



STRATA COMMUNITY INSURANCE



**Western Australia Strata Insurance Explained:
Owners' Questions Answered.**

The Strength of **Experience.**



What is a strata company?

A strata company is a not for profit, unlimited liability legal entity. That means it is financially responsible (on behalf of all lot owners), for all the assets such as the building and the land, and all liabilities it may have.

Owners need to be aware that there is no cap on these liabilities. Owners are exposed to any net liabilities of the strata company up to the full extent of their net wealth (not just what you invested into the property).

And like all legal entities, a strata company can sue and be sued. It's important to “get involved” and protect your asset.

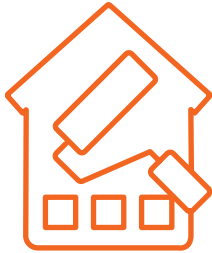


So, what do I own?

Most people say they bought an apartment. It might be more accurate to say that you bought the right to occupy a designated amount of cubic air space in a building complex that is jointly owned by other owners collectively forming a legal entity. This entity is known as a strata company.

You become a member of the strata company, and normally your unit entitlement will demonstrate your share of assets, liabilities, and share of running costs (such as quarterly levies).

So as an owner, you wear two hats. That of a lot owner, and that of a member of the strata company.



And the buildings and physical structures?

As a generalisation, the strata company owns the common property as defined by boundaries identified within the strata plan. The balance of the property inside a lot is owned by the lot owner.

Every strata complex can be slightly different with respect to the boundaries that define common property versus lot owner property. In some cases, the boundaries could extend to the external surfaces of the complex, but generally the boundaries focus on the internal surfaces. You should check your plan and be very clear on the boundaries.

The strata company has a statutory duty to maintain and repair common property. Not only is this an important safety issue, but it keeps the common property in good working condition and can help maintain the value of the complex.

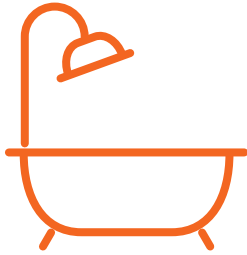


Why should strata insurance be important to me?

If the strata complex is destroyed – for example by wind, earthquake or fire – and there are no funds to rebuild the complex then the market value you paid for your apartment (air space) may be impossible to recover. And you still need to pay the bank back for your mortgage.

This is why legislators have made it compulsory for the strata company to buy insurance, to ensure that the level of cover will be enough to fully reinstate the building to its pre-existing condition, and that the insurance funds must be put towards the reinstatement of the building. This gives owners (and banks) confidence that a significant economic loss can be avoided.

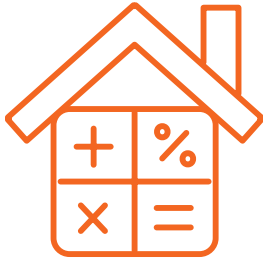
And because of the unlimited liability nature of the entity, legislators have also made public liability insurance mandatory up to a minimum of \$10m, which protects owners from third parties who may make claims for injury or damage.



What about my property that I own?

The good news is that, in addition to common property, the strata legislation makes it compulsory to insure all fixtures (such as kitchens, bathroom vanities, etc.) even though this property is owned by the lot owner. However, removable items (known as contents), and temporary flooring and carpets, etc., are excluded from this definition. Lot owners generally individually purchase contents insurance (if they occupy the lot) or landlords cover (if they rent out their lot) to ensure their own property is adequately covered.





So, what is underinsurance?

Underinsurance refers to when the level of insurance purchased is insufficient to pay for the building to be fully reinstated, and the shortfall must then be collected from owners. For example, if a 10-lot building with one owner per lot was insured for \$10m but it actually would cost \$20m to reinstate, the shortfall of \$10m must be collected from the 10 lot owners.



What are the implications for lot owners?

Owners have a joint and several liability to the strata company (or, in other words, to each other) meaning that the total shortfall must be collected from all of the owners (normally calculated by unit entitlement). In a scheme with 10 owners, if one owner defaults, and can't pay their share, then the other 9 must pick up that shortfall. The building must be reinstated for the benefit of the other 9 owners.

Underinsurance exposes owners to an unrelenting range of both financial and emotional stress that, with the correct planning with your strata manager, can be otherwise avoided.

Sounds ominous, how do I best protect myself?

The best way to mitigate this underinsurance risk (or shortfall in funds) will be to engage a professional valuer to assess the costs of replacement – including costs of demolition, site clearance and the remuneration of architects, surveyors, engineers and other persons whose services are necessary – and provide a figure that will be sufficient in the future to pay for the total rebuild, allowing for delays caused by DA approvals and building construction timelines.

Discuss valuations with your strata manager, because there are quality valuations, and then there are ‘tick-the-box’ valuations. The cost to purchase a comprehensive valuation from a specialist, and get a good outcome, is worth the investment. Once you have a quality assessment, you can index that amount each year, and only use the full valuation process once every 3-5 years.

For new buildings, avoid using the insurance value provided by the builder to the construction process, given they are retrospective wholesale costs. A credible valuation will take into account prospective building costs, planning approvals, and include incidental costs as required under relevant legislation, in addition to including GST requirements.

So, what drives the cost of insurance – how are premiums calculated?

THERE ARE FOUR MAIN DRIVERS THAT IMPACT THE COST OF STRATA INSURANCE. REINSURANCE, GLOBAL AND LOCAL EVENTS (CLAIMS), GOVERNMENT TAXES, DUTIES AND LEVIES, AND INDIVIDUAL BUILDING CHARACTERISTICS/QUALITY.

Reinsurance – this is the insurance that insurers purchase from a global market. Global performance influences capital flows and impacts the cost and availability for insurers in Australia. In the good times, capital is attracted into the market, availability is abundant, and prices are cheaper. In the not so good times, where capital is eroded, it's hard to attract more capital into the sector, leaving availability tight, and this results in cost increases. This impacts whether an insurer will quote a risk, and if so on what terms.

Claims costs - The number and value of claims across an insurer's portfolio will impact the average cost assumptions that are built into pricing. These assumptions will also take into account claims inflation (which is different to CPI). It is driven largely by the cost of building materials and labour, and supply and demand factors.

Taxes, duties and levies – All these forms of government taxes (terrorism levy, ESL/FSL, GST, stamp duty) apply in addition to the insurer's base premium, and vary depending on the product and which state or territory you are in. When premiums rise, so will taxes. If you're taking out a strata insurance policy in Australia as a strata community, then more than a quarter (27.45%) of what you pay on average goes to government taxes, stamp duties and levies.¹

Individual building characteristics – Building quality is a major factor influencing whether an insurer will accept a risk, and if so on what terms. Insurers look at a building's design, resilience (materials, standards, quality), location, maintenance and upkeep, and overall claims performance. Insurers are looking for well-designed, well-maintained buildings to offer their best terms, and are also looking to avoid those buildings where the quality and upkeep are poor. That is something all owners can influence.

¹ Johnston, N., Lee, A., Mishra, S., Powell, K., Bowler-Smith, M. and Zutshi, A. (2021) *A data-driven holistic understanding of strata insurance in Australia and New Zealand*. Deakin University.



So how do insurers approach the claims process?

The strata company has a statutory duty to maintain and repair. If there is damage to the common property, they need to get it fixed. Depending on the cause of the damage, generally the repairs are either funded by the strata company from reserve funds (i.e., maintenance, defects) or the insurer (for accidental damage).

Common claims – we generally see three types of claims: **1.** Genuine events, with genuine damage; **2.** Genuine events with questionable damage (i.e., pre-existing/maintenance); and **3.** Questionable events and questionable damage (causation is unclear). The first category is easy for insurers, and they get on with it. It's the claims in categories 2 and 3 that take all the time, as it needs to be established whether the strata company or the insurer pays for the damage.



Go to stratacommunityinsure.com.au/strata-managers-toolkit/ to download this as an e-brochure, plus many more information brochures available for download



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