

A Guide to
Home Warranty
INSURANCE



Prepared by JLT Builders Insurance Services



JARDINE LLOYD THOMPSON
Pty Ltd

Guide to Home Warranty Insurance

This Guide is to assist accountants and builders/contractors in the process of obtaining and maintaining Home Warranty Insurance.

Home Warranty Insurance is a compulsory insurance for residential work. It is the responsibility of the builder/contractor to obtain Home Warranty Insurance where the residential building work or the supply of kit home is valued at over \$12,000.00 including GST.

Home Warranty Insurance is a last resort Insurance that the builder/contractor obtains for the benefit of the home owner. Home Warranty Insurance allows a claim to be made where the contractor has become insolvent, disappeared or died. The home owner is covered for the loss caused by:

- ▲ Structural Defects.
- ▲ Non-structural defects.
- ▲ Incomplete work for a period of 12 months after failure to commence, or cessation of, work.

The Home Building Regulation 2004 (NSW) states that structural element of a building means:

- a) **Any internal or external load-bearing component of the building that is essential to the stability of the building or any part of it, including things such as foundations, floors, walls, roofs, columns and beams, and**
- b) **Any component (including weatherproofing) that forms part of the external walls or roof of the building.**

Please note: The insurers may consider some non-structural works as structural for the purpose of Home Warranty Insurance as if the work is defective it may have an effect on the structure (e.g.: Bathroom renovations as waterproofing is required)

For information regarding the Home Warranty Insurance legislation for your state please visit:

ACT www.actpla.act.gov.au

NSW www.fairtrading.nsw.gov.au.

NT www.ipe.nt.gov.au

SA www.parliament.sa.gov.au

TAS www.consumer.tas.gov.au

VIC www.consumer.vic.gov.au

WA www.slp.wa.gov.au

Home Warranty Insurance must be obtained before commencement of the work in all states.

Period of Cover Table for the different States.

STATE	MINIMUM VALUE OF WORK	LENGTH OF COVER FOR STRUCTURAL WORK	LENGTH OF COVER FOR NON-STRUCTURAL	MINIMUM COVER TO BE PROVIDED BY INSURER
ACT	\$12,000	6 Years	2 Years	\$85,000
NSW	\$12,000	6 Years	2 Years	\$200,000
SA	\$12,000	5 years		\$80,000
TAS	\$12,000	6 years		\$200,000
VIC	\$12,000	6 Years	2 Years	\$200,000
WA	\$12,000	6 years		\$100,000

The Insurers Risk

An insurer takes no direct security over the physical assets of the builder/contractor and therefore has no direct recourse against a builder/contractor if insolvency occurs. This is why the builder/contractor is required to undergo a financial assessment when initially applying for eligibility and undertake regular financial reviews to maintain eligibility to purchase insurance certificates. The reviews are important as the insurer can detect if there could be a problem in the business and recommend steps to minimise the insolvency risk.

In 2001 two builders became insolvent and left a total of 36 unfinished contracts between them. The cost to the insurer was over \$4,500,000.00.

For example: A small builder who undertakes ten jobs per year becomes insolvent could leave unfinished or completed but defective homes creating a maximum potential liability of up to \$14,000,000.00 for the insurer (6 years x 10 jobs per year x \$200,000.00). No matter what security the builder/contractor provides it is never likely to be sufficient to cover claims.

Gaining Eligibility

Some of the common elements that some insurers look for to gain a favourable assessment to grant eligibility of Home Warranty Insurance are:

- ▲ Job Costing Information
- ▲ Assets
- ▲ Creditor and Debtor days
- ▲ Financial profitability
- ▲ Gross Margins
- ▲ Credit History
- ▲ Some insurers also look at the quality control and risk management program of the business. They will also request copies of any awards that have been won in the building industry.

The assessment by some insurers is approximately 80% financial and approximately 20% non-financial.

The reason for this is that the Home Warranty Insurance policy only comes into effect as a result of the insolvency, death or disappearance of a builder. This means that the insurers main focus is the financial performance of the business.

Non-financial aspect of a building business

Claims and complaints History

A poor claims and complaints history can have an impact on the assessment. If there is adverse information regarding a claim or complaint the insurer will require details in writing and copies of official documentation.

Job Costing System

If you use a recognised computer system to cost jobs the insurer considers that you are more likely to be able to operate within budget and have fewer cost variations. However the insurer feels that if the business does not have a job costing system it may be subject to considerable cost blow outs.

Builder Experience or time in business

Technical competence

Net Tangible Worth (NTW)

NTW is the total assets position of the business, whether, company, trust, partnership or sole trader.

The NTW is calculated on the total assets after deducting, liabilities, goodwill, intangibles, related party balances including investments and applying a discount factor to the assets where appropriate for sole traders & partnerships.

NTW is important to the builder/contractor as it is the primary example of strength and the financial risk of the business.

For businesses applying for warranty for the first time some insurers may require a minimum NTW of 5 to 10% relative to the annual turnover sought. For example, if you were seeking an annual turnover of \$1,000,000.00 some insurers may require an NTW of \$50,000.00 to \$100,000.00

ASSET	DISCOUNT %
Primary Home (Assumes Home is jointly owned with spouse)	Equity x 25%
Primary Home if in Partnership with spouse	Equity x 50%
Other Property	Equity x 60%
Motor Vehicles	Equity x 50%
Tools/Equipment	Equity x 50%
Cash	100% if supported by a recent Bank Statement
LIABILITIES	
Credit Card Debt	100%
Overdraft	100%

NTW for companies

If the NTW of a company does not reach the 10% requirement, an insurer may request it to be made up of either a Capital Injection of funds into the company or an unconditional Bank Guarantee. (A Bank Guarantee is usually 20% of the annual turnover sought)

A capital injection must be in the form of fully paid up ordinary shares. When the NTW is increased by a share issue a copy of the ASIC FORM 484, minutes of meeting of directors and copies of the share certificates need to be provided to the insurer.

Some insurers may also request a Related Party Undertaking or Deed of Guarantee and Indemnity be completed by the directors. These forms are used to include assets from a related company or directors in the assessment. As these forms are legally binding, the insurer will recommend that you seek legal advice before signing.

Financial Information Not Included In the NTW Assessment

Related Party loans and Related Party Investments are removed from the calculation for NTW as in the event of insolvency, the loans owed by the company will remain, however the likelihood of recovery of loans out, or investments is doubtful. Attempts to recover these loans often leads to the insolvency of the related entity.

Investments in related parties often have no tangible value and are removed from the calculations.

Other assets that are removed from the calculations of NTW are goodwill, franchising fees, initial costs and other intangible assets as they normally have no value in the event of insolvency.

NTW for Trust, Partnerships or Sole Trader:

If the NTW does not reach the required level the insurer may request an unconditional Bank Guarantee.

A way in which a sole trader can increase their asset base is through retained profits to purchase assets. Similarly partnerships can also increase the NTW this way or the partners can choose not to take the partners drawings.

Some insurers will not accept trusts as an appropriate trading entity. Building licenses can not be issued in a trust name. Trusts usually have nominal capital and are unable to retain profits.

Please Note:

Bank guarantees that support turnover usually remain in place for the duration of the Warranty period relating to the last project completed.

For Example: You cease trading on 01/07/2005. The Bank Guarantee would be released after the period of warranty cover in accordance with the state legislation. This would mean in NSW, subject to the insurers discretion, if the very last project was completed 01/07/2005 the Bank Guarantee may be released 01/07/2011.

If the builder/contractor can demonstrate that they have reached a sufficient level of NTW and can meet other financial criteria to support the annual turnover, then the Bank Guarantee may be released at the insurers discretion.

Please be aware that running a company to minimise taxation is usually detrimental to gaining eligibility for HWI.

Other Financial Criteria

Insurers also take into account debtor days and creditor days. The insurer usually requires the creditor and debtor days to be no more than 30 days.

Supporting Documents Required to Apply for Eligibility

1. Job Status Report.

This report is often requested by the insurer when the builder has current eligibility for HWI or in some situations they will request the report to see what activity has taken place over the past 12 months, whether commercial or jobs under \$12,000.00.

Information that is to be included on a job status report:

- Owner Name
- Site Address
- Type of Construction
- Construction Stage
- Contract Amount
- Current Contract Amount Outstanding
- Start Date
- Expected Completion Date

2. List of Jobs Seeking to Insure.

This report is requested to give the insurer an idea of what jobs may be coming up. Information that is to be included on a list of jobs

- Site Address
- Type of Construction
- Contract Amount
- Start Date
- Expected Completion Date

3. Financial Information

This information is used by the insurer to calculate the risk rating and whether they are willing to approve eligibility.

- A company is to provide the full & final Financial Statements including, Profit and Loss Statement, Trading Statement, Balance Sheet, Notes to Accounts, Compilation Report, Accountants Statement and Directors Declaration. These accounts need to be signed by the Accountant and the directors. If a newly incorporated company an opening Balance Sheet is required.
- A sole trader or partnership is to provide the full Tax Returns (Not Assessment Notices). The insurers will accept Profit and Loss Statement and Balance Sheet if they are accountant prepared and are accompanied by the Accountants Statement or similar.
- Dependant on the annual turnover being sought or the time since the last financial reporting the insurer may request Interim Accounts. These accounts are dated from the 1st July to the most recent quarter. The Interim Accounts are not to be more than 6 months old.

4. Copy of Rates Notices

For properties listed on the Statement of Assets & Liabilities or Balance Sheet.

5. Technical References

References are required if you request a contract limit for individual jobs above the standard limit set by the insurer or if you require a contract limit for pools.

- Two written references from either an architect, surveyor or engineer in support of the builder/contractors technical ability. The references must be job specific and include details of completed works such as, job address, contract amount, start & completion dates, the type of work, the role of the builder/contractor and a comment on the competencies in technical skill and contract administration.

6. Copy of current building/contractor licence

In all states other than Victoria and Tasmania it is a requirement that the name on your builder/contractor licence and the name under which all finances for your business are recorded and all contracts entered into be the same. For example if you are trading as a company the building licence will need to be in the company name.

7. Copy of Registration of business

8. Copy of Industry Association Membership

For example: HIA, MBA, SPASA etc. Showing member number and expiry date. A copy of the current card will be sufficient.

9. Architect Tender Approval

Two written references from an architect, for work previously tendered and completed in a builder or management role. The references must be job specific and include details of completed works such as, job address, contract amount, start & completion dates, the type of work, the role of the builder/contractor and a comment on the competencies in technical skill and contract administration. If you have not previously tendered for work with an architect some insurers may require an architect/draftspersons statement be completed by the architect.

10. Pool Builders

A written complaint history from the relevant authority.

Please note: This information is the minimum requirement set by the insurers. If the information is not complete when an eligibility application is lodged we are unable to forward the application to the insurer, which will cause delays in assessment.

On occasions the insurers will request further information to assist in the assessment, particularly if you are trading as a company that has experienced losses, carried forward losses or if the company has minimal NTW.

This could be:

- ▲ Current Trade Creditors and Trade Debtors Lists
- ▲ Details of security to support secured loans listed as liabilities on a balance Sheet (this is usually only requested for company entities)
- ▲ If the application for eligibility is for a company and the company has experienced losses on the financial statements the insurer will request an explanation for the losses and the step being undertaken to bring the company into profit
- ▲ Bank Statement to support cash listed as an asset on the Balance Sheet or Statement of Assets & Liabilities
- ▲ Copies of Rates Notices to support properties listed on the Balance Sheet or Statement of Assets & Liabilities
- ▲ Details of related party loans and security details of such loans.

The insurers do not look favourably on retained losses, in particular if the loss has been carried forward over a period of time. Even in the event when the company has made an operating profit for the reporting year, however the retained loss carried forward has wiped the operating profit and returned a negative result.

High Rise or Multi Storey

Although new construction for Multi Storey development (Refer to the Building Code of Australia for multi storey definition) are exempt from the HWI requirements the refurbishment on existing developments does require HWI.

There have been problems in the past with obtaining Warranty Certificates for these projects however, the latest information is as follows:

- ▲ Vero will consider Multi Storey refurbishments on a case - by - case basis if it does not involve work to the common property.
- ▲ CGU will consider all Multi Storey refurbishments.
- ▲ Lumley General will consider on a case - by - case basis.

In cases where within a new development there are both hi-rise and low-rise components Vero at this time will not issue certificates of insurance.

Multi Unit

A Multi Unit project means a development with 10 or more units in Vic, SA, Tas, WA and 4 or more units in NSW. Each insurer has different assessment criteria for these projects, however on the most part require the builder/contractor to be technically experienced in this type of work.

For information regarding the Multi Unit or Multi Storey requirements please contact our customer service team on the telephone numbers listed below.

If you have current eligibility for HWI with another broker and would like Jardine Lloyd Thompson to be your broker of choice we only require a letter of appointment to be signed by the builder/contractor. For more information please contact our customer service team on the telephone numbers listed below.

Please be aware that this is a guide only and that the insurers can change the eligibility criteria.

To gain the best results for the eligibility assessments we are happy to meet or discuss the financial assessment with builders/contractors and accountants.

Jardine Lloyd Thompson Builders Insurance Services (BIS) provide Home Warranty Insurance products from the major insurers. We act on your behalf to gain eligibility for Home Warranty Insurance in NSW, South Australia, Victoria, Tasmania, Western Australia and in 2006 Northern Territory. We endeavour to make the eligibility process as effortless as possible by giving the best advice and choice of insurers.

At (BIS) our expert Account Executives and Brokers can offer an extensive selection of other insurance products and services for your business.

- ▲ **Contract Works**
- ▲ **Third Party Legal Liability**
- ▲ **Construction Plant, Machinery and Tools of Trade**
- ▲ **Advance Business Interruption**

- ▲ Professional Indemnity
- ▲ Business Pack
- ▲ Workers Compensation
- ▲ Motor Vehicle Commercial Insurance
- ▲ Industrial Special Risks
- ▲ Income Protection
- ▲ Insurance Bonds
- ▲ Director's & Officer's Liability

BIS also provide Premium Funding at competitive rates for certain products.

You can contact our customer service team on 1300 300 431, 1300 722 116 or 02 9290 8000 or alternatively send an email on builders@jlta.com.au.