure sufficient working capital to continue day-to-day operations.

Case law has established indicators of insolvency that can be used to assess a business’s financial position and many of these are considered by the Guidelines (as they apply to financial statements). Assessing the solvency of a business is not a straight-forward matter as a business can exhibit a number of insolvency indicators but still remain solvent. For an external party completing an assessment, it may come down to a subjective judgement based on objective factors.

The quality and skill of a builder does not necessarily correspond to a financially strong builder. As a consequence, a builder's qualifications and defects record have little bearing when it comes to assessing eligibility under the current system.

Builder Segments & Financial Risk Factors

At present, the Guidelines classify builders into one of five builder segments:

- New Builders – New Industry Entrant
- Small Builder
- Non-reviewed Small Builder
- Medium Builder, and
- Major Builder.

A builder is classified according to a number of factors; inter alia, turnover and years of experience in management or supervision roles. The classification of a builder affects the frequency of eligibility reviews and the information required to be provided for same. For further information, please refer to Section 2.2 of the Guidelines.

The classification of a builder is not the only consideration when it comes to frequency of reviews. Other factors such as court actions, change of directorship, change of nominated supervisor etc. may also trigger a review.

The Guidelines are prescriptive when it comes to what financial factors are to be considered in a financial assessment of an entity and the acceptable ranges for same.

The following table is included in Section 2.7 'Benchmarks of the Financial Strength' of the Guidelines.

Ratio	Low Risk	Medium Risk	High Risk
Gross Profit margin (Gross profit as a percentage of Cost of Goods sold)	>20%	12% - 19%	12%
Net Profit margin before tax	8%	4% - 7%	4%
Adjusted Net Tangible Assets ANTA/Turnover	10% - 15%	5% - 10%	3%
Working Capital (Current Assets/Current Liabilities)	>1.8	1.2 – 1.4	<1.0
Creditor days – Average accounts payable/Average Cost of Goods sold per day	<30 days	30 – 60 days	>60 days
Debtor days – Average accounts receivable/Average sales per day	<15 days	15 – 30 days	>30 days
Turnover change from average of past years	<50%	50 – 100%	>100%
Overhead expense (days coverage out of working capital)	>40 days	21 – 30 days	<14 days
Capital and retained earnings to turnover	>2%	1.5% - 2%	<1.5%

Many of the factors in the table on the previous page are directly assessing the solvency or risk of insolvency to the business.

While the Guidelines and assessment criteria are published (albeit have been superseded), the level of knowledge of the eligibility assessments and what the underwriters are looking for amongst builders is poor. Particularly in cases where the builder or their accountant has limited contact with the eligibility review process, this lack of understanding can create difficulties. Often what is optimal for a business from a tax planning perspective is at odds with the requirements of the domestic building insurance scheme.

Issues with the current Eligibility process

The focus of the Scheme is on maintaining adequate protection for homeowners and ensuring the ongoing financial viability of the Scheme. It is self-defeating if these objectives are satisfied to the detriment of builders as is the case in the current situation.

The main drawbacks of the current eligibility process that have been identified are:

- It reduces a builders ability to plan their workflow on a medium to long term basis
- It inhibits growth of businesses
- It is a one-size-fits-all approach when it comes to assessing the financial position of a business
- It is complicated and time-consuming

The current eligibility system does not allow the flexibility for builders to take advantage of opportunities as they become available. The eligibility limit approved for a builder is largely a function of the financial position of the business however any eligibility limit requested must be justified by a current forecast of upcoming works. This approach does not allow for much, if any, additional work than that which was reasonably expected at the time the review was conducted. Given the nature of the building industry it is not unusual for projects to be delayed or, alternatively, fast-tracked for reasons which are outside of the control of the builder.

This approach has resulted in many builders losing jobs that they otherwise could have completed were it not for the restrictions and inflexibility of the Scheme.

Many of the major issues with the current eligibility process are as a result of its restrictive nature around eligibility limits and growth. This is where it can be particularly frustrating for those builders that don’t neatly fit into the one-size-fits-all criteria. For instance, a builder who specialises in high-end builds where project values run into the millions and the construction time can be two years or more can find themselves restricted by eligibility limits. In this case an eligibility limit increase may only allow for an additional two projects whereas for a project home builder this could represent a potential increase in projects of a dozen or more.

Given the potential exposure to the scheme is capped at $340k per project the project home builder represents a much higher risk than the bespoke high-end builder for the same level of eligibility. Greater consideration should be given to this difference when it comes to matters such as eligibility limits and requests for increases.

Additionally, there are significant variations in the cost per square metre for alterations, for example, between regional and metro areas. This has the result of a builder in a regional area being able to take on more projects than an equivalent builder in the Sydney metro area despite the nature of the projects being largely the same.

These are but two examples that illustrate that the one-size-fits-all approach is flawed.

Lastly, builders generally find the eligibility review process time consuming and complicated. Master Builders believes that the compliance burden for builders can be reduced by streamlining the information requirements without adversely impacting on the Scheme or its outcomes.

Proposed Changes to Eligibility Guidelines

Overview

In order to effect change with respect to the eligibility criteria Master Builders' recommendations must balance the needs and intent of the eligibility criteria with the impact on builders.

Given this frame of reference Master Builders' recommendations will have to ensure that the financial position, and solvency, of a builder is carefully assessed while reducing the compliance burden on the builders and increasing the flexibility of the application of eligibility constraints.

Single Eligibility Review Process

The Home Building Amendment (Compensation Reform) Bill 2017 anticipates that in the future the insurance coverage provided by the Scheme will be able to be separated into two separate policies; one to cover the period of construction and one to cover the six year tail. An insurer would be free to offer either type of policy individually or both policies together as part of a package.

It is essential that, whatever the process, builders are subject to only one review of their eligibility limits. Given the amount of time and cost involved for builders in gaining and maintaining their eligibility approval, to subject builders to more than one eligibility approval process would be unjustly onerous.

Changes to Eligibility Segments

Increasing the eligibility bands for the various builder segments to account for increases in build costs and inflation will help to relieve the compliance burden on builders.

The table below illustrates the current criteria (with respect to turnover limits) and the proposed criteria to be applied to each builder segment.

Builder Segment	Current Criteria	Proposed Criteria
Non-Reviewed Small Builder	Turnover ≤$1.5m	Turnover ≤$5m
Small Builder	Turnover >$1.5m and <$3m	Turnover >$5m and <$10m
Medium Builder	Turnover >$3m and not a major builder	Turnover >$10m and <$30m
Major Builder	Various but roughly turnover >$15m	Turnover >$30m

Note: The above table addresses eligibility turnover limits only.

It is important to note that the above proposed criteria are primarily for discussion purposes and as such is general in nature and not evidence based.

According to the 31 December 2016 quarterly survey report of Major Project Homes Builders, approximately 50% of the market is serviced by only 105 builders. Smaller builders represent a relatively small risk to the Scheme and compliance time and resources could be more effectively deployed in segments that represent a greater risk to the Scheme.

Adjusted Net Tangible Assets Calculation

At present, one of the key measures of a business' financial position is Adjusted Net Tangible Assets ('ANTA'). To arrive at an ANTA position, the Guidelines provide guidance on how assets are to be discounted. The effect of this deep discounting is to arrive at a position that is analogous to that present in a liquidation scenario.

It is the Master Builder's position that a more realistic, and fair approach is to value the net asset position of a business at its going-concern value, that is without discounting the assets of a business while simultaneously including liabilities, even contingent liabilities, in full. Notwithstanding this, it would be prudent to exclude those assets that are intangible in nature.

The effect of applying the provisions of the Guidelines to arrive at an ANTA position means that a business is required to retain assets in the entity over and above those required for the business to function effectively. This can result in business inefficiencies which may hamper its ability to function at its optimal level.

It is essential that businesses are properly capitalised and supported to ensure their continued survival but this can be achieved by way of a standard net tangible asset position, rather than an onerous asset discounting regime.

Setting of Eligibility Limits – Turnover & Profile Limits

A frequent concern expressed by builders is the restriction that turnover limits, profile limits and open job limits place on their business. The main concern is not the presence of limits but rather the inflexibility of the limits and the resulting negative impact on their business.

Rigid limits impact on a builder's ability to be responsive and to take advantage of opportunities that arise in the market. It also impacts on the ability of builders to confidently plan and conduct their business.

HBCF and the underwriters have consistently advised that the preference is for a builder to seek an increase in eligibility only once per year. In addition, when it comes to considering eligibility increases only the year-end financial accounts are considered unless the interim accounts show a decline in financial performance or position. This can result in a builder being required to inject additional capital and/or sign a deed of indemnity based on out of date financial information when interim accounts indicate that a builder is sufficiently capitalised for the requested increase.

It is suggested that the eligibility guidelines can address these restrictions in two ways. Firstly, the underwriter could assess and assist the builder to manage growth over a 24 to 36 month period. This would be done while allowing sufficient room for the builder to grow and take advantage of opportunities while managing the risk associated with growth. It is not always possible to predict accurately the timing of projects given the impact that factors outside of a builders control can have on anticipated start times, construction times etc. A 12 month view of growth can often be limiting and reduce the builder's ability to manage workflow to take advantage of such things as prevailing conditions and staff availability.

Secondly, builders could be provided with greater flexibility around profile limits. Rather than profile limits being set on an individual basis, it may be more efficient to set bands for profile limits. For example:

- Band 1: single dwellings, new duplex, dual occupancy, triplex, terrace (attached), alterations and additions (structural & non-structural) less than $1m
- Band 2: single dwellings, new duplex, dual occupancy, triplex, terrace (attached), alterations and additions (structural & non-structural) less than $5m
- Band 3: single dwellings, new duplex, dual occupancy, triplex, terrace (attached), alterations and additions (structural & non-structural) above $10m.

Multi-unit dwellings would have separate bands, for example:

- Band A: multi-unit dwellings up to $5m
- Band B: multi-unit dwellings up to $20m
- Band C: multi-unit dwellings above $20m

By utilising a band structure it would reduce the need to obtain technical references for each increase requested where in many instances the skills required are no different.

An alternative approach could be to retain the current method of determining individual builders' profile limits but to build in greater flexibility in the application of limits. For instance, builders could be permitted to undertake jobs that exceed their individual profile limit by a certain amount without the need to undertake a lengthy eligibility review.

The degree of flexibility afforded to builders could be tied to their length of time in business (see suggested parameters in the following section).

For a builder with less than ten years of continuous, profitable trading the approach may be to allow the builder to exceed the individual profile limit by 25% providing the builder does not exceed their turnover limit by more than 10%.

In contrast, a builder with greater than ten years of continuous profitable trading the approach may be that the builder is permitted to exceed the individual job profile limit by 50% providing the builder does not exceed their turnover limit by greater than 25%.

Either of the above approaches to job profile limits would maintain the Scheme's ability to manage risk while allowing the builder flexibility to manage their business in such a way as to provide the best outcomes.

Reduced review requirements for long-term builders

Builders who have successfully conducted a consistently profitable business for an extended period of time should be rewarded in the form of reduced review requirements. Builders that have a proven track record and unblemished history (in terms of period of continuous trading, profitability and a sufficient net tangible asset position) should have a separate classification, for example 'Experienced builder – Reduced review requirements'. This classification should be made available to all builders and is irrespective of eligibility limit (except for non-reviewed small builders).

It is important to only include the building entity’s length of time trading rather than the builder as an individual (except when the trading entity is a sole trader). While a change of trading entity is not unusual or problematic, restricting this benefit to history of a trading entity would protect against that small number of builders who abuse the system by engaging in phoenix activity or the like.

Reduced review requirements could take the form of a decrease in the frequency of reviews. For instance, builders that satisfy the requirements of this category could be reviewed once every three years.

Both the builders and the Scheme would benefit from the use of this new category. For builders it will provide an incentive and reward for a proven track record of sound business practices as well as reducing the compliance burden. For the Scheme, it will allow scarce resources to be redirected to more high risk areas that would benefit from additional scrutiny.

When considering a building entity’s history and track record, the presence of court action should not be allocated undue weight. In many instances, court action arises as a consequence of a genuine dispute between the parties. It is not in the best interests of the builders, and therefore the Scheme, to tacitly encourage builders to settle claims where a genuine dispute exists.

Increase the weighting of non-financial factors

At present, the focus of the eligibility assessment is on identifying those builders at risk of insolvency. While it is not disputed that this is a necessary focus, it is also important to consider the quality of the work produced by builders.

The Claims Data shows that 75% of claims are for defects. It is understood that a significant portion of defects claims are as a result of such things as failed waterproofing.

There is significant scope for the eligibility criteria to attempt to reduce the level of defects claims through an acknowledgement of the skill and quality of builders. The difficulty arises in attempting to quantify this skill and quality focus.

An objective way of achieving this could be to recognise and reward those builders who undertake continuing education, particularly in those areas deemed to be high-risk from a claims perspective, such as waterproofing.

It would be important to ensure that any education is conducted to a high standard by a reputable provider. Continuing education needs to lead to effective outcomes rather than simply being a ‘tick-the-box’ exercise.

Another way of assessing build quality and skill would be for builders to engage independent assessors to inspect projects at key stages, including the quality of waterproofing (only a voluntary basis). In this context it is important to recognise that the current Australian Standard as it relates to waterproofing is insufficient in preventing damage and subsequently claims due to waterproofing failures. In circumstances such as this a better indicator of build quality would be a builder’s compliance with current best practice standards, rather than compliance with the minimum standards.

It is acknowledged that any additional inspection regime will likely result in additional costs. To make it attractive for builders to voluntarily undertake this additional cost they need to be supported by the Scheme. That is, the Scheme could encourage this approach by way of more favourable eligibility assessment outcomes for builders in acknowledgement of the reduced defects risk the builder would pose.

In this way, the eligibility criteria are working to minimising claims due to financial failure and also defective works. Together this approach would be more effective than attempting to tackle this issue from a single direction.

Conclusion

The collaboration between SIRA and Master Builders with respect to Builders’ Warranty Insurance presents a unique opportunity to positively change the way eligibility assessments of builders are conducted. Once implemented, these changes will improve outcomes for builders and the residential construction industry as a whole.

Master Builders advocates a holistic approach to eligibility assessments that incorporates not only rigorous financial assessment of a business but includes greater consideration of non-financial factors such as the length of time an entity has traded successfully in the Scheme and the quality and skill of the builder that is brought to bear on their construction projects.

In this way, the eligibility assessment segment of the Scheme is addressing both the risk of insolvency and the risk of defects, both of which have a significant impact on the types and number of claims paid out by the Scheme.

By addressing the inflexibility of the Scheme around turnover and profile limits it will allow builders to manage their workflow and job opportunities as they arise. This will assist builders to manage their businesses efficiently to achieve better outcomes.

The introduction of reduced eligibility requirements for builders with ten years or more of successful trading will assist to incentivise builders and provide a reward mechanism that recognises those builders who carefully manage their growth, profitability and build quality over the long term.

The Scheme will achieve the best outcomes when a sustainable balance between risk mitigation and minimising any adverse impact on builders’ ability to manage their businesses is achieved.

Recommendations

1. Maintain a single eligibility review process, even if the market moves to offering separate insurance policies for different parts of the construction process.
2. Increase the current eligibility bands for the various builder segments. The new bands proposed are:
    a. Non-reviewed small builder: turnover less than $5m
    b. Small builder: Greater than $5m and less than $10m
    c. Medium builder: Greater than $10m and less than $30m
    d. Major builder: Greater than $30m
3. Remove the ANTA calculation and utilise a standard net asset position (excluding intangible assets) instead
4. Managed an entity's growth over a 24 to 36 month period to allow flexibility in turnover
5. Set profile limits according to bands or allow profile limits to be exceeded up to a capped percentage of the existing limit
6. Reduce review requirements for long-term builders
7. Increase the weighting of non-financial factors in the eligibility assessment