

Home Warranty Insurance – Myths and Facts

Myth: Home warranty insurance is for builders

Facts:

- ❑ Home warranty insurance is acquired by the builder and issued to the homeowner to protect them against loss due to non-completion, defects and breach of statutory warranties by the builder. It is legally required and is only triggered if a builder dies, disappears or becomes insolvent before completing the home or fixing the defects.
- ❑ Home warranty insurance does not cover contractual disputes or defective work by a builder who is still in business. These matters are dealt with under consumer protection legislation, usually through tribunals.
- ❑ Home warranty insurance is needed because:
 - ✓ It is required for the builders' registration.
 - ✓ It establishes consumer confidence in the industry.
 - ✓ It promotes the builders' adherence to building standards, in turn providing the builder with a good reputation for his or her customers and prospective customers.
 - ✓ It recognises the economic importance of the residential building industry.
- ❑ Vero currently:
 - ✓ Protects over 700,000 homeowners throughout Australia.
 - ✓ Has more than 15,000 Australian builders on its books.
 - ✓ Issues approximately 100,000 home warranty insurance certificates every year.
- ❑ Builders apply to the insurer for eligibility to have their work covered for home warranty insurance. The average cost of the home warranty insurance certificate for a home is 0.5% of the average contract value. It is usually passed on to the homeowner in the contract price.

Myth: Good builders can't get home warranty insurance

Facts:

- ❑ HWI eligibility is a consumer protection threshold requirement.
- ❑ Vero receives approximately 1,000 new builder applications a year – in 2005, 10% of those were builders new to the industry.
- ❑ Vero's decline rate was under 4% in 2005.
- ❑ Some 80% of experienced builders operate with a turnover of <\$2m. The standard turnover level for Vero's Express Assess product is now \$3m.
- ❑ >95% of builders who apply to Vero for home warranty insurance eligibility obtain it and get the turnover levels they request.
- ❑ Vero has a home warranty insurance eligibility product for builders new to the industry, a simplified process called 'First Assess' that allows them to do their first jobs without having built up the required assets.
- ❑ Vero never turns down a builder without good reason. In most cases where a builder doesn't make the first cut, discussions continue into ways that the builder might meet eligibility requirements.

Myth: Eligibility requirements are onerous and unfair

Facts:

- ❑ No-one wins when a builder goes broke so Vero's home warranty insurance eligibility criteria is designed to:
 - ✓ Minimise the possibility of builder collapses.
 - ✓ Ensure only financially sound, technically competent, builders can access home warranty insurance.
 - ✓ Help ensure builders are better placed to ride out the downturns.
- ❑ To be eligible for home warranty insurance a builder must have real assets in a business equivalent to around 10% of their turnover and sufficient margin to allow them to keep that ratio as they grow.
- ❑ Builders are categorised by a financial analysis methodology used by the majority of Australian financial institutions to assess credit risk.
- ❑ This methodology works as 80% of all insolvency claims are generated as a result of collapses of low or negatively capitalised builders who, typically, over extend.
- ❑ Builders with sound business and risk management practices welcome the discipline home warranty insurance eligibility invokes.

Myth: Builders are leaving the industry in droves because they can't get home warranty insurance

Facts:

- ❑ There are more builders in Australia now than when the scheme was introduced five years ago.
- ❑ The boom home building conditions of 2002 – 2004, during which up to 180,000 new homes were built each year, would not have been possible if difficulty in obtaining home warranty insurance eligibility had been systemic.
- ❑ During 2005, 150,000 new homes were started, nationally. Five years previously it was just 115,000.
- ❑ The annual amount spent on new homes and renovations has almost doubled in the same period with Australians now spending over \$20bn each year.

Myth: Builders rarely go broke

Facts:

- ❑ Building is a cyclical industry. Underlying economic conditions have a significant impact on the likelihood of builder collapses. In 2000, the year GST was introduced, Vero received more than 1000 claims from homeowners as a result of builder insolvencies.
- ❑ Builder insolvencies, deaths or disappearances resulting in claims on Vero were approx –
 - ✓ 2000 – 165 builders
 - ✓ 2001 – 155 builders
 - ✓ 2002 – 110 builders
 - ✓ 2003 – 90 builders
 - ✓ 2004 – 95 builders
 - ✓ 2005 – 95 builders
 - ✓ 2006 – 50 builders so far.

- ❑ The average builder insolvency affects at least 5 homeowners.

Myth: Vero caps the work the builder does

Fact:

- ❑ Builders are provided eligibility for home warranty insurance up to the amount of turnover that the current assets in the business will support. Builders who are growing can request higher turnover eligibility and, provided they are earning sufficient margin on their new jobs, the request is usually approved.
- ❑ Tying eligibility to turnover has been represented as a 'cap' by those who want a return to a state run insurance scheme or home warranty insurance abandoned as a consumer protection mechanism. In fact, less than 10% of builders, nationally, request an increase in their turnover eligibility.
- ❑ Eligibility utilisation rates by Vero builders runs at approximately 40% of the aggregate amount on issue.

Myth: Small builders and new builders are disadvantaged

Fact:

- ❑ Vero offers builders with a turnover less than \$3m home warranty insurance eligibility up to \$3m with a contract level of \$450,000 along with an easier assessment process and a rapid application turnaround. This caters for around 80% of all builders.
- ❑ The average contract value for builders with eligibility up to \$3m is less than \$120,000.
- ❑ The aggregate eligibility utilisation level for those builders is less than 20%.
- ❑ Start-up / new builders can also apply for home warranty insurance eligibility on a job by job basis without a requirement for capital until they build their business and are ready to move into a different classification.

Myth: Insurance companies aren't taking on any risk

Fact:

- ❑ Home warranty insurance provides cover to the homeowner for up to seven years after the home is completed. So the premium taken at the commencement of the project is for claims that may arise at any time during this period.
- ❑ Claims can occur throughout the policy period and, typically, there is a spike in claims as the seven year period is ending.
- ❑ A combination of tighter home warranty insurance eligibility criteria and improved economic conditions has seen the number of homeowners making claims because of builder insolvency drop, but they are still significant. Vero received:
 - ✓ 1,000 insolvency claims during 2000
 - ✓ 1,000 insolvency claims in 2001
 - ✓ 650 insolvency claims in 2002
 - ✓ 600 insolvency claims in 2003
 - ✓ 650 insolvency claims in 2004
 - ✓ 550 insolvency claims in 2005
 - ✓ In 2006 we have received 300 insolvency claims to date.