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YSP Podcast Transcript: Episode 026. Does your NSW strata building need a valuation for insurance purposes? - With Amanda Farmer

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Amanda Farmer: Hello and welcome. I'm Amanda Farmer and this is Your Strata Property. Today I am flying solo and I am here to answer a question from one of our listeners.

Heather Law asked a question a couple of weeks ago and I mentioned this one in episode 023 at the beginning of the interview with Leonie Milonas from Strata Community Insurance.

Heather is a Strata Manager from Essential Strata in Bega, and Heather's question was about Section 85 of the Strata Schemes Management Act in New South Wales. Heather has noticed that that section has actually been repealed together with Section 11 of the Strata Schemes Management Regulation, and Heather's questions were: firstly, when was that section repealed? And secondly, what recommendations do I have when it comes to managers and owners ensuring that their property is adequately insured in the absence of this section of the legislation?

So it's a great question from Heather and it's one that I've wanted to devote an episode on, particularly because we have some new legislation coming in here in New South Wales on the 30th of November 2016, and I just want to cover off the current legislation as well as the new and to answer Heather's question: what is it that owners and managers should be doing when it comes to insuring strata properties?

Now, firstly, what did this former Section 85 of the Strata Schemes Management Act provide for? Before it was repealed, this section said that owners corporations in New South Wales need to obtain a valuation for insurance purposes, once every 5 years. Now the intention was to help owners to understand with some certainty how much they should be insuring their building for and to make sure that they were meeting their legal obligation to comply with minimum insurance requirements.

Now when was this repealed? Well, it was repealed as part of the Regulatory Reform and Other Legislative Repeals Act of 2015. Now this piece of legislation actually commenced in March 2016, so not that long ago, and it was an act to repeal and amend a number of pieces of legislation dealing with different types of reforms that the legislator had decided to make, in particular, it was designed to deal with a policy change whereby real estate valuers no longer had to be registered under the Valuers Act.

So there were a few Acts that needed to be changed to reflect that change in terminology essentially and, in the course of making those changes, this reform Act also repealed Section 85 of the Strata Schemes Management Act. It also, interestingly enough, repealed the same requirement in the Community Land Management Act, so the act that relates to Community Schemes here in New South Wales.

So apparently the rationale behind removing this requirement for insurance valuations every 5 years was simply that the lawmakers felt that the legislation already sets out how the minimum amount for insurance is to be determined, and they decided that we didn't need a separate section of the Act telling us to get a valuation. Now, on the one hand, they are correct: the legislation does set out how to calculate the minimum insurance requirements for a strata building but it's pretty complicated.

Now I will try to give you the simplified version, but I will also give you the relevant section so that you can go and look them up for yourselves if you're interested in the more complicated version. So the relevant section in the Strata Schemes Management Act is Section 83, which is certainly still there, and this is the section that says: An owners corporation must insure the building, and the building is to be insured for at least the amount determined in accordance with the regulations.

Okay so we then turn to Regulation 12 in the Strata Schemes Management Regulation and this is the current law, and Regulation

12 says that in order to calculate the amount of insurance for a building or the minimum amount of insurance for a building you've got to look at a few things.

You have to look at the estimated cost of rebuilding the building; plus the expenses that might be incurred, such as demolishing and removing any rubbish; plus you look at the remuneration of architects and any other professional services and consultants that are necessary to effect the rebuild; you've got to add all of that together and then you have to add an amount on top of that to account for any increase during the period of 18 months following the commencement of the policy.

So you have to assume that there will be some increase in construction costs over that period of 18 months and factor that into your minimum insured amount. So, whatever figure you get out of all of that, you have to insure for at least that amount, though it can be more. Having heard that, if there is any owners corporation or strata manager out there who knows exactly how to calculate that figure and how to do it accurately without the expertise of a qualified valuer, then I'd love to hear from you.

I'm not sure that the lawmakers really thought that one through when they suggested that, because the process is set out in the legislation for how to calculate the minimum amount for which to ensure, we don't need to legally require our buildings to obtain valuations.

Now, as I will get onto shortly, that doesn't mean you shouldn't be getting a valuation, and that is certainly my recommendation, and I will get stuck into that in just a moment. Now let's have a quick chat about the new law here in New South Wales that is about to commence on the 30th of November. Does that make the position any better? Unfortunately no, it basically says the same thing. The relevant section in the new law is Section 161 of the Strata Schemes Management Act, and that says that a building is to be insured for at least the amount determined in accordance with the regulations, and the new regulation commencing on the 30th of November is Regulation 39 and that basically says exactly the same thing as the current Regulation 12, which is that you add together the estimated cost of rebuilding the building, the expenses incurred in demolishing and removing rubbish, you add the remuneration of architects and other professional services, add all of that together and on top of that an estimated amount for the increase – and this is slightly different – for the period 24 months, so 2 years, following the date of commencement of the policy.

So currently we have to take into account any increase in construction costs and costs of rebuilding and replacing for a period of 18 months… the new law requires us to do that for a period of 24 months.

Alright, so what's my recommendation for dealing with this? What are the action steps, what are the practical things that you as managers and owners should be doing to ensure that (a) you are meeting your legal obligations and (b) you have adequately insured your strata building?

Well, in short, even though you are not legally obliged to, I recommend that you get a valuation. Get a valuation at least once every 3 years I recommend, and insure the building for at least the value that is set out in that valuation.

If you are a strata manager, what you will be doing is seeking instructions from your owners corporation to get that valuation, and you will be telling them "look, guys, this is no longer a legal obligation but I highly recommend that this valuation is obtained."

The other thing that I think you should be doing is to review that amount annually and that's to take into account changes that are happening on site. For example, you just completed a refurbishment project, you might have put half a million dollars into that, then you need to make sure that your insurance is reviewed in order to account for that improvement in the building.

I also recommend that when you're instructing a valuer to carry out this valuation for you, you instruct that valuer to take into account the requirements of the legislation, and if we're dealing with the new law that commences on the 30th of November, you're directing the valuer to Section 161 of the Strata Schemes Management Act and Regulation 39 of the Strata Schemes Management Regulation.

So you're telling that valuer "these are the legal obligations that we have to comply with, please make sure that when you are evaluating the building you are taking these obligations into account when you're coming up with a final figure for which we should insure our strata building."

Now, it's really important to get this right. If you get it wrong and you're under-insured, as Leonie Milonas from Strata Community Insurance explained to us in episode 023, any liability that's not covered by your insurer, is going to be the personal responsibility of the owners.

So the consequences of under-insuring are quite serious. You could be left having to put your hands into your own pocket, which is of course not a position any of us want to be in. Now, something else to remember is that the costs of construction, particularly here in Sydney, are growing at an exponential rate, faster than CPI, and that's why I'm recommending that you review your valuation annually. It's not just to take into account improvements that might have been made to the common property, but also this increase in construction costs.

And of course, how are you supposed to know what the going rate is on construction costs? One guide that you can refer to is called the Cordell housing price index, and that's an index on construction costs, so labour and materials, and that's something that reviewed and updated regularly to take into account this rapidly changing aspect of the construction world.

I will put a link to their website in the show notes under this episode, but I think some insurers actually use Cordell's calculators when they're reviewing sums insured, and of course valuers would do that also. So, in practical terms, what I'm suggesting you do each year is that when you're going back to your insurance broker, when your policy is being renewed, you're going to ask them to review the sum insured and take into account the Cordell Housing price index, and advise of any recommendations for change.

And as I said, the index on construction costs is generally higher than CPI, so don't just assume that you should simply increase your sum insured by CPI because you could be left under-insured.

So, thank you for your question, Heather. I hope that has assisted you, and no doubt many other listeners out there who may have been caught off-guard by these amendments, they certainly went through very quietly. Remember that you can ask me a question anytime by posting a comment on the Your Strata Property website: www.yourstrataproperty.com.au

I want to keep delivering content that is relevant to you, that you find useful and engaging in your day-to-day experience of strata, and the best way to do that is to hear directly from you. So please don't hesitate to drop by the website and give me your question. That's it for me today, catch you next time.

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