

WHITE PAPER

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“Adjusting” the government buy-back schemes

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W+K TURNING POINT COMPETITION



Overview

The *W+K Turning Point competition* has been established to promote international thought leadership across key sectors – mining, power generation, gas and renewables – via the lens of risk and insurance.

The annual prize aims to inspire the leading professionals across the industry to submit novel and inspired thinking in a publishable format to challenge how the customary world of transactional insurance products will need to evolve to meet accelerated change in the technologies and industries that insurers are underwriting.

Finalist Sumeet Bhardwaj from Integra Technical Services partnered with Doug Heard from W+K's national Property, Energy & Infrastructure team to write this insightful paper which looks at the issues associated with local government home buy-back schemes that attempt to solve the problems caused by catastrophic loss events, such as flooding, and the susceptibility of locations to future events. The paper also examines the potential role for insurers in improving the schemes and reducing future loss outcomes.

Executive summary

Australia has a long history of disasters linked to natural hazards such as floods, bushfires, cyclones, and storms. Catastrophic loss events and the susceptibility of locations to future events can make properties uninsurable.

Insurers indemnify homeowners for damage caused by a loss event. The application of municipal rules can mean that damaged properties cannot be reinstated at the current location.

Residential insurance policies do not cover diminution in value of the land or the cost of reinstatement at an alternative location. Many homeowners have insufficient funds to relocate to appropriate land elsewhere. This is a live issue from the 2022 Eastern Australia flooding.

Local governments have implemented buy-back schemes to attempt to solve the problem. Buy-back schemes are a welcomed support mechanism but they have not been as successful as intended for a range of reasons, including lack of awareness of the schemes, insufficient scheme funding/ resourcing, and the lack of technical understanding to enable eligible homeowners to adequately understand or access the schemes.

The problems have caused significant delay in applications being made and then processed to resolution. Delay is the most significant factor undermining the schemes' effectiveness. It impairs public perception of the government's response. Without an effective solution, many homeowners will remain at risk from future loss events.

Scheme funding and resourcing are a matter for the government, but there may be an "Insurance Industry" solution related to shared resources that can address awareness, the technical skills gap, and delay.

A solution could be to allow the schemes and eligible homeowners to rely on the technical expertise of insurance service providers, their national networks, and early presence on the ground following catastrophic loss events.

The simple premise is that following a catastrophic loss event, insurers appoint insurance service providers (usually loss adjusters) to attend site. Service providers are usually among the first on site. They assess damage and progress reinstatement of property or adjust a claim for indemnity under a policy of insurance.

Service providers are well placed to complete initial assessments on behalf of the schemes (in tandem with their insurance policy response role). This will save time and costs.

The cost to insurers of sharing resources to support the schemes will not be significant. Costs could be worn by insurers, passed back to government, or potentially be funded by an insurance levy on residential insurance policies against which the service providers' additional costs (i.e. over and above claim adjustment) are reimbursed.

The benefit of insurers sharing technical resources would be significant for the schemes. It would provide immeasurable benefit for homeowners affected by catastrophic loss events. The proposed solution would dramatically shorten the scheme response times, moving more people from harm's way and reduce the risk from future loss events. This will benefit the insurance industry and Australia as a whole.

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PERILS, the independent Zurich-based organisation providing industry-wide catastrophe insurance data, disclosed its fourth and final industry loss estimate for the Eastern Australia floods in March 2023 – the final estimate of the insurance market loss is AUD \$6,527 million^v



The social costs of natural disasters in 2015 were at least equal to the physical costs – if not greater

Deloitte Access Economics¹

Introduction

Australia's recent history has shown that it is prone to natural disasters such as floods, bushfires, cyclones, and storms. Many cause significant damage and destruction to properties and lives.

Catastrophic loss events are a major issue for insurers in Australia and for the government.

They raise significant challenges for homeowners, whose homes can be destroyed or significantly damaged.

Municipal rules can mean that homes can't be reinstated at the relevant location (because the relevant location remains susceptible to future loss events).

Insurers indemnify damage from the event, but residential insurance policies do not cover:

- the cost or value of the land; or
- reinstatement at an alternative location (like an ISR policy might).

Homeowners may end up with an indemnity pot (for the damage) but often do not have sufficient funds to relocate to an alternative location, as the policy does not indemnify for this loss and the land at the relevant location cannot be used for a residential rebuild. The land at the relevant location is worthless.

The Queensland (Qld) and New South Wales (NSW) Governments have implemented buy-back build back schemes and voluntary home buy-back programs to help residents in hazard-prone areas recover from natural disasters. This whitepaper considers two buy-back schemes:

- Voluntary Home Buy-Back (Qld scheme) vii – part of the Resilient Homes Fund providing \$741 million in funding through the jointly funded Commonwealth-State Disaster Recovery Funding Arrangements (DRFA); and
- Home Buy-Back (NSW scheme) ix – part of the Resilient Homes Program providing \$700 million in funding, run by the Northern Rivers Reconstruction Corporation (NRRC).

The schemes have including lack of awareness, insufficient funding and resourcing, eligibility issues, long processing times, and limited technical support.



It is estimated that the impact of the 2022 Eastern Australia Flooding on Queensland was \$7.7bnⁱⁱ

The schemes operate along broadly similar lines.

- Homes must meet eligibility criteria.
- Homes must have been damaged by a relevant event.
- Funding on a case-by-case basis (at market value on just terms basis but subject to any insurance indemnity).



We're on track to have at least 250 formal offers on the table by the end of April 2023.

NRRC chief executive David Witherdin^{xi}

The Qld scheme expects to purchase approximately 500 homes. \$350 million has been allocated to fund buy-backs. More than 5,700 homeowners registered and the scheme remains open for registrations.

More than 6,500 applications were submitted to the NSW scheme but only 130 applications were processed as part of a "case management pilot" by the anniversary of the floods.

First offers were made in February 2023, and it was estimated that 250 offers were to be made by May 2023.

The schemes are welcomed but have not been a complete success. Many affected homeowners have a sense of uncertainty and frustration.^{xii}



Approximately 18,000 homes and businesses affected, with 10.9% classified as being severely damaged.^x

The schemes

The schemes are designed to encourage homeowners to relocate from high-risk areas, voluntarily, predominantly through financial compensation from the government for damaged homes.

The government returns the land to its natural state or repurposes the area, eliminating the risk of future residential flooding at the relevant location.



January 2023: 160 property evaluations conducted for the Qld scheme. 131 offers accepted.



The Queensland floods of 2022 destroyed over 7,000 homes. Modelling from the Climate Council shows that over 200,000 Queensland homes will be considered uninsurable within 10 years, with 6.5% of homes predicted to be 'high risk' for insurers by 2030.^{ix}

What's holding back the buy-back schemes?

The schemes have encountered challenges, including lack of awareness, insufficient funding and resourcing, eligibility issues, long processing times, and limited technical support.

In February 2023, it was confirmed by NRRC at a public meeting that only 25 homes had been properly assessed for buy-back.^{xix}

Progress has been slow, with relatively few buy-back offers made. Delay has hindered the schemes' effectiveness and left families in limbo, sometimes in temporary accommodation, or at risk of further catastrophic loss events.

Increasing the scheme funding is not a solution in the short-term. It will not address the delay aspect.

Insufficient funding

Scheme funding will not cover all affected homes.

"The rollout of the buyback scheme has left us confused and created anxiety because we know there is a limited budget,"^{xxiii}

Lack of technical support

Homeowners lack the technical expertise to understand the schemes, their eligibility, and how to access.

"The biggest problem with the reconstruction authority is communication", "A line should have been drawn on a map and everything on that side of the line should have been moved, swapped, bought out"^{xxv}

Lack of awareness

Some of the most vulnerable people are not aware of the schemes or do not have the resources to access.

Eligibility criteria can be difficult to understand.

Homeowners have expressed concerns about what the actual eligible areas are and how long the process is taking.

"There has been talk of eligibility and zones but it has been so vague that no one knows where they sit"^{xxvii}

Bureaucratic processes

The schemes require multiple approvals from different agencies.

The organisations responsible for implementing the schemes have only finite resources, insufficient for the volume of requests.

The process is taking so long that in Lismore — the city that was at the epicentre of the floods — scores of residents have given up waiting and sold on the open market, sometimes for hundreds of thousands of dollars less than they would have received under the buyback scheme." Adam Harvey (7.30 ABC)^{xiv}

Delayed decision making in relation to land-swaps and buy-back arrangements could lead to suboptimal decision making by affected households, such as rebuilding in existing high risk flood areas, inability for communities to make decisions on rebuilding and indirect issues relating to contractual obligations for insurers processing claims honestly, fairly and expeditiously."^{xxviii}

Is there an “Insurance Industry” solution to the delay?

There is currently some discussion in the insurance industry regarding relocating whole communities in vulnerable areas. This is clearly a complicated approach (and is not considered in this whitepaper).

The notion of the insurance industry assisting the government by funding the schemes (in whole or part) via an insurance policy levy has been disregarded. This raises complex issues:

- high-risk areas are not evenly spread across Australia; and
- policyholders may be reluctant to “fund” what can be perceived as “underinsurance” or deliberately locating in risky areas.

The scale of the funding needed for the number of properties affected would likely make a levy unfeasible and uneconomic.

Instead, the insurance industry can assist the government schemes by providing resources – particularly assessing expertise. This will also address issues of awareness but predominantly could reduce delay.

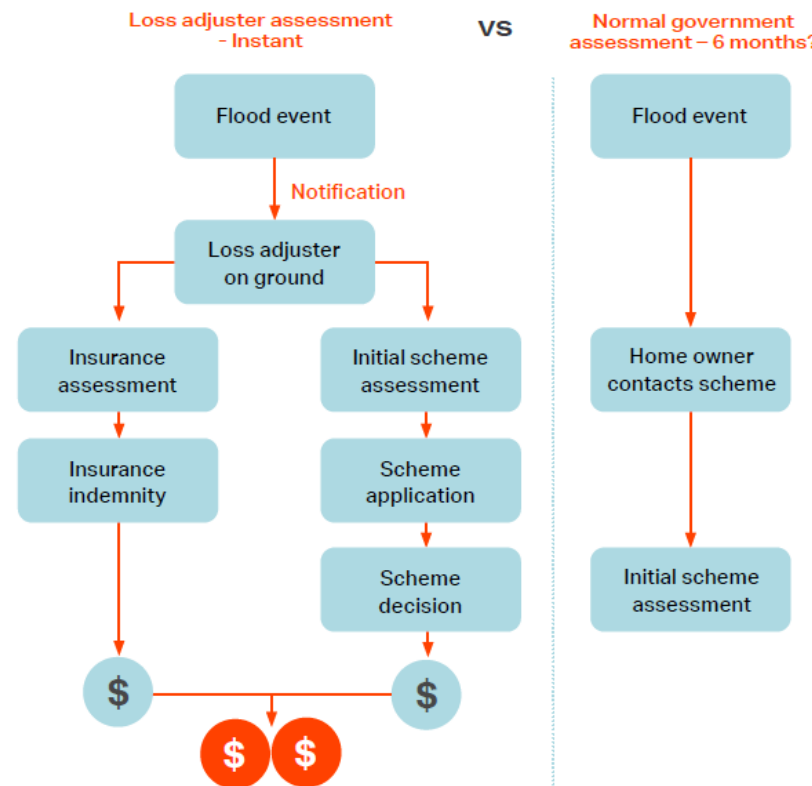
Sharing technical resources aligns with the Insurance Council of Australia’s recommendations on major flooding events.



After six weeks of rainfall, around 230,000 insurance claims were notified. According to the ICA, as of 30 November 2022, insurers have already closed 70% of claims and paid out AU\$3.59 billion, leaving around AU\$2.04 billion outstanding for the 30% yet to close.

The upside

Following the 2022 Eastern Australia flood event, government assessments began sometime after the event with the process taking months to complete. In comparison, loss adjusters are typically on site within days of a claim notification. Insurers have a network of loss adjusters throughout the country. Loss adjusters have the relevant technical experience to support an initial assessment of eligibility for the schemes.



Loss adjusters can complete initial assessment on behalf of the government. They can identify issues such as total losses and flood zones quickly while completing an initial insurance assessment. This can save homeowners waiting months for a government assessment.

Insurers are adept at quickly and cost-effectively managing and resolving claims. Loss adjusters could quickly provide homeowners with:

- awareness of the available government support (including the schemes);
- initial guidance on eligibility and possible outcomes. Where local reinstatement is unlikely to be permitted, homeowners could save months. This would allow them to make better, more informed decisions faster; and
- connect the homeowners to loss adjusters' wide network of consultant/construction contacts, including builders, engineers and hydrologists who were "in high demand" following the 2022 Eastern Australia flood event.

To facilitate this, the government's assessment criteria could be provided to loss adjuster firms so that accredited loss adjusters can undertake initial assessment alongside their initial insurance site inspections.

This "Insurance Industry" solution would save costs and time overall.



Co-design effective ways of working with ICA and the insurance industry to deliver rapid event insights, prompt issue resolution, and holistic consideration of response, recovery and resilience challenges^{xx}

It would streamline:

- **eligibility and damage assessments** – allowing them to take place within days of an event;
- **processing** – loss adjusters would be familiar with the assessments/administration;
- **allocating and scheduling** government assessors (where required);
- **homeowners' access** to the government help; and
- **insurance assessing processes** – facilitating optimal decision making by affected households.

The government and Insurance Industry already collaborates in many ways. A great example, in the context of the schemes, is the partnership between the Qld Government, Suncorp and RACQ – where builders appointed to carry out "insurance funded" repairs can also carry out "scheme funded" works.

This solution builds on this sort of collaboration. It should not raise challenges around competing interests between any insurance indemnity and entitlement to funding under a scheme. Provided that the paperwork is approved by the homeowner, loss adjusters would not be taking on additional risk because the eligibility assessment would continue to be completed by the scheme provider.

Loss adjusters carrying out the early assessments is a natural streamlining of the process to mitigate against future risks.

The cost

There are costs to this solution, but they are unlikely to be significant. It is anticipated that carrying out an initial assessment and the associated administration would take on average no more than 2-3 hours additional per property affected*.

The Insurance Industry could seek to recoup the additional costs through a levy on residential policies or by invoicing the government at an hourly or fixed rate. Ultimately, insurers that are willing to share resources – particularly by supporting homeowners with technical expertise – will be able to differentiate themselves in a crowded market.

More importantly, if the Insurance Industry and government (whether Local, State or Federal) can find meaningful ways to collaborate, the systems that may be adopted now could ensure that the response to the next natural disaster is more effective.

Conclusion

Government funding schemes, think tanks and public policy initiatives all acknowledge the long-term social impact and economic costs of natural disasters.

There is a need for greater collaboration and partnership between governments, businesses and other groups.

The Insurance Industry has a network of experienced and skilled resources and sharing technical expertise would support the schemes significantly.

This Insurance Industry solution of “adjusting” the scheme is likely to go some way to resolving what is holding back buy-back schemes, particularly in terms of the current delays.

Relocating homeowners more quickly from high-risk areas will help families recover faster, reduce the risk of future loss from natural disasters, and will benefit Australia as a whole.

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- xii ABC News: NSW Resilient Homes buybacks begin in Northern Rivers but anxious residents feel ‘no certainty’ (February 2023)
- xiii Bruce MacKenzie ABC News, Lismore residents protest Northern Rivers Reconstruction Corporation flood recovery (News Article, 23. January 2023)
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- xv ABC News: Slow pace of buyback scheme pushes flood affected residents to sell homes on open market (23 February 2023)
- xvi ABC News: Slow pace of buyback scheme pushes flood affected residents to sell homes on open market (23 February 2023)
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