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Consumer Property Acts Review Issues Paper No. 2 – Owners corporations

SUBMISSION – Strata Community Insurance Agencies Pty Ltd, 27 April 2016

About Strata Community Insurance

Strata Community Insurance is an independently owned strata and community title insurance specialist, underwriting on behalf of the Allianz Group, the world's largest property & Casualty Insurer. It is a business founded, owned and staffed by a group of Australia's most experienced strata insurance professionals, and designs and builds specialist insurance products and services to the strata and community title sector Australia-wide. The directors and staff have over four decades of strata and community insurance experience across six countries, including some of the world's most challenging markets – the United States of America, the United Kingdom and the Middle East – and are well positioned to offer credible input into this process.

Strata Community Insurance welcomes the opportunity to make a submission to Consumer Affairs Victoria (**CAV**) in relation to *Consumer Property Acts Review Issues Paper No. 2 – Owners corporations* (**Issues Paper**), as part of its Consumer Property Law Review.

Further information

Should the CAV wish to discuss any aspects of this submission or require any further information, please feel free to contact:

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Approach to this submission

This submission primarily addresses Part 4.6 of the Issues Paper dealing with insurance – and particularly consultation question 24. However, the matters discussed are of broad application and may have relevance with respect to other consultation questions and discussion prompts throughout the Issues Paper. In this regard we have not structured the submission as a response to any particular consultation question(s), but as a series of topics of relevance to the current review.

The important role of risk transfer (insurance)

A significant number of owners in strata developments do not understand what an owners corporation is, nor what role insurance plays in reducing risk and exposure to them personally for unplanned financial call ups (via special levies).

Owners corporations are unlimited liability legal entities, and lot owners have an uncapped financial obligation to the full extent of their personal assets arising from the shortfall of funds to meet:

- the statutory obligation to fully reinstate the building following loss or destruction;
- liabilities the Owners Corporation or its members may have to its employees, contractors, or to third parties; and
- (*for those who volunteer to act as office bearers or sit on committees*) funding for legal defence to claims from fellow owners in tort or equity, arising from any alleged act, error or omission.

When we acknowledge that Owners Corporations and their owner members face an inherent mismatch between the assets of insurance (which is finite) and the unlimited liabilities of the legal entity, one will recognise the value of that insurance plays as a risk transfer mechanism - thus forming an integral part of financial risk management of owner's personal liabilities.

The closer the match of the level of insurance cover is to the owner's corporations current, future and other potential liabilities, the less owners need to fund from the reserves of the owners corporation (*which are negligible at present*) or from emergency call ups. Owners who are retired, without income, or perhaps even highly geared, are unlike to have cash or other liquid assets readily available to meet unexpected financial call-ups. Thus exposing other members to their potential default.

With this in mind, we offer the following observations and recommendations:

(A) Building Valuations for Insurance purposes

The importance of obtaining valuations for insurance purposes

To some extent all strata legislation specifies the type of insurance policies required for schemes and their buildings. Sometimes it is as simple as requiring a "replacement or reinstatement" policy. In the case of Victoria, there are four critical elements that must be satisfied:

- The cost necessary to replace, repair or rebuild the property to a condition substantially the same, but not better or more extensive than its condition when new – including the owners corporation's portion of any shared services.
- The payment of expenses necessarily and reasonably incurred in the removal of debris.
- The remuneration of architects and other persons whose services are necessary and incidental to the replacement, repair or rebuilding of the damaged property.
- Public liability insurance in respect to any bodily injury to or death or illness of a person; and any damage to or loss of property, in connection with the common property.

The amount of cover required must be sufficient to achieve the outcomes required by the legislation. The most effective way to determine this figure to ensure sufficient coverage is by regular valuation. This helps to prevent underinsurance, which can result in substantial loss to lot owners in the event of a major incident.

In our experience, many owners corporations either do not engage a qualified valuer, or rely on valuations that are many years old and not updated. This places the owners corporation and its members at risk of being substantially underinsured and of being unable to reinstate their assets in the event of a major or total loss.

A statutory requirement to undertake regular valuations for insurance purposes is one way to ensure that lot owners are aware of the full cost of replacement, and provides them with important information they require to properly establish appropriate sums insured – to avoid underinsurance and limit their own exposure.

Valuations need to include an escalation factor accounting for the amount by which the above costs and expenses may increase over the approval and rebuilding process, calculated as from the expiry of the relevant policy of insurance (assuming a loss occurs at the end of the period of insurance). Indexing limits each year to take into account building cost inflation is also essential between valuations, to ensure owners are minimising risks to underinsurance.

We also see the need for a statutory requirement for compulsory valuations to prescribed standards following the handover from a developer upon the registration of a new development as a strata scheme. In most cases, developers insure to minimum requirements – essentially enough to cover sunk building costs. There is a quite a gap between this level of cover (which owners inherit) and what they find out they need upon an adequate valuation (base on future costs). Some new schemes can be significantly underinsured in the early years of taking occupancy – anecdotal around 30% from our experience.

Current law – section 65

Section 65 of the *Owners Corporations Act 2006* (Vic) (the **Act**) requires '*prescribed owners corporations*' to obtain a valuation – every 5 years or earlier as determined by the owners corporation – of all buildings that they are liable to insure.

The current definition of a '*prescribed owners corporation*' is one that either levies annual fees in excess of $200,000 in a financial year, or that consists of more than 100 lots: *Owners Corporations*

Regulations 2007 (Vic) (the **Regulations**) – Reg. 5. It is noteworthy that the Issues Paper itself identifies that currently only 0.46% of all owners corporations in Victoria have 100 or more lots (Issues Paper – Table 1, page 6).

Recommendation

(1) That owners corporations be required to undertake valuations to prescribed standards no less than once every three years.
(2) That the obligation to undertake valuations should extend to all owners corporations (as opposed to being limited to prescribed owners corporations), to provide owners within smaller schemes with this important consumer protection mechanism and acknowledge that smaller schemes are not immune from the risks of underinsurance.
(3) That valuations are required to account for the likelihood of a total loss event occurring at the end of the period of insurance. That is, valuations should be 'indexed forward' and include an escalation factor, acknowledging the increase in costs involved in removing debris, obtaining necessary approvals and fully reinstating property if a loss were to occur at the end, rather than the beginning, of the period of insurance.
(4) That an owners corporation be required to obtain an updated valuation within a period of no greater than 6 months following handover from a developer.

(B) Public Liability Insurance

Section 60 of the Act requires owners corporations to take out public liability insurance for common property, with a minimum limit of liability of $10,000,000 for any one claim and in the aggregate during any one period of insurance.

In our experience this level of cover in today's commercial and legal environment is grossly inadequate, particularly with aging buildings and regular crowd exposures (many balcony collapse examples). It is noteworthy that many insurance policies covering detached housing (home building and contents policies) routinely carry a minimum of $30m cover. Whilst it is common to see some owners corporations insure for a limit of liability in excess of the statutory minimum requirement (acknowledging that the prescribed limit is insufficient to mitigate their inherent risk), many others cling to the minimum prescribed amounts creating large gaps in exposure.

Again, lot owners face an uncapped exposure to call ups and other liabilities should the limit of indemnity of the owner's corporations public liability insurance prove to be inadequate.

Recommendation

That the minimum limit of liability in respect to public liability insurance be raised to at least $20 million, with provision for a minimum limit of liability of $30 million to be applied to larger schemes where crowd exposures and other public liability risk is higher.

(C) Office Bearers Liability Insurance

Strata Community Insurance has consistently lobbied for the introduction of compulsory Office Bearers Liability (OBL) insurance cover as a part of the statutory insurance requirements across all State and Territory jurisdictions.

What is Office Bearers Liability Insurance?

OBL insurance generally provides protection for individuals against claims made and notified during the period of insurance arising from any actual or alleged act, error or omission of the individual in their capacity as an Office Bearer (committee member) of the owners corporation. The 'omission' part of this coverage is essential, because while many people take care and exercise diligence in their decisions (acts), in our experience we see an increasing trend involving claims made on the basis of omissions. That is, where committee members ought to have considered something and failure to do so has led to a loss.

Importantly, OBL insurance also covers defence costs associated with claims, which can be the most expensive element of any action taken against committee members. The limits of cover are generally expressed as an aggregate limit for each period of insurance, meaning it is capped for the period and the insurer will pay no more than this amount.

Why is it needed?

Committee members are volunteers who make many choices and decisions in managing the affairs of the owners corporation. The potential for being sued exists because errors, misstatements, omissions, neglect and breach of duty do happen – even despite best intentions.

Again, owners corporations are unlimited liability legal entities, meaning that all owners face an uncapped exposure to special levies for unfunded costs and expenses. Individual owners and other stakeholders often look to the decision makers of the owners corporation for recovery of unexpected losses that they cannot otherwise claim from the owners corporation. Committee members face the very real prospect of having their personal assets exposed to such legal actions, unless they have adequate insurance in place to indemnify them. They need not even necessarily be culpable for a claim to be made against them, or to become caught up in litigation around the affairs of the owners corporation.

Substantial resources are often necessary to defend against such claims, as the process can be protracted and associated legal costs can be expensive. It is our experience that an adequate sum insured with respect to OBL insurance is in the vicinity of a minimum $500,000 limit per committee member.

The role of a committee member comes with inherent exposures, which can be mitigated with adequate OBL insurance. We believe this class of insurance, which is relatively inexpensive for owners corporation members, should be made compulsory.

Current law

Owners corporations may resolve to insure for office bearers liability by ordinary resolution pursuant to section 62 of the Act, however OBL insurance is not mandatory.

It is noted that while section 118 of the Act currently provides for the immunity of committee members from personal liability for any acts or omissions exercised in good faith, this statutory immunity does not prevent claims being made against them that must be defended.

Recommendation

(1) That the Act be amended to include, where there is a committee in place, OBL insurance as a compulsory type of insurance along with reinstatement and replacement insurance and public liability insurance.
(2) The minimum limit of cover under OBL insurance be established at a minimum level of $1m per scheme, with a recommendation to allow for $500,000 per committee member.

Examples:
- Scheme A has 6 committee members = $3m minimum in OBL cover.
- Scheme B has 2 committee members = $1m OBL cover.
- Prescribed schemes should have a minimum of $10m OBL, and subject to assessment of exposure, may require substantially more.

(D) Insurance for 'voluntary workers'

This type of insurance cover is included as a standard offering as part of most strata insurance policies, and provides cover for the owners corporation with respect to compensation payable to any person who sustains bodily injury while undertaking voluntary work (without reward or remuneration) on behalf of the owners corporation.

Insurance cover for voluntary workers is mandatory with respect to bodies corporate in some other jurisdictions (such as New South Wales), or has otherwise been or is the subject of strata law reform initiatives.

Recommendation

That insurance for voluntary workers be included as a compulsory type of insurance along with reinstatement and replacement insurance and public liability insurance.

(E) 'Fidelity guarantee' insurance

This type of insurance cover is included as a standard offering as part of most strata insurance policies, and provides cover for the owners corporation with respect to fraudulent misappropriation of owners corporation funds (which may include money, securities or tangible property).

Fidelity guarantee insurance is mandatory with respect to bodies corporate in some other jurisdictions (such as South Australia), or has otherwise been or is the subject of strata law reform initiatives.

Recommendation

That fidelity guarantee insurance be included as a compulsory type of insurance along with reinstatement and replacement insurance and public liability insurance.

(F) Collective insurance and the ability to 'opt out'

Strata Community Insurance supports that wholesale application – to all owners corporations – of existing requirements for full reinstatement and replacement insurance cover. It is noted as it currently operates, section 61 of the Act provides the ability for some owners corporations to opt out of the requirements for collective insurance otherwise applicable pursuant to sections 59 and 60. Some members of the strata community (rightly or wrongly) refer to **Owners Corporation SP26824D v Saponja (Owners Corporation) [2011] VCAT 2402 (20 December 2011)** in support of this interpretation. This is specifically a problem in relation to single-storey dwellings.

Irrespective of whether consistent with what was envisioned or intended by the legislature, this interpretation and application creates anomalous circumstances exposing individual owners to uncertainty and unnecessary risk and exposure.

By way of example, application of the provision as currently drafted might mean that owners in a development consisting of a row of townhouses with party walls would not be required to collectively insure. In this scenario, while some owners may then secure insurance with respect to their own lot(s), others may fail to do so or may secure insurance that is inadequate. Such circumstances potentially carry implications for all individual owners.

To illustrate, in a case of loss or damage affecting more than one lot, one (uninsured or underinsured) owner may be required to rebuild wholly or substantially at their own cost, while another affected owner may claim against the building insurance in place with respect to their lot(s). It might also be the case that an individual owner is not compelled to undertake repairs following loss or damage, resulting in loss of amenity and value to the remaining owners.

There are a number of other potential problems associated with owners taking out insurance individually as opposed to collectively insuring as part of the owners corporation, including but not limited to the following:

- Failure by one or more owners to renew their policy(ies) of insurance, creating additional risk for other owners;
- The potential for owners taking out policies of insurance with entities other than specialist strata title insurers and holding insurance not suited to the nature of the risk;
- The potential for additional expenses for individual owners opting to insure individually as opposed to collectively;
- Complications in relation to insurance claims arising from loss or damage affecting more than one lot – such as coordination of repairs between different insurers and other service providers.

Recommendation

That the drafting of section 61 and its interaction with sections 59 and 60 be reconsidered, to prevent its facilitation of anomalous circumstances whereby owners corporations may 'opt out' of collective insurance.

END