Publication Date: 3 July 2018

YSP Podcast Transcript: Episode 119. Practical tips for reducing risk in strata - with Paul Keating

Listen to this podcast episode here.

Intro: Welcome to Your Strata Property. The podcast for property owners looking for reliable, accurate, and bite-sized information from an experienced and authoritative source. To access previous episodes and useful strata tips, go to **www.yourstrataproperty.com.au**.

Amanda Farmer: Hello and welcome. I'm Amanda Farmer, and this is Your Strata Property. With over 30 years' experience in insurance and financial services, Paul Keating has overseen business in both board and executive positions and is the co-founder of Strata Community Insurance, which he started in March 2014, and he's also the company's managing director. Prior to this, Paul spent 8 years as a managing director at CHU and BCB and 13 years at Zurich Financial Services. Paul has worked within the insurance markets of the US, Canada, the UK, Switzerland, Japan, Hong Kong, Singapore, and the UAE. He holds an Executive MBA from the University of New South Wales and is a Senior Associate of the Australian and New Zealand Institute of Insurance and Finance. Paul's also a fellow of the Australian Institute of Company Directors and an associate fellow of the Australian Institute of Management. What a busy guy.

Now, on top of all of that, Paul also found time to be a member of our expert panel at our YSP Live event, which was held back in April 2018. The video from that event, as you may have heard by now, is available from ysplive.com/video, so if you like what you're about to hear, check out that video for more of Paul's insurance wisdom, but right now, today, we have him here. I am delighted to welcome, Paul Keating of Strata Community Insurance. Welcome, Paul.

Paul Keating: Thank you, Amanda. Very impressive introduction. Thank you very much.

Amanda Farmer: If you do say so yourself.

Paul Keating: Yes, absolutely. Thank you.

Amanda Farmer: It's lovely to have you. I've been wanting to have you on the show for some time now and your expertise, and you have been recommended to me by so many in the strata sector. Strata Community Insurance, I know, puts on fabulous forums and information events for managers, for those of us who are servicing the sector, and they're always so well attended, and you're always the first one to put your hand up to share your knowledge and your expertise, so finally I've got you here.

Paul Keating: Yes. Thank you. Look, I think it's everyone's has a role to help educate the strata community. It's a tagline that we have, and we're pleased to sort of bring the expertise that we have within our business to all the stakeholders. As you know, owners ultimately ... There's a lack of knowledge right across the industry, so it's just a part of our giving back to the strata community.

Amanda Farmer: Yes, very important and very valuable work. We're here today, of course, to talk about risk in our strata communities and how we might be able to best reduce that risk, some strategies, some steps we can take, and you are certainly the expert to talk to on that topic. I'm going to start by asking you, Paul, why do you say it's critical for strata buildings to at least think about this issue of risk and think about how they might be able to reduce their risk?

Paul Keating: Yes. Look, it comes back to the nature of what people have bought into. Most people will still say, *"I bought an apartment."* No one comes around and says, *"Hey, friends, family, I just bought the right to occupy a space in a building that's owned by a legal entity, and I've become a member of that legal entity, and I share in its assets, which is the bricks and mortar and the land, but I also share in the liabilities of that particular entity. Oh, by the way, it's got an unlimited liability legal entity structure."*

When you think about what people have bought into, inherently, they're walking into, I guess, a number of challenges, risk exposure, unfunded liabilities. It's the way in which they're managed makes a difference to, not only their asset value, but how much it costs them during their period in that owners corporation as a member of that owners corporation, so no, it's very, very critical.

When you think about that and you think about buildings, generally, the fact that they have a fixed life, there are maintenance issues, there's a statutory duty to maintain and repair and, yes, occasionally, a storm will come across, and there'll be some form of accidental damage or something that may occur. Not everything is covered by insurance, so there's always gaps. We spend our life talking about risk. Yes, we sell insurance products, but it's always focused around risk. Most of our education for managers and brokers, owners, and other stakeholders are really looking at how do you actually reduce risk to ultimately lower cost and prove the amenity of a building?

Amanda Farmer: Couple of things you raised there, Paul, that I want to dig into a little bit deeper. You mentioned this concept of liability and, importantly, unlimited liability. Now, this is a question that we strata lawyers get asked every now and again. What does unlimited liability mean? What does it mean for strata buildings? It's quite unusual that you would buy into what has the semblance of a corporate structure and not have your liability capped at the level of your investment.

When you buy into a strata building, you do have what we call this unlimited liability. That means, in my words, and you can give me yours, Paul, if there is some debt, let's say, that the owners corporation is stuck with and has to pay, if it can't be met from the owners corporations funds, then the person who's entitled to receive that payment can look to each and every owner to repay that debt. That comes as a shock to some owners in strata to realise that they are personally exposed and, just because the money is not in the kitty of the owners corporation, that doesn't it's the end of the story. The person who is entitled to be paid can look to the owners personally. That's kind of scary.

Paul Keating: Yes, look, it is, and it is right. In its simplest form, even with a block of 10 units and there's an unfunded liability, that you, essentially, can go around to each member, and they have to contribute up to the full extent of their net wealth, not the full extent of what they've invested in the property, the full extent of their net wealth. If that bankrupts one person, then the other 9 have to pick up the shortfall of that person, so these concepts are important.

I'm sure when I bought my first strata investment property, if my lawyer, as a conveyancer, was helping me through explain this fundamental structure, the first thing I'd be saying is, *"Oh, my God. I've got to get involved and help the committee and pay attention to it, because there's this complete lack of understanding and apathy when it comes to proactively managing the asset."* Yes, it is there, but by the same token, I don't want to spook owners. I've been in strata for a long, long time. It provides good way of life, and there are certain protections. For example, the reasons that regulators have made insurance compulsory is to lower that unfunded risk. Most owners may or may not know about the statutory duty to, not only to maintain and repair, but to reinstate, so that there's some big event that's happened and there's some damage, that it has to get reinstated. Insurance is there, and the insurance funds have to be put towards that reinstatement.

However, as I keep saying, insurance is finite, so you've got this inherent mismatch between the assets of insurance and the liabilities, unlimited liability that owners face within this legal entity. If people get the concept, you can more proactively work with your strata managers and other advisors to help lower risk. You won't eliminate everything, and you can transfer a lot, but at least be aware and have a discussion about how you approach risk in that particular scheme.

Amanda Farmer: I want to jump into that very shortly about that exercise of proactively lowering your risk and what an acceptable level of risk might look like for a building, but before we get there, something you mentioned in your opening there, Paul, was that not everything is covered by insurance.

Paul Keating: Yes.

Amanda Farmer: Can I put you on the spot there and ask you to point out for our listeners some of the things that they might not realise is not covered by insurance?

Paul Keating: Yes. No, I'm happy to talk about ... We should be talking more about it, so the perfect world to explain it. Strata insurance is quite comprehensive, is quite broad, but certain risks are ... there's an inability for insurers like ourselves to buy reinsurance for, in other words, to be able to provide the protection that we need to give to all of the buildings and all the assets we

An example of that might be acts of war, hostility. More recently, terrorism has been a big issue in the last decade or so, and that cover moved away from the strata sector. Around about 2008, 2009, we were able to bring back a form of coverage there up to about 50 million, and we've now brought in 100 million of coverage, and now the actual terrorism pool, the ARPC have changed their cover to actually incorporate more strata buildings to provide that protection. Yes, there's a few examples there. I encourage people to talk to their strata managers and talk to their insurance brokers about those exclusions because every policy will have some of those, yes.

Amanda Farmer: What about cladding?

Paul Keating: Cladding, yes. Well, cladding, in itself, can I say, is a symptom of the defects epidemic that faces the strata sector, okay, so here we have a couple of issues. Number one, a nonconforming product, and we also have some conforming products which make cladding been used in a non-conforming way, so it's 2 issues. An insurance policy will see that as a defect because it's non-conforming, so it is a defect.

Generally, if we're on risk and there's a defect like that on a building and something happens, we will pay for the consequential and cover the consequential damage that occurs out of that, but we won't pay for the replacement of the cladding or we won't pay for defects, the fixing of defects. This is a real issue because now we know those buildings have these defects. We're saying, *"Well, hang on a sec. We've got to get the defects fixed,"* and, of course, it's a massive issue for owners to be able to raise funds to be able to do that, and there's been little support of government in some sort of funding mechanism to help make sure that that takes place.

Amanda Farmer: It's definitely a huge topic which we can devote a whole episode to, but I couldn't let you go, Paul, without asking you that question of how the insurers are dealing with that, because we have been anticipating for some time the knock-on effects from this defective building material being installed, and insurance plays a really big part there.

Paul Keating: Yes, and there has been some knock-on impacts. There's no doubt that some of your listeners would have seen that. There's no doubt that it's there, but I keep saying to the government, *"This is not an insurance issue. This is a public health and safety issue. When you have a flammable product on a building, and your building standards say no flammable product on the building, there's an issue, a fundamental issue,"* and it's complex in terms of who's going to pay for that. I think only with government intervention will we get an equitable solution for owners, and the pressure needs to continue for that.

Amanda Farmer: Let's move back to proactively managing risks and reducing risk. I think you said there, Paul, that we're never going to be able to eliminate risk. There's always going to be a level of risk. What is this acceptable level of risk? How do we get down to it? How do we manage our buildings so that we're only exposed to that acceptable level of risk?

Paul Keating: Look, it's a great question. It's a big question, and I want to position it to say that every owners corporation is different and their risk tolerance will be different, and so a risk profile of, say, a 4-lot scheme and a 200-lot scheme is completely different. There's a different public risk profile. There's a different profile around the exposure to common property. There's a different profile of ability to raise funds. There's a whole range of different aspects around it. Then you take that aspect, and then you add occupancy, so the different risk profile of owner and tenant, someone who's there has a dress shop or someone that has a fish and chips shop are different profiles. The fact of the matter is I think strata committees need to sit down and actually talk about risk. No one does, so the first point is to talk about it.

For me, you just have to look at what are the major concerns? What are the possibilities it could have? You need to measure it, really, in 2 ways: the likelihood of a risk occurring and the probability or the severity of, when that risk does occur, what's it likely to be? For us, a risk of an earthquake is a very, very small probability, but the severity is going to be quite significant, so we pay a lot of attention to how we would buy reinsurance for that particular contingency, right, just as an example. For owners, defects, the risk of managing defects. The earlier that they identify those defects and proactively work through, the lower the risk it will be for themselves and also for the rest of the owners.

There is a process there, and once those risks are identified, owners can do a number of things. They can decide that they might decide, *"This risk is acceptable to us. We can self-fund it. We can put some money aside for it."* They could transfer it. Insurance is an instrument to transfer risk from an owners corporation to a capital provider like an insurance company. You could do something about it and actually eliminate the risk like, repair a leaking window, you've reduced the risk or eliminated the risk that the floors would get wet and get damaged, for example. This is risk management process, and we, as an insurance company, are on the tail end of that because we deal with the risk transfer, but it's really about the discussions upstream that's really, really important for strata committees to have, and it's very rarely on the agenda.

Amanda Farmer: You just took the words out of my mouth. I don't know if I have come across a strata committee, that I'm aware of, that has sat down and engaged in this discussion. Have you been involved with committees who have been proactive in this way, or have you got an example of a building, a committee, even a manager who's working with a building and successfully reducing risk and taking these proactive steps?

Paul Keating: Yes. I think what happens is the issues of risk are actually discussed but they're not, *"Let's talk about risk and risk management."* For example, preparing a sinking fund is actually a form of risk management because you're saving, and you're forecasting, and you're doing a nice thing, so it is happening in different places. I think I've come across ... There's a number of examples where we've identified risks and we've worked with strata managers and owners to help do some risk improvements. Probably the best and simplest case to articulate was a scheme in Queensland which we underwrote in around 2014, and it had no prior history. All of a sudden, within the space of about 3 months, had something like about 4 or 5 burst pipelines and water damage coming out, which was very unusual. We spoke with the manager, and we spoke with the committee and chairman at the time, and we recommended to get a plumber in to do some pressure testing, and so they did some pressure testing of the pipes in the building, which worked out to be around about 460 psi, for example. Then they went to the mains and tested the pressure of the mains, and it was 1,100, nearly 2 and a half times the pressure that the pipes could take inside the building, so it had become inevitable. Simple case there. They've taken, *"What can we do?"* Pressure reduction valve, put it on the mains. They've reduced the pressure down to about 300 psi coming in, and all those burst pipe claims went away.

We've dug into this a bit deeper because what actually happened subsequently in the next year or 2 was some of the neighbouring properties started having the same problems. We've realised that, at certain times, a fire brigade will work with the water authorities to get them to increase the pressure of water mains in the street, but no one gets any notice out of it, and if you can imagine the flow-on effect, so sometimes owners don't know, *"What's happened to my building all of a sudden? There's water coming out everywhere?"* The pressure in the water mains has increased because fire brigades need it to be at a minimum amount, so there's lots of ... We're still learning. There's lots of different examples like that, but this particular committee and the strata manager, they listened, they took action, and they've mitigated that risk. That's just kind of a simple example where it can avoid the costs of those claims.

Amanda Farmer: Really good tip there for a practical tip for buildings who might be experiencing some problems with burst pipes and water pressure to take those steps. You mentioned there, Paul, a committee that listens, a committee that takes action. How do you get them to listen? How do you get them to take action? What are the problems? What's the pushback that you're seeing that managers are getting when it comes to trying to engage a committee or a building in this exercise of thinking about the future of managing risk? How do we get past that initial objection that this is not necessary, this is boring, this is expensive? How do we resolve those objections?

Paul Keating: Yes. Well, there's probably 3 areas that come to mind, and you'll know the first one. Owner apathy is the biggest challenge for managers to get some form of activity. I think it also depends on the building because, on average, we have something like 55, 60% of the strata schemes around Australia tenanted. We find that buildings that have got a high proportion of owner-occupiers tend to be more invested in amenity and being proactive around risk issues than a building that's predominantly rented out or leased out and a mix of owner-investors, because they're looking more for yield and, of course, the owner-occupy is looking for amenity, so that's one thing.

The cost becomes the second-biggest pushback that strata managers have, but there's real cost and perceived cost. I think what people see part of their roles on strata committees, they get a budget and, "If I can save money on that budget, I've been very good committee member," but that's only one part of it. The hidden cost, no one measures the hidden cost of not doing something, only the direct cost of actually spending something on a repair or a maintenance issue, so I think that whole cost-benefit exercise is not well understood.

I think, also, that the third element that we see is what I'd call owner entitlement, *"Oh, we've got insurance. Push it through that. That's what insurance is for, right? Let's do that,"* and it's right. People have a right to claim on insurance, and that's what it's there for, but generally, it works better for bigger claims and bigger events, but you see lots of little claims come through. Very few people understand, if you put through $100 of claims, particularly in New South Wales where you've got this massive tax on insurance that the state government's imposing a lot of tax, funds fire brigade from people who buy insurance, but if $100 of claims will turn into around about $300 in premium, that's the kind of level. In the end, it might be economical day one, but is it really economical over a longer period?

In the US, by contrast, most strata communities over there, they self-fund most claims up to about $10,000 because they realise that it's cheaper for them to repair things. Pay, and just pay GST on top, a consumption tax on top, rather than go through and incur all these other state taxes, and they'll use insurance for the larger claims and for catastrophe events. It's just a different psyche, you know?

Amanda Farmer: Yes.

Paul Keating: It's a different [crosstalk 00:20:08]-

Amanda Farmer: A really interesting point. Something that I have discovered in my years of practicing strata law, and you tell me if you feel this on your side, but I feel that strata insurers are particularly generous when it comes to meeting claims, accepting claims. The policy terms are generous. I wonder if that has something to do with this culture that we're developing of, *"Oh, we'll just claim on insurance because that's what it's there for, and they'll cover it."*

It's unusual, in my experience, that a claim ... and I'm often involved in claims for legal defense costs, for example, so we've been taken to the Tribunal, and I've said to the building, *"Well, you've got a policy of insurance. Maybe inquire with your insurer whether that's covered,"* and 9 times out of 10 it is, and the building's sort of saying, *"Oh, wow. This is amazing. This is wonderful."* I've taken to using the line, *"Look, that's strata insurers at the moment. They just seem to be ... They're there for us, and that's great,"* but taking the long view, like you say, Paul, how is this then affecting our premiums? How is this affecting the culture of claiming? Let's not forget that the government's aware of this now too and is jumping on with that tax slug.

Paul Keating: Yes, yes. The shorter answer is insurers are always kind of positioned to say, *"Well, it's fair game, and we'll have a crack at it,"* but we are exceptionally benevolent. I would say, in my 35 years in the industry, probably no other class of insurance are we more benevolent. There's black and white, and then there's grey. I would say, in the strata sector, we're probably ... 9 times out of 10 we will look at owners positively when there's a grey area around the claim. That won't always be the case. I think you'll find now that things are starting to tighten up because the number of claims and the average cost of claims are going well above insurer's predictions, and they'll see that now through higher deductibles and higher premiums over the next sort of 12, 18 months. It's starting to happen at the moment.

How do we change the culture? That's a harder one, particularly if not everyone like to talk about insurance, and not everyone understands the mechanics. It's just a financing end of that risk transfer process, but we're here to help, to talk to strata managers, and if we need to talk to committees about how they could more efficiently manage over the medium to long term, but I would say, particularly in New South Wales where that tax proportion is between, depending on the building, between 30 and 40% added to the cost of insurance, I'd be self-funding. I'd put aside a reserve fund and be funding all that small stuff myself and go to market for a really competitive insurance policy with a claims-free history and use it for the large losses and those big events that you can't predict.

Amanda Farmer: Yes, very good advice. Thank you for those practical tips. Now, everyone who comes on the podcast gets the book question. What books have had the greatest impact on you and why?

Paul Keating: Okay. I'm not a big book reader, I have to admit, but yes, probably one of the earlier ones was ... I've been more into sports and biographies. One that hit me, in particular, was The Rise and Rise of Kerry Packer, from which I learned a lot about ... so Frank Packer, and you could see sort of the history and the behaviour, and you can understand how Kerry acted and behaved and probably jumped to a certain extent, a lot of pressure.

The one that I'm really keen about and really excited is one that's been recently promoted. It's called Why We Sleep by Professor Matthew Walker. He's a neuroscientist, and he's been looking at sleep and the issues in society around sleep deprivation and how that's exacerbating health, obesity, cancer, Alzheimer's, and the fact that it can actually reverse through getting regular sleep. The brain can actually help heal itself over a period of time, so all research that he's done. I've seen a video clip of it which was given to me by a staff member, believe it or not, and I loved it. I've got the book. I'm getting on a plane next week, and that's the first thing I'm going to read, so I'm really looking forward to that.

Amanda Farmer: Excellent, yes. Let me know how that goes. I'm always fascinated in that data that we have, increasingly, around the importance of sleep, especially in our crazy modern lives. Really good that we're getting some good research out there in lots of different ways, whether it's a journal article, or a novel, a book to understand how important it is for us to be aware of the impact that sleep deprivation has on us because it is so insidious. I think back to my days of being a new mom and also a new business owner and working long hours into the night just because I had to and probably not realising the mistakes that I was making. You don't realise until it comes back to bite you, the nature of that sleep deprivation and the risk, that's the word, the risk that you put yourself at.

Paul Keating: Absolutely, absolutely.

Amanda Farmer: All right. Now, before we wrap up today, Paul, let us know how our listeners can find out more about you and anything you'd like to add.

Paul Keating: Yes. Look, Strata Community Insurance is our flagstaff brand and business, so but we can find us on the web there. I'm on LinkedIn, so people can contact me there. Yes, look, we're here to help. I guess our proposition that what we want to do in the strata market is to continue on help educating people and help improve. We've got a lot of work to do with government, a lot of work to do with the regulators, and we'll be a part of it along the way, so looking forward to that.

Amanda Farmer: Excellent. I'm looking forward to seeing the impact that Strata Community Insurance continues to have. I know you have a wonderful team there supporting you, Paul, and I love catching up with all of you at various conferences and events. I'm looking forward to the next one. Our listeners should make sure if they want to hear more from Paul and his expertise that he added to our panel at YSP Live this year, check out the video at ysplive.com/video. Thanks so much for your time today, Paul.

Paul Keating: Absolute pleasure. You take care.

Amanda Farmer: You too.

Paul Keating: Thanks, Amanda.

Outro: Thank you for listening to Your Strata Property, the podcast which consistently delivers to property owners reliable and accurate information about their strata property. You can access all the information below this episode via the show notes at www.yourstrataproperty.com.au. You can also ask questions in the comments section, which Amanda will answer in her upcoming episodes. How can Amanda help you today?