Warranty insurers ill-equipped for flood of claims

THERE have been some high-profile building company collapses recently at the top end of town. Whether this trickles down into the residential sector remains to be seen.

Historically, the combination of a decline in building approvals with a downturn in construction activity has caused a spike in residential builder insolvency.

If this occurs then some of the insurers that provide residential warranty cover may be caught unawares and could well take a bath.

Last week's interest-rate rise certainly won't help the home building sector.

Insurers in this sector have only known the good times; they have underwritten home warranty in a prolonged period of construction buoyancy.

Yet even though insurers have operated in a robust economy, until the past couple of years they were smarting, if not haemorrhaging, from the cost of claim payouts.

This led to the big insurers pressing state and territory governments to water down the insurance requirements in the state regulations.

The result was that insurers now provide very little protection to consumers.

In Victoria, a consumer can only claim indemnity from an insurer if the builder has disappeared or become insolvent. Short of this occurring, the insurer has no obligation to pay a claim for defects or the costs of incomplete work.

Kim Lovegrove

Privately funded cover is under threat from a rise in builder insolvency

Changing times: Insurers have underwritten home warranty in a prolonged period of construction buoyancy

It's a bit like the *Dire Straits* and Sting collaboration of the late 1980s, *Money for Nothing*. Well, insurers ain't seen nothing yet. Take the case of Victoria, where residential insurance was privatised in the mid-90s.

Before then, state-backed schemes such as the Housing Guarantee Fund indemnified consumers for residential defects.

But construction activity has been buoyant since then.

Were there to be a rise in insolvency activity in the residential sector, then insurance companies would be inundated with claims.

The payout costs could be huge.

Typically, if a building company goes belly-up, many of its homes will be partially completed.

Having acted for insurers dealing with builder insolvencies, I can vouch for the fact that the cost of completing such projects increases by 30 to 50 per cent, sometimes more. There have been cases where construction cost blowouts have exceeded 100 per cent.

I remember discussing these issues with the previous government in Victoria, where the then planning minister said that the real cost blowouts on construction claims concerned builder insolvency indemnity.

The Liberals had an inkling that such indemnity could not be a long-term proposition, and consideration was indeed being given to scrapping insolvency cover.

Since then, ironically, the laws have been changed to exclude any type of claim for building defects upon an insurer, except (primarily) where insolvency occurs.

Underwriters and governments will have to keep a close eye on insolvency activity in housing.

An increase will stress the already fickle supply of product and governments could then anticipate dozens of insurers descending upon them pleading for omission of insolvency cover.

If this were to occur then privately funded warranty cover would in effect be dead, because if insolvency cover goes, there's nothing left of the product.

Governments would then have no option but to do what they have desperately been trying not to do: go back into the business of state-backed underwriting.

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