LEGISLATIVE ASSEMBLY OF THE NORTHERN TERRITORY

13th Assembly

PUBLIC ACCOUNTS COMMITTEE

Public Hearing Transcript

12.00 pm, Tuesday, 14 May 2019

Litchfield Room

Members:

Ms Sandra Nelson MLA, Chair, Member for Katherine
Mr Terry Mills MLA, Deputy Chair, Member for Blain
Mr Tony Sievers MLA, Member for Brennan
Mrs Kate Worden MLA, Member for Sanderson
Mr Gary Higgins MLA, Member for Daly
Mr Gerry Wood MLA, Member for Nelson

Witnesses:

Department of Infrastructure, Planning and Logistics

- Andrew Kirkman, Chief Executive Officer
- Mark Meldrum, Senior Director Building Advisory Services
- Fabio Finocchiaro, Executive Director Land Services

Department of Treasury and Finance

- Sarah Rummery, Assistant Under Treasurer – Economics

Master Builders Association of the Northern Territory

- David Malone, Chief Executive

The Committee convened at 12.04 pm.

Public Hearing on Master Builders Fidelity Fund

DEPARTMENT OF INFRASTRUCTURE, PLANNING AND LOGISTICS

Madam CHAIR: On behalf of the Committee, I welcome everyone to this public hearing into the Master Builders Fidelity Fund. I welcome to the table to give evidence to the Committee this afternoon Mr Fabio Finocchiaro, Executive Director Land Services, Department of Infrastructure, Planning and Logistics; Mr Mark Meldrum, Senior Director Building Advisory Services, Department of Infrastructure, Planning and Logistics; Mr Andrew Kirkman, Chief Executive Officer, Department of Infrastructure, Planning and Logistics; and Ms Sarah Rummery, Assistant Under Treasurer Economics, Department of Treasury and Finance.

Thank you all for coming before the Committee. We appreciate you taking the time to speak to the Committee and look forward to hearing from you today. This is a formal proceeding of the Committee and the protection of parliamentary privilege and the obligation not to mislead the Committee apply. This is a public hearing and is being webcast through the Assembly's website. A transcript will be made for use of the Committee and may be put on the Committee's website.

If, at any time during the hearing, you are concerned that what you will say should not be made public, you may ask that the Committee go into closed session and take your evidence in private. During the Committee proceedings, if you could please each state your name and the capacity in which you are appearing. Would you like to make an opening statement?

Mr KIRKMAN: Thank you, Madam Chair. For the purposes of Hansard, my name is Andrew Kirkman, Chief Executive of the Department of Infrastructure, Planning and Logistics. I thank the Committee for the opportunity to provide information on the fidelity fund scheme and to respond to any questions you may have.

By way of a broad overview, the fidelity fund is regulated by the relevant legislation and controlled by the trustees with a management agreement with the Master Builders Association. The departments will be able to respond regarding the establishment of the fund. Sarah is here on behalf of the Treasury and Finance. We will be able to respond on the establishment of the fund and consumer protection policies relating to the building industry generally.

During 2012, government passed amendments to the *Building Act* to provide for the Residential Building Cover Package which commenced on 1 January 2013. Under the Residential Building Cover Package, builders are deemed responsible for rectifying structural defects for a period of six years and non-structural defects for a period of one year from completion.

The Commissioner for Residential Building Disputes works to resolve disputes between owners and builders. Registered builders must obtain an insurance or fidelity certificate that provides the owner with cover should the builder die, disappear, become bankrupt or be deregistered.

The Residential Building Cover Package commenced after a number of years of difficulty for all jurisdictions in establishing viable consumer protection schemes relating to the building industry. The Residential Building Cover Package was developed to provide for either private insurers or discretionary fidelity funds to be able to offer cover in the NT.

Since its commencement in 2013, no insurers have sought approval to issue residential building insurance policies, and only one independent fidelity fund has been established. Feedback from insurers at the time included submissions that it was not viable for them to offer their insurance products in such a small market.

The Master Builders managed fidelity fund was the result of an agreement with the government that included a $750 000 interest-bearing loan and a guarantee regarding any claims that exceeded the balance of the fund. Both the loan and the guarantee required the Treasurer's approval under the *Financial Management Act*. The Department of Treasury and Finance was involved with the Department of Infrastructure, Planning and Logistics and the Department of the Attorney-General and Justice in drafting the original documentation, including the memorandum of agreement with the Master Builders Association NT.

A fidelity certificate provides cover for consumers by providing up to 20% of the contract price to a maximum of $200 000 for transition to a new builder to complete the works. This covers the cost of changing contracts, amending building permits and any other increases in costs associated with materials and labour.

The fidelity fund assesses each builder before issuing them with a fidelity certificate to ensure the builder has the capacity to undertake the works. Since 2013, the fidelity fund has supported a number of homeowners whose homes were at various stages of completion when their builder went into administration.

The fidelity fund is regulated by the Building (RBI and Fidelity Fund Schemes) Regulations 2012. The trustees must manage the fund in accordance with the approved trust deed, the prudential standards set out in the regulations, and any requirements the Minister specifies by the *Gazette* notice. The legislation requires that the trustees of the scheme appoint an auditor and an actuary for the scheme. The auditor and the actuary provide reports annually to the Department of Infrastructure, Planning and Logistics. This department provides the reports to the Department of Treasury and Finance for advice as part of preparing briefs to government.

I am happy to take questions and provide any clarification on information which may assist the Committee and its work, along with my colleagues at the table. Of course, neither I nor any of the other department officials available today can answer questions on government policy, therefore, our questions will be on a factual basis. Thank you.

Madam CHAIR: Thank you, Mr Kirkman. I will open it up to the Committee for questions.

Mr WOOD: Mr Kirkman, what was the initial amount of money that the government put in? You said $750 000? Was that a loan or a grant to the fidelity fund?

Mr KIRKMAN: It is a loan.

Mr WOOD: Loan. So, that loan is still ongoing?

Mr KIRKMAN: Yes.

Mr WOOD: That is the input. Has it increased or is it the original $750 000?

Mr KIRKMAN: I will pass to Mr Finocchiaro to answer the details of the loan.

Mr WOOD: That original amount is still in the fund?

Mr FINOCCHIARO: The loan was $750 000 and interest is payable on the loan. The purpose of providing the loan was to enable the MBA to establish the fidelity fund scheme—the nuances that had to go into setting that up. The remaining moneys that were not spent of that $750 000 then went into the trustees as seed money for the account. It is a loan and it is payable. The loan was for five years and became payable at the end of 2017 because the fund had been operating for five years. We are in the throes of settling a new agreement to continue that loan.

Mr WOOD: Thank you.

Madam CHAIR: Do you have any other questions?

Mr SIEVERS: The loan is underwritten by government as well if the seed is $750 000?

Mr FINOCCHIARO: Correct. There are two things—a loan of $750 000 and a guarantee that if claims on the trustees exceed what is in the fund, the government would guarantee that net difference.

Mr WOOD: I have another question, is that all right?

Madam CHAIR: Yes, Mr Wood.

Mr WOOD: Does the department have any role in determining the cost of fidelity certificates?

Mr FINOCCHIARO: No.

Mr WOOD: Fidelity certificates are paid for by the builder and the builder can recover the cost from the owner who is the actual beneficiary of the cover. Are builders required to purchase any other building indemnity or warranty insurance to cover liabilities in the event of non-completion or structural defects?

Mr FINOCCHIARO: No. Regarding the RBI certificates, they are obliged to take that out and that covers them off on default in case of insolvency, death, and disappearance. Whether they carry other insurances—I understand they do, but they are not regulated to carry those insurances.

Mr WOOD: Just from reading what the fidelity fund does—it may be an MBA question but I will ask it anyway—the people who are excluded in the one case that I know of—in my case it might be company that has three names. The owner might be one but he might have two other names for companies. He or she may be building a house, decides not to renew the registration, has two other companies operating—nothing to do with the building that is going on—and that person therefore cannot get cover under the fidelity fund for work not completed because that person who was building the residence is no longer registered, even if that person is operating in the Territory on other residential projects under a different name. Is that correct? Does that make sense?

Mr FINOCCHIARO: I am trying to understand the question.

Mr WOOD: Someone simply does not renew their registration and pull out of that job—they are not sacked by the Building Board, they just do not register. They might have another company or two under a different name and they are operating—either interstate or …

Mr FINOCCHIARO: For that company to be—I am trying to understand it. A company registration relies on individuals who are registered in the company. So, if the individual is registered in his own right and then is registered with three companies, he can pull out of one company, but the other two he still has to be registered to be able to act for those.

I think your question is if someone decides—I will refer to the Master Builders on how they would answer that question. It seems to me that if someone decides to stop building something, to either trigger the insurance or otherwise, I would leave that to the fidelity fund to answer how that is treated.

Mr WOOD: The only reason I asked you, the legislation was drawn up by the government. The answer I have been given about that is that person should have to go to Consumer Affairs. But that person really …

Mr FINOCCHIARO: There are two things. One, the insurance—the only way an individual can claim on it is if the builder is deceased, disappeared or became insolvent and he is not there. Andrew's opening statement was that during the first six years of the life of the building, redress about structural matters are directed back to that individual. So, if the individual is not registered but still around town or otherwise, that is where it would go. You would then go through the Commissioner of Building Regulation …

Mr WOOD: The issue is the individual has gone to Queensland.

Mr FINOCCHIARO: I accept that makes it difficult, but the person is still around, he has not disappeared.

Madam CHAIR: So, whether he is interstate or not, he is still around?

Mr FINOCCHIARO: The person would have a cause before the Residential Building Commissioner.

Mr WOOD: I suppose the question is why can it not be covered under this existing legislation, instead of having that loophole, if I can call it that?

Mr FINOCCHIARO: It is a loophole, but equally, you do not want to create a loophole that says, 'I will get in halfway through this project but things are getting too difficult for me, I will just walk away and somebody else can pick up the pieces. That is the other component of it. You have to have a scheme that actually has some checks and balances in it. If we do not have that quite right we need to fix that. But you should not be entitled to be able to start building something—a contract with an individual—and say, 'We will do it for half the price, then I will walk away and don't you worry about it, the scheme will fix it'. I do not think anyone would want that either.

Mr KIRKMAN: It would be worth pursuing this line of questioning with Master Builders. They have experience with pursuing builders who have gone interstate, so they will be able to give you some broader experience with dealing with this.

Madam CHAIR: Anyone else?

Mr WOOD: No, you go.

Madam CHAIR: I want to quickly pick up on something Mr Wood just mentioned. You talked about at the end of the construction or building …

Mr WOOD: I know there was a case in Katherine where a person had only half a house built. That person did not disappear, but was not registered anymore.

Madam CHAIR: I was going to touch on that. I know which case you are talking about in Katherine. I was going to touch on that, but I might take your advice and refer that question to the Master Builders at the next session.

The other one comes back to the recent structural issues that have been raised about some of the buildings in Darwin, where they have now been completed and they were certified by structural engineers and everything was signed off and fine. Years later now, obviously—just to rehash—we find that the structural stability or the structural integrity of the buildings are not to code. Who gets that?

Mr KIRKMAN: On that matter we still have quite a bit of work to do. I can say that every owner has now appointed a structural engineer to deal with their issues, which is good news because we want those issues dealt with as soon as possible. There is no necessarily exact model with each building and building owner, so we are having to work through with each individual.

On the impact on the fidelity fund, we have yet to understand that or, in fact, any other insurances et cetera. Certainly owners now have structural engineers on board and they are going through it very diligently. They understand the need to get moving quickly on this, and they are doing that. That is good news from our perspective.

Madam CHAIR: Thank you, Mr Kirkman.

Mr WOOD: Madam Chair, could I ask a follow-up question?

Madam CHAIR: Yes, Mr Wood.

Mr WOOD: Are any of those buildings outside the six-year time limit?

Mr MELDRUM: Mark Meldrum …

Mr WOOD: You cannot claim after six years.

Mr MELDRUM: A lot of the buildings are not covered by a fidelity fund because of the height and the age of the buildings. Yes. Not all of them, only a couple are covered by the fidelity fund.

Madam CHAIR: Okay. That clarifies a couple of things for me on that. I have a quick question. The fund was underwritten by the NT government for the first five years of operation, which you have stated has now expired and you are in the process of renegotiating or reinstating it. That ensures that claims can be paid while the fund was building its cash reserves. Correct? Yes.

Does the NT government have any responsibility for the fund if it cannot cover liabilities?

Mr FINOCCHIARO: Yes, on the basis that it provides a guarantee. If there were $5m worth of claims—just to pick a number—and there was $4m in the fund, the government would have to pick up the liability for the $1m that is short in the fund.

Madam CHAIR: That is still in place now, even though it has expired until the new agreement is signed and delivered? Correct?

Ms RUMMERY: The Treasurer approved in December 2018 extending both the loan and the guarantee under the *Financial Management Act*. So, those extensions have been approved.

Madam CHAIR: Correct. Thank you for that. In 2015, which you mentioned briefly in your opening statement, the NT government commissioned the Cureton review, which made a number of recommendations, including that the fund be replaced by a residential warranty scheme. Many of the recommendations were not actually supported by the industry. I want to find out if the government has undertaken any further reviews of the fidelity fund and are any future reviews planned.

Mr KIRKMAN: At this stage, we are looking to continue with the fidelity fund. I do not know if there is anything else, Fabio you can add to that?

Mr FINOCCHIARO: The fidelity fund—there are no changes in place in the legislation. You just mentioned the Cureton report. It is worth noting that that was commissioned by the former government and there was some consultation at the end, but industry was not consulted as part of that process. The former government did not bring it to any formal conclusion. We have briefed the current government about it, but there has been no move to adopt or otherwise. Suffice to say that anything that is in that Cureton report could be used in government in a future reform project, including looking at what might be improvements for the Residential Building Insurance Scheme.

Mrs WORDEN: Back to the previous discussion regarding the liabilities and the loan. Do you have any idea of when the loan might be paid back? It is obviously going through an extension period at the moment. At which point will the fidelity fund be in a position to pay it back?

Ms RUMMERY: With the annual actuarial report, the actuary makes a recommendation about, essentially, the level of reserves required in the fund that would be a prudent point at which to repay the loan. The fund has not reached that level of reserve at this point, so the actuary's recommendation was to extend the period before which the loan was to be repaid. So, it has been extended for a further five-year period. It can be repaid at any point in that period.

Mr WOOD: Can I ask that other question we have there?

Madam CHAIR: Yes, Mr Wood.

Mr WOOD: Has any consideration been given to mandating the publication of annual reports made by the fund to the Minister and the Commissioner of Consumer Affairs to enable the public to access information relating to the operation of the scheme? I add on to that. You also mentioned the government is putting money into the fidelity fund. Why is the Auditor-General not able to also look at what is happening with the fund?

Ms RUMMERY: I believe under the *Building Act*, the requirement is for the annual audited financial statements and the actuary's report to be provided to the Minister for Infrastructure, Planning and Logistics. That is the requirement under the current legislation.

Mr FINOCCHIARO: The fund is not audited by the Auditor-General. Arguably, the financial performance of the fidelity fund is really a matter for trustees. But to answer your question, no, there has been no consideration on that, but that would be a matter for government policy as to whether they are released or not.

Mr KIRKMAN: I do not think there has been a request to date, has there? Yes, that is not something that has been considered.

Mr WOOD: It is just that the government has lots of little annual reports that we deal with at the Estimates Committee. I just wondered why this one would not be included if it has funding from the government.

Mr KIRKMAN: It still is a privately-operated fund. I guess it is similar to a number of other organisations which get loans and grants from government. They are not necessarily reviewed during the estimates process.

Mr WOOD: It is just that there is a report that goes back to the Minister. Although it is private, it is still required to report back to the government. It is in that grey area.

Mr KIRKMAN: If there was a request come forward we would certainly look at that.

Mr WOOD: Yes.

Madam CHAIR: Do you have any other questions from the Committee members?

Mrs WORDEN: Not on this one.

Mr WOOD: No.

Madam CHAIR: Thank you.

Mr KIRKMAN: Thank you.

Ms RUMMERY: Thank you.

Mr WOOD: Thank you.

The Committee suspended.

MASTER BUILDERS ASSOCIATION OF THE NORTHERN TERRITORY

Madam CHAIR: On behalf of the Committee I welcome everyone to this public hearing into the Master Builders Fidelity Fund. I welcome to the table to give evidence to the Committee Mr David Malone, Chief Executive, Master Builders Association of the Northern Territory. I appreciate you making the time to come. I know you guys have very limited resources. Thank you so much for being here and coming before the Committee. We appreciate you taking the time to speak to the Committee and look forward to hearing from you today.

This is a formal proceeding of the Committee and the protection of parliamentary privilege and the obligation not to mislead the Committee apply. This is a public hearing and is being webcast through the Assembly's website. A transcript will be made for use of the Committee and may be put on the Committee's website.

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Just before we go on, I quickly note that Mr Terry Mills and Mr Higgins will be coming back into the meeting shortly.

Mr Malone, would like to make an opening statement?

Mr MALONE: Yes, thank you very much. I have a short statement for today and am obviously happy to take any questions you may have.

The fidelity fund is a not-for-profit trust controlled by six independent trustees. The fund is an approved fidelity fund under the Act, as Andrew mentioned earlier.

The *Building Act* requires one of four trigger events to occur for a claim—the builder either dies, disappears, becomes insolvent or—importantly, based on the questions we heard—loses their licence. That is the current legislation. While those are general terms in which we all have common usage there are quite specific legal definitions for each of those trigger events. Those legal definitions are really important.

As well, the homeowner pays the cost of the cover. Builders do not pay for any activities associated with the fidelity fund. Going back to one of those questions earlier, the builder purchases it on behalf of the homeowner, but the homeowner pays for that cover.

Fidelity funds are pooled risk models where surplus receipts remain in trust. There are no distributions to third parties. Funds also fulfil three separate roles in comparison to a typical insurance company. They are, essentially, the broker, the underwriter and the claims manager as well. With a not-for-profit status, along with this model of putting the three elements together, it provides a very efficient model for small markets as we have in the Northern Territory.

Master Builders NT helped set up the fidelity fund and based those arrangements on the structure and experience of the ACT fund operated by our sister organisation since 2002. Today, Master Builders NT is a subcontract service provider to those trustees. We are much like a plumber subcontracting to a house builder. That arrangement entails the provision of two distinct sets of services.

The first set of services are those provided by specialist third-party organisations. They are not Master Builders but contractors—organisations with particular expertise that is essential to the governance and risk management activities of the fund. Examples include actuarial services, audit services, contractor risk assessment, legal, financial and building and project reinstatement services, as well as quantity surveying.

The second suite of services are administrative. They leverage the basic business infrastructure that already exists within Master Builders NT. This is done to optimise the overall depth of the fund. Examples include operational staffing, backup for absences and leave, office accommodation, the full suite of business and IT systems, marketing services, fund administration reporting and oversight, secretariat functions and claims receipt and administration.

It is important to emphasise that Master Builders NT is not the decision maker of the fund. That is solely the discretion of the trustees. As well, Master Builders do not assess builders. That is done by a firm specialising in assessing risk. Master Builders does collate the annual reports provided by the trustees to government, which we mentioned earlier.

The first of those is the summary of claims which goes to the Commissioner for Residential Disputes. The second report is provided to the Minister for Infrastructure, Planning and Logistics and contains the various matters required under the regulations, including the independent actuary's report, a solvency certificate, a rate card, the independent audit report and declarations by trustees about compliance and contingency plans.

Certificates of cover are issued in the name of the property owner. They are capped at a total of $200 000 at this stage. There have been quite a number of claims for non-completion and for defects. However, unlike insurance companies that look to charge a price for a policy that covers claims and their margins, fidelity funds look to minimise claims by active risk management. Funds subscribe to the principle that the best protections they can provide to a homeowner is to maximise the chances of a completed project and to limit any defects. That is why there is a lot more scrutiny of each project before a certificate is issued.

Checks on certificates include compliance with key regulations such as builders' licensing. Other checks include elements of the contract, payment schedules, project values, proposed completion dates and a range of other matters. As well, there are checks on the builder business which go to company history, key personnel histories, financial status, actions against those companies, payment history, industry information and complaints from suppliers, subcontractors and clients.

No system can prevent a default by a business. Businesses go broke, no matter what. But those checks work to minimise the risk for all concerned. The fidelity fund model is the most stable consumer guarantee system in Australia, proven by the success of the ACT model over its 17-year history. It also works very well in small markets like the Northern Territory.

As I think Andrew mentioned, the market is completely open here and any insurance business or another fidelity fund could choose to enter at any time. It simply requires an application to, and approval by, the Minister.

Finally, the business relationship between Master Builders NT and the trustees has enabled the Territory to have an effective consumer warranty scheme in a very small market like the Territory.

I thank you for your time, and I look forward to this discussion.

Madam CHAIR: Thank you, Mr Malone. Do we have any questions from Committee members?

Mr WOOD: I will open the questions. Hi, David. I will follow up on that question about the builder that would just not register and leave. He was not kicked out.

Mr MALONE: I think I mentioned at the start of that short presentation that the definition in the Act is the builder loses their licence. The act of an expiry of a licence is not a trigger event under the Act, so the fidelity fund is unable to deal with that project because we require a trigger event to exercise a claim and have a valid claim.

In those cases, it defaults to the Commissioner for Building Disputes to follow up. It is an area where, if there were any legislative changes, would be an area you look at because of the fact that the fund cannot deal with that. The reason it cannot is because of this insurance issue of moral hazard—you put an incentive in place for people to abandon projects if they are losing their way as a business.

Mr WOOD: If that company had two other companies operating, can anything be done about those? Can money be claimed back from those companies?

Mr MALONE: I am not in a position to answer on behalf of trustees. If I was to answer more generally as an industry representative, I would imagine if there were three companies and someone had simply walked away from their responsibilities, I would be quite surprised whether those other two companies would be supported by the fidelity fund, unless people had worked to make it difficult for people to find that out.

Mr WOOD: I will keep going. I read about the annual eligibility assessments which has to be done by an independent person, I gather. Do you have any idea what the cost of those assessments are?

Mr MALONE: That is a commercial-in-confidence contract between ourselves and the provider. But I can assure you it is quite significant. It is one of Australia's leading risk assessors that specialises in construction activity. Not only do they look at the financial performance of the firm, they look at all the key personnel, they scrap every public database for histories—for example, whether the nominee builders have been bankrupt before—and they look at the work currently in progress and how quickly people are finishing the jobs. They put that together into an overall recommendation to the trustees who then make a decision about the level of cover that a builder would receive.

Mr WOOD: So, the builder pays for that?

Mr MALONE: No. The builders do not pay for anything in the fund.

Mr WOOD: The consumer pays for it?

Mr MALONE: The consumer pays for it.

Mr WOOD: Via the builder, I presume.

Mr MALONE: The Act requires the builder to purchase a fidelity certificate before securing a building permit for a job. But the builder purchases on behalf of the homeowner. In 99.9% of the cases I have seen, it is identified as a line item in the building contract and a cost directly to the homeowner.

The builder is, essentially, the mechanism to secure a certificate. It is paid for by the homeowner. The homeowners, the beneficiaries, fund the scheme and the fund's obligations are back to those beneficiaries. The builder is just the mechanism.

Mr WOOD: Do you have some idea what those eligibility assessments have cost over the last five years? Is there a global figure for that, or is that still …

Mr MALONE: I do not want to give the exact number, but I can say that in any one year it costs hundreds of thousands of dollars.

Mr HIGGINS: Just on the builder is the mechanism by which the homeowner gets insurance, why do we have the issue with an owner builder not being able to make a claim in that instance …

Mr MALONE: The owner builder …

Mr HIGGINS: I cannot get the logic behind that.

Mr MALONE: I can understand that. There are couple of bits to that, but if I answer the direct question it might lead on from there. The owner builder cannot make a claim for non-completion because the owner builder is in control of the building process. Again, you would get moral hazard where someone says, 'I give up. I cannot finish this home. I am tired of renovating or building my home. Come and finish it for me.' They are excluded from non-completion cover, but they receive structural warranty cover and defects cover—sorry, the building receives those if the building is on-sold to a third party.

Sorry, it is a little convoluted. The fund is a last resort fund. So, at any time the builder is the responsible agent for completing a project. If you were an owner builder and sold your home to a third party, that third party is covered from the day that settlement is made for the life of those covers.

Mr HIGGINS: What would happen in the instance—you get certificates issued by electricians, solar people, plumbers, tilers, all of that. If you have a fault with that, where is the claim back if it is not through the fidelity fund?

Mr MALONE: The builder is the principal agent, so the builder enters into a contract with the homeowner. Under the Act, they are responsible for the project. The collect those certificates from all the key tradesmen—window manufacturers, the lot. Because the contract relationship is between them and the owner they are responsible for the building being fit for purpose. If some of that work is not up to standards, it is up to the builder to rectify that work. In the event that the builder is no longer around, it defaults to Master Builders Fidelity Fund.

Mr HIGGINS: I am missing here. What is the point, if you are an owner builder or any builder, and the windows are issued with a compliance that they would meet certain standards like cyclone et cetera. If they are then found not to, how does the builder have recourse against that person? Or is the fidelity fund intended to cover that? Which would then prompt the question: why do we even bother getting a certificate off them?

Mr MALONE: Those certificates are for building control and to allow the builder to sign the section 40, that the building has been built in accordance with the plans and the building code. Those certificates provide certainty to the builder. In the case of substandard work, the builder is still liable for that work. Even though they have a certificate, and you discover that it is wrong, the builder is liable for that as the person who entered into the contract.

Were the builder no longer to be around and one of those trigger events occur, then the fidelity fund becomes liable for those risks.

Mr HIGGINS: My thing is then, okay, an owner builder—I am not being critical of it—and we are issuing all these certificates to the building people, the government people—effectively you have no protection at all. The owner builder—nothing to claim back on even though they are paying the insurance.

Mr MALONE: The owner builder has no protection because the owner builder is a builder. When the home is sold—and we have had examples of that—and we discover that there are defects, the fidelity fund is then protecting the new homeowner.

Mr HIGGINS: So, why do we have to pay the insurance then for a period up to when it is sold? Why? I presume the amount you pay is identical. If someone does something and it goes for five years, you have paid out insurance you could never ever claim on. Whereas, in another instance, someone might sell it in the last year, which is 20% of that period. Why is there not a proportionate amount that you pay in that insurance?

Mr MALONE: There are probably two answers to that I can provide. The first is that the legislation requires it. Right? From my position it is required by the Act and we work within the Act.

The second reason is that there is a pool of funds that are paid annually. If you remove owner builders out of the scheme, then you will have to increase the fees for everybody else because, essentially, you need a pool of funds to operate a service.

You can go down the path of not covering owner builders, for example, and you just put the price of certificates up for everybody else.

Mr HIGGINS: I did not ask those questions to defence owner builders like me. It was more to get an understanding of how it works, because there are lot of people—especially in the rural area—who do not understand that and I often get those questions.

Mr MALONE: And we do too.

Madam CHAIR: As an owner builder you would want to be covered and stay in there. I certainly would.

Mrs WORDEN: I am not buying Gary's house.

Madam CHAIR: I am not buying Gary's house either.

Mr HIGGINS: If you buy it you will get the insurance. You will be okay.

Madam CHAIR: No, I will not buy it, Gary.

Mr MALONE: We would be happy if you bought it six-and-a-half years after he finished.

Madam CHAIR: Oh, thank you. Boom, boom!

Mr HIGGINS: I did not build my own house. It was actually a cabin.

Madam CHAIR: If have a quick question, Mr Malone. If I am an owner builder and I have started the construction, like you allude to, I am halfway through and said, ‘I cannot do this. I do not have the expertise. I will call a builder in.’, what is the process then?

Mr MALONE: We get many projects which change tack part way through a building process. For the fidelity fund, that is a tricky situation. Normally what would happen at that point is we would want full documentation of the work that had been completed up until that point. The owner builder would be responsible for that work. But any work done by a registered builder after that point would be covered by the fund if the builder defaulted and disappeared.

We find a number of projects with either of those scenarios. Either the builder starts and the homeowner finishes or the reverse. There is no elegant solution to that. It is just a fact of life and you try to find the least inelegant solution to try to make it work.

We just look for full documentation and get photos and drawings. To be truthful, most of those projects have worked out pretty well.

Madam CHAIR: So, the processes are there in place and they are effective. It covers …

Mr MALONE: The interesting thing for operating this scheme is that it is as complicated to run this little scheme in the Northern Territory as it is to run the New South Wales scheme, which turns over hundreds of millions of dollars a year, with very similar compliance obligations as well. The building industry is full of specialised projects where people want to do particular things or some of the work themselves. So, you will never find legislation that covers every eventuality. That has made the challenge. A lot of the complaints that come up are those unique experiences just like you touched on, where there is no elegant solution. The best you can do is the least inelegant one.

Madam CHAIR: Yes. You mentioned it and it was previously mentioned as well that the cost is actually to the owner, not to the builder. Why is that?

Mr MALONE: The legislation was set up that way.

Madam CHAIR: Yes, okay.

Mr MALONE: In actual fact, the fund is protecting the homeowner in the event that the builder fails. So, the builder is not the client in the process, the builder is the risk. The scheme is set up to protect the homeowners from the risk, which is the builder.

It becomes tricky because the Act requires the builder to purchase a certificate. It would be much clearer if the homeowner purchased the certificate directly from us.

Madam CHAIR: I was going to ask you that. Why can the homeowner not purchase directly?

Mr MALONE: The Act requires the builder.

Madam CHAIR: Because it requires, yes.

Mr MALONE: It is connected to the building permit process. You purchase a certificate, you can then go to your certifier and purchase your building permit. It is done as part of the responsibilities of being a builder, but it leads to misunderstandings by people about who is being covered by the fund.

Madam CHAIR: Absolutely. Mr Malone, is there any other jurisdiction anywhere in Australia where the owner purchases the certificate?

Mr MALONE: I am not sure. I have not reviewed the Acts in other states.

Madam CHAIR: Okay. Yes, Mr Wood.

Mr WOOD: What proportion of premiums collected is spent in operating costs? The question from that is, if you are still relying on the loan from the government to keep having enough money there to pay out any claims, is it—and looking at the financial statements for the MBA it says the administration fee is $870 000 and there is an expense transaction around $331 000. Are they normal costs that a fidelity fund would have? If those costs are every year—which is about $1m—is there any chance of ever being able to get enough money in the account so you will not need that loan anymore?

Mr MALONE: There are quite a few answers to those questions. If we can step through them that would be really good.

Madam CHAIR: Thank you.

Mr MALONE: First, Master Builders' accounts pick up some of the direct expenditure as Master Builders Fidelity Fund expenditures. That is the $330 000 you found in the audited returns for Master Builders. That is not the cost of operating the fidelity fund. They are where we show explicit costs. It is a decision we make about where the costs sit in our ledger. It is not a statutory report to government on where expenditure might be.

The amount you identified as revenue is correct. As I went through my opening statement, there is a range of third parties that are paid first before the fund can open its doors. It is in excess of the amount that you saw there for costs. Then, we are required to keep the doors open 270 days a year, with all the additional costs that come into that.

The thing with the fidelity fund is that where it sits financially will depend on where the market sits at any particular time. So, its costs are pretty well fixed because you have to open your door, employ people, pay your insurances, for example, which are substantial. There is no choice but to do that.

But the market moves around you, so there will be years when the fidelity fund adds significantly to its trust account, and there will be years when it does not add anything to the trust account. It depends on the cycle.

In addition to that, the way that risk is accounted for is also quite complicated. There are two different standards that apply to how we measure risk. We identify, we look forward and ask what sort of claims we expect to have in the coming year for non-completion and for defects. We do an estimate with our actuary on that basis.

The actuarial standard then requires a buffer to be added to that. That buffer is added on. Because we also need to meet the international accounting standards, there a second pricing of risk as well and a second buffer.

The trustees need to maintain sufficient reserves to meet those expected costs and the buffers that come with them as well.

The fidelity fund was moving very quickly towards self-sufficiency until this market started to go backwards. It would have been in a position, should it have chosen to, to pay the loan back at that time. But it has not done that because the market is not in that position today. For people who have been anywhere near Darwin's residential market in recent times, you will know that the residential market has been down 75%. The fidelity fund feels that impact just as much as every single builder in the town.

The trustees have every intention—without me putting words in their mouths because it is not my position to do so—they are professional people running a professional organisation and you could expect them to make good, sound financial decisions about that money.

Mr WOOD: Does the fund have its own separate books?

Mr MALONE: Yes, absolutely.

Mr WOOD: They are the ones that go to the Minister?

Mr MALONE: Yes.

Mr WOOD: If we wanted to look at those books for the fidelity fund, we would have to ask the Minister?

Mr MALONE: I mentioned in my opening statement that the Minister receives a report which has an independent actuarial assessment and independent audit. You asked earlier that question about why the

Auditor-General not take a look. Well, there is an audit done every single year by an auditor appointed by the Minister, so you get the same result as if the Auditor-General was looking at it.

There are also solvency certificates from the trustees, rate cards from the trustees which are developed by the actuary. The actuary provides the advice on how much you should charge for a fidelity certificate—also declarations about the compliance and contingency plans.

Mr WOOD: Can I ask you on that about the charge for the certificates? On the website it says 1.2% of the value of the resident …

Mr MALONE: For unit developments, isn't it?

Mr WOOD: That one there, anyway. I am not sure if that is unit, but it goes up from $12 000 up to—oh, big money—$2m.

Madam CHAIR: It is 1.2% across the board, is it?

Mr WOOD: When I did the 1.2% on $700 000, I think it came up at about $8400. The figure there is $4000. So, the website says it is 1.2%.

Mr MALONE: I have not had …

Mr WOOD: I did not know whether that was a …

Mr MALONE: There is a sliding scale for certificate charges for houses that start at $700 for a project up to $25 000 …

Madam CHAIR: Yes.

Mr WOOD: Yes.

Mr MALONE: … then goes right through to $7500 if a home was to cost $2m.

Mr WOOD: Yes, I think the 1.2% works from some of the lower numbers. Once you get to the bigger numbers it seems to be different.

Mr MALONE: I also mention that when the fund started, the fund was at the higher end of the range for cover in Australia, but is now one of the cheapest providers of cover in Australia. The fees up until this moment have not change since the start of 2013.

Madam CHAIR: Any other questions?

Mr WOOD: Yes, there are a few there. I will ask about eligibility assessments again. If a builder does not agree with the eligibility assessment, can they appeal against that?

Mr MALONE: The trustees have a mechanism in place where a builder, if they disagree with the assessment, can choose to go to a third party. We have an arrangement with Deloitte in Darwin to do those assessments. Those assessments have been done in the past and in 100% of the cases, the builder has got less than the original recommendation from the specialist interstate.

Mr WOOD: I saw somewhere that you can get a free eligibility assessment. Is that …

Mr MALONE: All eligibility assessments are free.

Madam CHAIR: They are all free.

Mr WOOD: Yes.

Madam CHAIR: There is no charge.

Mr MALONE: No.

Mr WOOD: In relation to non-completion claims and also overview of defective works, the department mentioned—I wrote it down here somewhere—the Commissioner of Building Disputes. I am not sure I have heard of that. Does that come into this?

Mr MALONE: Yes. The regulations appoint the Commissioner for Consumer Affairs as the Commissioner for Building Disputes as well.

Mr WOOD: So, if you are appealing against some of these matters, you can go to that commissioner?

Mr MALONE: You go to the commissioner when you have a dispute with the builder, where the builder still is operational and conducting business, because there is no trigger event that would involve the fidelity fund. They become traditional building disputes. That is the commissioner's role.

Mr WOOD: If the builder has completed the house and then you put a claim in, and the claim is not accepted, is there any way you can appeal against that decision?

Mr MALONE: There are provisions in the Act for people to take court action against the trustees.

Mr WOOD: The regulations provide that a cover period for non-completion of guaranteed work is 90 days. Have owners had their claims refused because they did not lodge a claim within this 90-day period?

Mr MALONE: What you are talking about is the time bar.

Mr WOOD: Yes.

Mr MALONE: There is a 90-day claim after an event is triggered. There have been a number of circumstances where homeowners have not met the 90-day time bar. The trustees have discretion—because it is a discretionary trust. They have never knocked back a claim based on the 90-day time bar.

Mr WOOD: Is it too short, do you think?

Mr MALONE: If I offer a general opinion?

Madam CHAIR: Yes, please.

Mr MALONE: This is not the fidelity fund and it is not Master Builders, but a general opinion. If you do not put a time bar in you run the risk of people hunting for claims towards the end. If you look at some of the schemes that have operated interstate, there are people who set themselves up as building inspectors, they go around before your warranty period runs out and create claims.

Mr WOOD: Like some of those big law companies?

Mr MALONE: I do not want to suggest that they are ambulance chasers, but I probably just did. But …

Madam CHAIR: There has to be a time limit.

Mr MALONE: There has to be a time bar.

Madam CHAIR: Absolutely. Mr Malone, I want to ask you a general question about the Master Builders Association. I know you are not-for-profit. How many people are working in the Master Builders Association?

Mr MALONE: The Master Builders is now a company limited by guarantee. So, it is not an association anymore. It is Master Builders Northern Territory.

Madam CHAIR: Great.

Mr MALONE: We have 1.5 people operating the fidelity fund. Then there are between 5.5 and 6.5 people who operate inside Master Builders NT.

Madam CHAIR: Okay. Is it an expectation that all builders are members of the Master Builders?

Mr MALONE: No.

Madam CHAIR: No.

Mr MALONE: It is just like any other organisation. People are free to choose whether they are involved. The Act makes it very clear as far as the fidelity fund is concerned that there can be no discrimination between people are members or non-members. So, when it comes to the fidelity fund, it operates as a separate entity. It is basically leveraging the overall structure of fidelity funds between here and the ACT in expertise and our own staff.

Madam CHAIR: Great. Say, for example, I am interested in buying. I will buy a house and land package and I have selected my builder, Can I go to the Master Builders Association and say, 'Hey, is this guy a member?'

Mr MALONE: You can go to Master Builders NT and ask …

Madam CHAIR: Ask, yes.

Mr MALONE: … 'Is the builder a member of your association?' If you wanted to know whether that builder currently has cover under the fidelity fund, at the moment, no, you cannot ask that question because that is the builder's business, so that would be a question the homeowner needs to ask the builder …

Madam CHAIR: Directly, yes.

Mr MALONE: As we would say to anybody, if people are looking to build a new home they should be asking for references and checking on this information. We also have significant problems with people paying in advance for work.

Mr Wood, you touched on some matters which, if you dug deeper, you would find that people had paid in advance. The Act specifically prevents cover for that.

Homeowners, unfortunately, are inexperienced when it comes to contracting to build a home. Master Builders, at the last election, recommended to both sides of politics the establishment of a small office of the residential ombudsman—someone who could help before contracts are signed, not after disputes arise. Both major political parties in the Northern Territory accepted that recommendation but we have not been able to get it up.

The number one issue for consumers in the building and construction sector is inexperience in entering into a very major contract.

Mr WOOD: Could someone else be involved in that, like the people who give the loan? Could they say, 'We would like to see evidence, when you are now asking for your second loan payment, that the builder has done the job'? In other words, do not just rely on the owner to say, 'Yes, it has all been done'.

Madam CHAIR: They ask for project updates, don't they?

Mrs WORDEN: They ask for invoices for work completed.

Mr WOOD: That is right.

Mr MALONE: I think I know where you are coming from, Mr Wood. A number of the financial institutions no longer do inspections of progress on building projects and simply require the homeowner to certify the claim. If a builder was to fall over, many homeowners would not know the difference between the various stages in their contracts. So, if a builder provides an invoice which is still less than the total amount, they feel comfortable paying, only to discover that they have paid for a stage in advance of where the project is.

It goes back again to this knowledge about contracting. We, as a building industry, are of the view that the banks have a responsibility to be honest, to visit the site and satisfy themselves that the works have been completed to the stage it has been invoiced.

Mr WOOD: I go back to the cost of running the MBA. Without fidelity fund, would MBA be a lot smaller? A fair bit of the work they is in relation to the fidelity fund?

Mr MALONE: What sits below that is the suggestion that Master Builders are profiting from the operations of the fidelity funds. I have had to live with that criticism now for six-and-a-half years. At various time, we have had to deal with that pretty strongly.

Some years there will be a small margin for Master Builders because things go well. Some years, we lose money because things do not go quite so well. If there are significant claims against the funds, there is no way Master Builders NT can make a margin. We are a claims manager, so some years we have done okay, some years we have lost money on it.

Master Builders is able to stand on its own two feet without the fidelity fund. The big advantage of the fidelity fund is it allows us to have more scale and the fidelity fund to have scale. It is a marriage of convenience.

Madam CHAIR: It is greater scope that provides …

Mr WOOD: You are underwritten by the government …

Madam CHAIR: Mr Sievers.

Mr SIEVERS: David, sorry.

Mr WOOD: I was just saying you are underwritten by government at least.

Mr MALONE: Can I deal with that, if I can?

Madam CHAIR: Yes.

Mr MALONE: The government gave one original loan of $750 000, which paid for the establishment costs. Then the money transferred to the fidelity fund. Master Builders NT does not have any access to those funds at all. That loan is no different than any other commercial loan that exists across this market right now. There have been no additional funds ever provided to the fidelity fund.

The reason for the guarantee that sits behind those claims, which I think Mr Finocchiaro touched on, is that once upon a time, government carried the risk for structural warranty in the Northern Territory for residential housing. That risk is transferred to the fidelity fund. Under the previous home building certification funds, the government had its own funds and if those moneys were expired, government put more money into the fund and that covered structural integrity for 10 years. Under this new arrangement government has no exposure to structural warranty. That has been transferred to the fidelity fund.

Mr WOOD: So

Madam CHAIR: Mr Sievers, sorry.

Mr SIEVERS: I go back to the claims. How many claims are you talking about a year and what are they for?

Mr MALONE: I do not have the numbers with me because the claim information belongs to the trustees, rather than to me as the administrator. The majority of our claims are for non-completion. A significant number are for non-completion. Up until perhaps 18 months ago, we had not had any defect claims. That is the nature of defects. They tend to become visible in year four, five or six. We are now starting to see more significant defect claims. But the majority of claims have been for non-completion.

Madam CHAIR: Okay.

Mr WOOD: I ask about the cap on it. I think the minimum cap is $200 000, but it is also—am I right—capped. It is a minimum of $200 000 and it is capped at $200 000. Is that right?

Mr MALONE: That is right.

Mr WOOD: It just sounds a bit funny when it is $200 000.

Mr MALONE: The issue about what level of cover you provide goes straight to how much you will charge consumers. So, if there is more risk built into the fund the actuary will price that risk accordingly and people will pay more for their certificates as a result because of the potential that you could have a claim for more money.

The ACT scheme has a cap at $85 000, for example. New South Wales has a cap of $300 000. Essentially, the market pays for the level of cover you put into the market.

Madam CHAIR: Do we have any other …

Mr WOOD: There was just that very last question—the one about regulation 41(2) provides that the trustees may take whatever action they consider appropriate against a builder to recover any amount paid by the trustees as the beneficiary. Can you provide any examples of what action the trustees can take and how common it is for trustees to pursue builders to recover funds paid to the beneficiaries?

Mr MALONE: I cannot talk on behalf of the trustees, but I can talk more generally. The fidelity fund has what is called full subrogation rights, which means that the moment you make a claim, the rights of the consumer pass to the trustees of the fidelity fund, which allows them to go after the builder, individual subcontractors or suppliers, or the insurers of those people to recover some of the costs associated with a claim.

The reality of the experience we have had so far—and I mentioned earlier that most of the claims are for non-completion. In those circumstances that means the business has gone broke. There is already a liquidator in place as a rule, and there is no money left in the business. That is the reason the liquidator is there.

So, the trustees are well aware of the subrogation rights, but it is almost impossible to exercise those for non-completion.

If a builder was clearly to mischievously complete a project and they were covered by some insurances, it may be possible to go after the insurance company to recover some of those moneys. Court action is expensive and you do not even get to the front door unless it is a very large claim. So, the reality is that the right exists, but you would have to find a unique set of circumstances to exercise that right.

Madam CHAIR: Okay. I think we are done with questions?

Mr HIGGINS: Yes.

Madam CHAIR: I have a comment to make. It is like car insurance, I guess. Everybody has to have …

Mr HIGGINS: You cannot compare the building to car …

Madam CHAIR: I am not comparing them. But the point is that everybody pays—you have to have car insurance. I have been driving for 30 years and never had to put in a claim for car insurance. But it is there and I am comfortable and confident having the knowledge that I am covered by insurance. It is the same things here, is it not? Really? That is the reassurance we can take, Mr Higgins.

Mr WOOD: Except you do not build your car, you own the car.

Madam CHAIR: No, you do not, but you are relying on the fact that somebody else has built it to some code, and that is basically what happens with a house—in laymen's terms, a simple understanding of it.

Mr Malone, thank you so much for speaking to the Committee; we really appreciate it.

Mr WOOD: Thank you.

Madam CHAIR: That concludes our public hearing.

The Committee concluded.
