

Important Information about Home Warranty

Legislation

Currently Legislation or similar Orders are State based and written in the Building Acts.

South Australia and Western Australia follow similar regulation whereas Victoria have a model more aligned to NSW. However NSW due to recent changes is now more complex from both a licensing point of view and coverage. All other states and territories are either Government controlled or do not require the product to be compulsory.

As coverage in each state is considerably different , please contact our friendly brokers for further clarification on your requirements.

Who is Covered and who obtains Home Warranty Insurance

The Building Contractor undertaking the work is required to obtain Home Warranty Insurance for every project they undertake where the contracted amount exceeds a set value depending on the state or territory (say \$12,000). The party the Builder is contracted to, usually the Owner of the property, is the beneficiary of the Insurance (not the Builder). Any future Home Owner of that property within the statutory period (say 7 years) is also protected. The Builder obtains no benefit from this Insurance – it is legislated as 'Consumer Protection'.

It is also important to note where the contract involves a contract deemed Multi Unit work, the Builder noted in the contract cannot claim under the policy, only the end purchaser of the unit.

Insurers

Current Insurers are QBE and Calliden. The Insurers Vero, Lumley and CGU have all exited the Home Warranty market in 2009/2010 and are no longer accepting new submissions. At this stage – only a two horse race, making it very important which one you back for your unique set of financial circumstances.

Underwriting philosophy of Insurers

Sole Trader / Partnerships

These entities are reviewed predominately on their personal Assets and Liabilities position, plus the profitability of their proposed building entity seeking insurance.

Generally, Insurers are looking for Net equity of 3%-10% of required turnover. That is, assets less liabilities have to be in this range of the required turnover sought. The main asset is usually the Builder's main residence. These assets can be discounted if co owned (ie wife). Investment properties are also discounted considerably. Market conditions can also affect how a Insurer will value a property. Confirmation of ownership of properties is required as part of the assessment process by the underwriters (Insurers).

Other Assets like motor vehicles etc are discounted heavily.

Cash at Bank is also considered where supporting documentation is provided.

Companies and Trusts

When assessing Companies and Trusts, net tangible worth is the key measurement.

Net tangible worth (assets less liabilities) needs to be 3% -10% of requested turnover as a rule. A full set of financial accounts including Profit and Loss, Balance Sheet and notes of accounts are required for a review. They need to be fairly current and always prepared by your accountant. Note they will not initially accept in-house Management Accounts. However interim Management Accounts can come from internal accounting systems when we require it as an important tool for reviews where limits need adjusting (ie increasing).

Assets

These are generally cash, stock or work in progress, trade debtors, property, plant and equipment. Basically most things that appear on your Balance Sheet. Loans from directors, shareholders or related companies can also be considered assets by accountants but are discounted as not being tangible by Insurer. Other assets that may be discounted are Goodwill and start up costs, again considered intangible assets.

Liabilities

Legitimate Liabilities of a company include Trade Payables, accrued expenses, equipment finance, bank overdrafts and term debt. Borrowed monies from directors, shareholders and related companies are not considered legitimate obligations as generally no formal payment plan is in place. These are added back in the calculation, hence being in your favour by increasing the gap of assets minus liabilities.

If there are interest bearing liabilities such as bank loans which is secured by assets off the company's/trusts balance sheet, then these are also added back as company generally is not responsible for the repayment of the liability.

Generally, clients will not own a lot of tangible assets in the company's balance sheet as Accountants (for tax purposes) generally recommend different structures. Our experience shows they are generally placed in trust structures or special vehicles for future development. Therefore after all the calculations, it generally comes back to looking at the Directors personal asset position and the use of an 'Undertaking' or 'Deed' by the Director that can then bring the assets into the calculation for higher allowed turnover.

Note on Trusts

These are vehicles used to protect tangible assets. They are held on behalf of beneficiaries thus Insurers cannot take those assets into account when doing assessments. If the trust is also the trading company, some consideration can be given (each one on its own merits). If the Trust can retain earnings and not distribute all earnings, then Insurers can consider it more favorably but it will usually attract a higher premium or restricted limits.

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Premium Rating

Insurers will generally have several Premium scales which affect premium charged. The key drivers of this are as follows;

Gearing Ratio = Net tangible Worth / Total Assets. Where tangible assets are nominal, the Gearing Ratio will be high showing reliance on debt, thus driving the category down, attracting higher premiums.

Return on Capital (Profitability) = Net Profit before tax / Total Assets. This ratio measures profit generated by company's total resources. If it is break-even or making losses this gearing will be poor also driving down rating, attracting higher premiums.

Note NSW now has only one premium model (everybody is on the same premiums) – more of one size fits all approach. However the stronger the above ratios will allow easier reviews and increases in requested turnovers. In all States if you follow the above logic, it will generally determine your strength and how the Insurers treat you.

Retrospective Cover

Where a client has undertaken a contract requiring Home Warranty Insurance and not yet taken out the Insurance, Insurers will often be hesitant to get insurer the project unless the reason is sound. If the explanation is sound and logical, it will then require a defect/ inspection report for further consideration. This is a breach of the State's Building Acts and is taken seriously where a constant trend appears. Strongly recommended to avoid this scenario at all costs.