Body Corporate [redacted]

The Secretary
House Standing Committee on Social
Policy and Legal Affairs
PO Box 6021
Parliament House
CANBERRA ACT 2600
AUSTRALIA

13 January, 2012

Re : Inquiry Into Residential Strata Title Insurance

This submission responds to the Terms of Reference notified on the website for the Parliament of Australia, in relation to rising insurance premiums for residential strata title dwellings. While some confidential information is provided in this submission, the Body Corporate sees no reason for it to remain confidential as it relates to the case that is made herein.

Terms of Reference

That the House of Representatives Standing Committee on Social Policy and Legal Affairs also inquire into and report on the affordability of residential strata title insurance, particularly in Northern Australia, and factors influencing this, including:

(a) The magnitude of the increases in the cost of residential strata insurance over the past 5 years, the reasons for these increases and whether these increases are likely to be sustained;
(b) The ability of insurers to price risk and the availability of accurate data to allow for this;
(c) The extent to which there is a failure in the insurance market for residential strata properties either generally across Northern Australia or in some regions in particular, for example due to a lack of competition between insurers;
(d) Whether consumer awareness of different insurance options should be enhanced;
(e) The extent to which the nature of body corporate arrangements are contributing to affordability difficulties;
(f) Whether the conclusions regarding (a)-(e) provide justification for government intervention in the residential strata insurance market, noting the existing responsibilities of Commonwealth, state and local governments, for example:
- the Commonwealth Government has responsibility for insurance regulation under the Insurance Act and the Insurance Contracts Act and

competition and consumer regulation under the Competition and Consumer Act; and

- state governments (and local governments where appropriate) have responsibility for strata title legislation, building regulation, land use planning regulation and specific state government interventions in insurance markets (for example home builders warranty insurance, compulsory third party insurance).

The Inquiry should have regard to the following principles:

- Individuals and businesses should be encouraged to insure themselves where practicable.
- Government intervention in private insurance markets is justifiable only where, and to the extent that there is clear failure by those private markets to offer appropriate cover.

Executive Summary

The Terms of Reference applicable to the enquiry identified above are individually addressed herein. The primary points are as follow :-

(a) There is a legal obligation on the Body Corporate to provide building insurance cover on our strata title property;
(b) Insurance premiums have risen, even despite the lengthy years of drought and will continue to do so;
(c) The rate at which premiums have increased to date bears no relationship to the meagre increases in the value of the property;
(d) Withdrawal of insurance companies from the market has resulted in the need for the remaining companies to pass additional risk to global re-insurers;
(e) There has been no corresponding withdrawal of insurance companies from other markets involved with natural disasters in other regions of Australia;
(f) Global re-insurers price risk according to worldwide events, not to events in the North of Australia;
(g) The rate at which premiums continue to increase is beyond the ability of the Body Corporate to assess or provide for adequately in our budget;
(h) Property values reduce because of the few buyers who might be prepared to accept the upward spiralling premiums;
(i) Reduced property values trap owners because, for the most part, they are unable to sell as there are few buyers;
(j) Reduced property values result in reduced construction activity for new properties, impacting on employment availability and taxation revenue;
(k) Reduction in availability of housing will discourage decentralisation of the population and result in a greatly reduced contribution to the local, State and national economy;
(l) The case has been made, herein, for government intervention in the re-insurance market so that risk assessments can be based more equitably on the local level of risk, without consideration of natural disasters anywhere else in the world.

Given these points, the Body Corporate believes that the principles governing the inquiry can be readily met.

Response to Terms of Reference

The magnitude of the increases in the cost of residential strata insurance over the past 5 years, the reasons for these increases and whether these increases are likely to be sustained.

The following tabulation shows the status of insurance premiums for our strata title property for the past five (5) years (Note that BSI means "Building Sum Insured") :-

Period	Insurer	BSI	Premium	Percentage
2006/2007	[redacted]	$3,339,000.00	$4,800.00	N/A
2007/2008	[redacted]	$3,410,000.00	$5,790.00	+ 20.625%
2008/2009	[redacted]	$3,567,000.00	$5,270.00	– 8.981%
2009/2010	[redacted]	$3,689,000.00	$6,290.00	+ 19.355%
2010/2011	[redacted]	$3,836,000.00	$10,216.00	+ 62.417%

For the period 2011/2012, based on a BSI value of $4.066,000.00, the quote by [redacted] was $27,833.00, which would have represented a percentage increase over the previous year of 172.445%. By **excluding** "catastrophe cover", we obtained a quote from [redacted] of $13,598.00, which represents a percentage increase of 33.105% over the previous year. For comparison purposes, the percentage increase in the BSI value in each period is as follows :-

Period	BSI	Percentage
2006/2007	$3,339,000.00	N/A
2007/2008	$3,410,000.00	+ 2.126%
2008/2009	$3,567,000.00	+ 4.604%
2009/2010	$3,689,000.00	+ 3.420%
2010/2011	$3,836,000.00	+ 3.985%
2011/2012	$4,066,000.00	+ 5.996%

As with any other responsible Body Corporate, we have always budgeted for an increase in the insurance premium and kept fairly close to the upward trend although increases around the 20% mark were beyond our expectations. It needs to be noted, of course, that we must set out our budget over a year in advance, in order to meet our reasonable expectations in regard to the likely nature of an increase in the next year. The increases for last year – and the quote from [redacted] for this year – were, however, well beyond our expectations because, at the time when we framed our budget, there had been no significant natural disasters and it should be noted that, in the previous years, the risk had been very low due to the prolonged drought which affected the whole of Australia.

Insurers have progressively withdrawn from the market for strata title properties, right across the north of Australia, due to increased risk of natural disasters. It seems that they were happy to take our money when times were easy, but not when times started to become harder. The lack of insurers in the market, combined with the overall level of risk assessed by re-insurers for worldwide calamities, especially meant that last year's increase was out of proportion to the risk for strata title properties across the north of Australia.

Given the very slight increases in BSI value over the period involved in this review, combined with a continuing risk of natural disasters in Australia's summer months, the upward trend that has been evident to date will continue. This will be especially true with fewer insurers being prepared to engage in this market – and the level of risk assumed by re-insurers, due to their potential exposure to other episodes such as earthquakes in New Zealand, disasters in Japan, floods in Thailand, tornadoes and hurricanes affecting the United States of America, etcetera. All insurers are obliged to prove adequate funds to cater for the risks to which they are exposed and the situation is compounded by the greater risks assumed by re-insurers, resulting is a never-ending upward cost spiral.

It must also be noted that, in the period under review, the majority of the properties that have been affected by natural disasters, across the North of Australia have generally been the older types of properties. Damage has certainly been inflicted on some of the newer strata title properties – especially those right in the path of Cyclone Larry in 2006 and Yasi in 2010, but few of those properties were actually destroyed, requiring total rebuilding. Indeed, while our own strata title property has existed for 30 years, it has weathered many cyclonic events very well indeed, so we have to wonder why our insurance premiums are penalised because of events that occur elsewhere in the world.

It also concerns us that the insurance companies do not appear to have withdrawn from their markets in other parts of Australia, outside of the tropics. They continue to offer insurance in the wake of the Brisbane floods, as well as flood and bushfires in New South Wales and Victoria. It is our belief that our premiums are likely to be have been increased to subsidise premiums in other regions of Australia and we see this as being completely unfair.

The ability of insurers to price risk and the availability of accurate data to allow for this.

As indicated above, we believe that the problem rests with insurance companies who offset risk through re-insurers that take a global view of exposure to disasters. The only time that we have accurate data to assess our own level of risk is when the quotes arrive for each year's premium, as the insurance companies will not provide any transparency of process ahead of time. If we had access to their own risk assessments – which will be made 5 or even 10 years ahead – we might be able to budget more accurately.

Being unaware of the level of risk that insurers and re-insurers assess – and clearly not being able to access their risk assessments – we have no idea what sort of data they use. We are left with a guessing game and, as shown in the previous tabulations, it is impossible to predict the massive increases that we have seen to date. All of our budgeting is based on the level of risk that we see in our own region because we understand our own risks very well – the thing we do not (and cannot) understand is the risks to insurance companies profits from events that occur outside our region.

We accept that private and public companies are in business to make money, but we feel that they are profiteering from us in order to remain competitive in all their other markets.

The extent to which there is a failure in the insurance market for residential strata properties either generally across Northern Australia or in some regions in particular, for example due to a lack of competition between insurers.

At a meeting held in Cairns, in November 2011, it was explained that a progressive withdrawal of insurance companies from the strata title market, across Northern Australia, complicates the situation for those that remain in the market. The problem for them is that they either accept more risk – for which they are legally obliged to have sufficient financial resources – or they have to decline new business, while passing on their existing risk to re-insurers.

There is a limit for this level of risk to the re-insurers too, so they need to increase premiums in order to cover the higher risk. This gets back to the issue of worldwide exposure to risk for the re-insurance companies and, therefore, the level of their exposure rises beyond that which has been seen in Northern Australia.

Whether consumer awareness of different insurance options should be enhanced.

We, like most other responsible Body Corporates, have had to deal with an ever expanding "learning curve" when it comes to insurance options. The reason why we were able to reduce our insurance premium for the current year is by learning that we can remove the "catastrophe cover", which would result in payment of much more than the BSI value. We found that many of the insurers who are still in the market are not prepared to issue cover that includes a provision for "catastrophe cover".

The effect, for us, is that in the event of a total loss, we will only receive the BSI value, which may or may not be adequate for rebuilding. This is a risk that we have been forced to take from the insurance company, in order to meet our own legal requirement to provide insurance for the building. We believe that the BSI value should be adequate recompense for lot owners but it is most unlikely that any of the owners will want to rebuild in the wake of a total loss.

Such a decision will result in less housing availability for an expanding population. As such, it is most unlikely to be in the national interest and certainly not in the interests of the government of Queensland.

The extent to which the nature of body corporate arrangements are contributing to affordability difficulties.

This Body Corporate tries to make responsible and considered decisions in its insurance dealings. To do otherwise is a dis-service to lot owners and a violation of the regulations governing the activities of the Body Corporate. With 16 lots and 2 units within our complex, involving 18 owners of strata title property, we have a small Body Corporate membership which has been relatively stable over the years involved in this review, but we believe that our arrangements do not contribute to affordability difficulties as we are very careful with budgeting and expenditure.

It needs to be noted that our obligations include property maintenance costs as well as having to provide funds to meet ever-expanding legal requirements such as those related to pool safety. We have met each of those obligations responsibly but the costs did not allow us to continue the building insurance with catastrophe cover. As we are not in the business of making a profit, we are in a very different situation to that of the insurance and re-insurance companies with whom we are required by law to deal.

Whether the conclusions regarding (a)-(e) provide justification for government intervention in the residential strata insurance market, noting the existing responsibilities of Commonwealth, state and local governments.

As already indicated in this submission, the lack of insurers in our market means that more risk is passed on to re-insurance companies that take a global view of risk. This means that there is no local body to assess local risk appropriately, in the interests of Australians living in Northern Australia. Accordingly, we believe that our actual level of risk is not being assessed in Australia's own interests.

It seems clear that the upward spiral of insurance premiums will continue and this will become less and less affordable in a situation where the law requires us to have building insurance. Owners are now trapped in this spiral because there is no way to sell their property because buyers will not accept the heavy burden of such high premiums. This will make strata title properties valueless and will not contribute to further building of such properties – which will impact of housing availability for Australians in Northern Australia.

State and Federal governments encourage decentralisation of the population. There are a great many strata title properties across Northern Australia but, if they cannot be built and/or occupied, people will not come to this region. The value of all these properties will plunge, affecting everything from land tax valuations to the decentralisation policy itself, which will not allow the region to prosper and provide further employment.

Perhaps the most significant individual factor is that many strata title properties are in the rental market. With massive rises in insurance premiums, owners of such properties are forced to contemplate massive rent increases. To do so, however, will force people out of this type of rental accommodation because they will not be able to afford to pay the higher rent. People who look to the rental market will not want to pay significantly higher rent and so owners are forced to continue to rent their properties at a loss that will have an impact on their own viability as well as to national tax revenue.

Given these factors, amplified by the considerations in the previous parts of the Terms of Reference, we believe the case has been made for government intervention to establish a locally-based re-insurance scheme. Such a scheme is likely to entice more insurance companies back into the market, which improves competition and thereby reduces the premiums that Body Corporates must pay.

Government intervention in re-insurance will result in more building growth that will be attractive to people seeking to move to Northern Australia, to increase the workforce and provide more jobs. More jobs means more tax revenue; more building means more land tax revenue – all of which facilitates decentralisation and a flourishing economy, which is in the national interest as well as the interest of the Queensland, Northern Territory and Western Australia governments and all of the citizens across Northern Australia.

An expansion of jobs will be of great assistance to the Tourism and Hospitality industries as well, thereby encouraging more international and domestic tourism. This would also be in the national interest, as well as the interests of the individual States and Territory involved.

We believe that government intervention should be confined to re-insurance and not be targeted at locally-based insurance companies themselves. A scheme that involves re-insurance will provide encouragement to the insurance companies without the need to legislate a requirement for insurance companies to enter the market. Any such legislation can only result in much higher premiums, which will do nothing to address the underlying cause of the problem, which is re-insurance.

Response to the Guiding Principles of the Inquiry

Individuals and businesses should be encouraged to insure themselves where practicable.

The Body Corporate is required to provide insurance and is happy to do so, provided that the premiums relate to the risk applicable to our property. As indicated in the points made in preceding sections of this submission, we believe that this can only happen if we have a government-based re-insurance scheme to encourage competition between insurers and attract more insurers to the market.

Government intervention in private insurance markets is justifiable only where, and to the extent that there is clear failure by those private markets to offer appropriate cover.

The law requires insurance companies to have adequate resources to cover the level of risk that they accept and this can only be achieved through the use of global re-insurers. The failure is in the re-insurance market because many insurers have been forced to withdraw from the market because they cannot compete realistically on premiums and, therefore, face higher risk themselves.

Government intervention in the re-insurance market will allow risk to be priced on the basis of the local level of risk in each region of Northern Australia, which should include the historical safety of strata title units over many years of natural disasters. This is the action that will encourage more insurance companies into the market, thereby allowing market forces to provide competition for business and, as a consequence, allowing insurance premiums to reduce to more realistic levels.

Committee Member
On behalf of the Body Corporate
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