

16 December 2021

Treasury Cyclone Reinsurance Pool Taskforce
Langton Cres
Parkes ACT 2600

Re: Exposure draft legislation: cyclone and related flood damage reinsurance Pool

Dear Treasury,

We write to provide feedback on draft legislation for the Treasury Laws Amendment (Measures for a Later Sitting) Bill 2021: Cyclone Reinsurance; released by Treasury on December 4, 2021.

Introduction

SCA

The Strata Community Association (SCA) is the peak association supporting the strata sector, with corporate members who help oversee, advise and manage assets exceeding \$1.3 trillion. As the peak body for the strata industry, SCA is in the unique position to understand the sector from all angles.

SCA is in a position to understand the sector from a broad array of viewpoints owing to its diverse membership. SCA represents strata managers, community titles schemes with committee members acting as nominees, lot owners as individuals, and service providers to the strata industry. They include specialist insurers, painting suppliers, energy suppliers, solicitors, accountants, water and plumbing providers, banks, elevator maintenance professionals, cleaning providers, surveyors, valuers, glaziers, IT providers and maintenance providers.

In preparation of this submission, the broadest possible spectrum of the industry was consulted, including lot owners.

SCA has four recommendations for amendments to the draft legislation to enhance the design of the ARPC Cyclone and Related Flood Damage Reinsurance Pool (henceforth “the Pool”) to ensure it achieves its policy goals.

Abstract

SCA maintains the following issues must be addressed if the Pool is to achieve its affordability and coverage goals in Northern Australia for owners of strata properties:

- Premium reductions in higher risk areas that will be substantial enough to generate improved take up of insurance through reduced levels of non-insurance and underinsurance;
- Specific changes to the proposed eligibility requirements to ensure all residential strata owners are treated equitably and that small business owners of mixed use strata properties are included in the scheme

SCA also believes that increased mitigation funding for strata properties is an essential ingredient for ensuring the sustainability of the Pool.

Northern Australia Strata Insurance

Northern Australia insurance premiums, particularly strata insurance premiums, have grown substantially in recent years.

At a macro level insurance can be considered an essential akin to basic utilities. Rates of non-insurance across the Northern Australia region stood at approximately 20% just two years ago according to the ACCC¹. This figure has undoubtedly climbed since as some insurers have left the market and, in the context of strata, bodies corporate are bound by various pieces of state legislation to insure to the full replacement value of the common property.

Affordability and Availability

Premiums for strata insurance in Northern Australia are on average approximately double those of owners in the rest of Australia, [ACCC reference?] Also averages do not tell the full story because there are many properties in the higher risk areas where the strata insurance premiums are as much as 3 times or 4 times the average elsewhere, if they are able to be insured at all.

Figures suggested in Senate Estimates by Treasury Officials put the projected average premium reduction at 10% as a result of the implementation of the Pool.² A 10% reduction would be immaterial to most owners. SCA's assessment is that, for many owners, a premium reduction of more than 30% and in some cases 60% or 70% would be needed to overcome current affordability problems for the most at risk consumers. If the Pool is unable to do this, it will not achieve its goal of relieving the acute availability and affordability pressures around insurance in Northern Australia.

Government intervenes in instances of market failure to achieve policy and social outcomes that citizens consider desirable. This is such an instance and the SCA believes that consideration must be given to the overarching policy intent of the Pool, which is to relieve cost of living pressures on consumers; even if it puts at risk the proposed cost neutrality of the Pool.

SCA therefore recommends that targets for premium reductions for the higher risk properties be set and that the ARPC and the reviewing actuary be required to report at least annually against those targets in their premium setting roles.

The SCA also believes that transparency of the Pool's operations is important. The ACCC must be sufficiently resourced and have appropriate powers to ensure that savings made by insurers via the Pool are passed on to consumers. It is also the view of SCA that release of the actuarial analysis around how the Pool will work may help provide confidence for insurers to promote their re-entry into the insurance market in Northern Australia.

Eligibility Criteria

The eligibility criteria for strata properties in the Draft Legislation are too narrow and risk excluding thousands of owners of residential and small business strata properties.

¹ <https://www.accc.gov.au/media-release/high-premiums-leading-to-rise-in-uninsured-homes-in-northern-australia>

² https://parlinfo.aph.gov.au/parlInfo/download/committees/estimate/25211/toc_pdf/Economics%20Legislation%20Committee_2021_10_27.pdf;fileType=application%2Fpdf#search=%22committees/estimate/25211/0001%22

The proposed 80% mixed use threshold

As we understand it, strata properties with 80% or more of the residential floorspace will be eligible but those with less than 80% will be ineligible. This 'all or nothing' approach seems inadequate and may not stand the test of time given the growing popularity of new mixed-use strata developments.

It is also proposed that commercial properties insured for up to \$5m are to be eligible. It seems anomalous that, for example, a property that is 75% residential with say a \$1m commercial use component would be ineligible but a standalone commercial property of \$5m would be eligible.

In the context of mixed use strata, which is becoming increasingly common, a more equitable threshold for inclusion in the Pool is required. Lot owners are lot owners and residents are residents. The make-up of a scheme where an owner chooses to live does not necessarily reflect their ability to pay exceedingly high insurance premiums, nor does it change the legislative requirements placed on their body corporate. This must be amended to ensure equity to all Northern Australia strata owners.

SCA therefore recommends that the threshold for mixed use eligibility be defined in a more practical and equitable way, for example allowing commercial use for the higher of 20% and \$5m in value (or the equivalent in floor space) or, alternatively or additionally, by applying a different threshold such as 50% instead of 80%.

The definition of commercial property

Substantial parts of North Queensland, most particularly Cairns and the Mackay-Whitsunday Region, which are also large regional population centres, are heavily reliant on tourism.

Under the present scope of the Pool, we understand that schemes which are largely used for accommodation such as motels, hotels and mixed use resorts will be classed as commercial and therefore subject to the proposed \$5m threshold. This is undesirable for a variety of economic and social reasons.

Queensland particularly has created legislative structures to ensure that these resort style schemes are common. Specifically, one of the Regulation Modules under Queensland's strata legislation is known as the Accommodation Module. This module regulates about 10% of total schemes in Queensland.

These schemes are critical to the viability of the tourism industry in this state. It is important to note the specific role and economic niche these schemes occupy, as well as their general ownership structure.

Specifically, the module is designed to facilitate the on-site management of schemes by caretakers for a lengthy period of time. These caretaking businesses are near universally owned by small business operators, who purchase both the management rights and a lot within the scheme. Typically, these caretakers manage the holiday letting of lots as well as tending to the general maintenance of the scheme.

The lots within these schemes are typically owned by mum and dad investors who use the lots to facilitate their own holidaymaking in the state and also generate income via holiday letting. This arrangement ensures there is sufficient accommodation to sustain the large tourist sector in Queensland. Many of these schemes also have a very large portion of permanent residents.

This unique structure has underpinned the Queensland tourism sector for decades. The lots in these schemes are owned by discrete individual owners and the management of them is undertaken by small business owners. The Pool should include these small businesses, owners and investors to ensure both equity and the long term viability of the tourism sector in Queensland. We therefore recommend that Treasury include them as part of the Strata element of the Pool to ensure the long term viability of the tourism sector in the region.

If all schemes which are primarily residential are not covered, a situation may arise where large numbers of ordinary Australians face exorbitant ongoing insurance costs, or unavailability. This conflicts with the policy goals of the Pool.

SCA therefore recommends that, for the purposes of Pool definitions of residential and commercial or mixed use strata properties, the legislation enable the ARPC to look beyond the nominal or legislative definitions of residential versus commercial to the underlying ownership structure of strata properties.

Policyholder excesses

The Explanatory Memorandum at paragraph 1.59 states that “All eligible claims are funded by the reinsurance pool above the policyholder’s excess for cyclone events for the first three years.”

There are home and strata policies currently issued by insurers in Northern Australia that have higher excesses for cyclone damage than for other damage. They can be much higher and for strata properties can be prohibitive for some strata owners.

SCA would be concerned if policyholder excesses on eligible strata policies were different on a per owner basis from the excess levels on home insurance policies and would be doubly concerned if excess levels for cyclone events covered by the Pool were different from excesses applied by insurers for non-cyclone claims.

SCA therefore recommends that claims covered by the Pool be subject to a policyholder excess that is commensurate with the policyholder excess for other types of claim.

Mitigation

We note that part of the initial announcement of the Pool included references to the Strata Title Resilience Pilot Program, to be funded to the amount of \$40 million. We welcome this program. Mitigation and risk reduction in Northern Australia will be critical to ensuring the ongoing Northern Australia insurance crisis.

SCA is pleased to see the intent to apply pricing principles which specifically incentivise risk reduction and mitigation works. This is a critical factor in the long-term sustainability of the Pool and Northern Australia more broadly. We believe that the unique requirements of strata need to be considered in this context and we await further information on how this intent might be delivered.

The strata industry operates a consensus model of decision making whereby owners vote on whether or not to undertake works, both small and large. This communal nature can at times create a situation whereby owners collectively are reluctant to either raise or spend money within a scheme. In short, often times strata owners do not see the value in spending money on “the scheme” or “the body corporate”. When this occurs on a large and repeat scale, the whole scheme ultimately suffers. This is a common issue facing many in the sector.

This phenomenon ultimately leads to a poor standard of maintenance and building repair in the long term. To this end, we are concerned as an organisation about the uptake of significant mitigation works (particularly structural roof works) in strata schemes without sufficient government funding.

Whilst we welcome the Strata Title Resilience Pilot Program, we believe by considering these abovementioned factors, that there should be increased funding to this program to ensure widespread building standards improvement in the strata sector. There must be significant investment in most particularly, ensuring roof construction is to a category 5 standard in as widespread a fashion as possible.

To ensure the Pool is sustainable longer term, it is advisable that mitigation funding be at the highest levels feasible. Widespread high quality construction will lower the overarching risk of catastrophic damage to strata schemes in the Northern Australia Region and have the long term effect of ensuring insurance is more available and more affordable to strata residents and businesses.

To this end, we urge the government to make substantial continuing investment in strata resilience, acknowledging the difficult nature of raising the funds amongst individual communities as well as the substantial long-term benefits of same. Any increase in the present \$40 million provided for this program will help ensure that the Pool operates as efficiently as possible.

Conclusion

In summary, SCA believes the Pool design must consider, in the interests of limiting both strata premiums and the risk exposure of the Pool, its overarching goal of more affordable insurance for consumers and small businesses in Northern Australia above all else. To this end, we believe the three changes to the Draft Legislation we have recommended are both equitable and important in the interests of achieving this goal.

Sincerely,



Chris Duggan
National President
SCA Limited



Greg Nash
Chair
SCA National Strata Insurance Taskforce