Your Strata Could Be Under-Insured Without Even Realising

A look at some of the effects of the pandemic on construction in Australia

Do you know what the global pandemic has done to your Insurance Replacement Valuation? The figure that you adopt as the total cost to rebuild your building, if it was completely destroyed.

If you are insured for $40 million, could you really rebuild your strata scheme for this amount tomorrow if the worst happened? Could a builder even start work in the first 6 months following your building's untimely demise?

Even a 20% increase in material costs and labour as well as delayed construction times would mean that you are suddenly $8 million short. We all know that a strata scheme must be insured for full replacement value, the legislation makes that very clear, but the cost to rebuild your scheme in 2019/20 is a distant dream compared to the costs right now. So what do we do? Do we take the gamble (against our legislative duty) and hope that the world economy and the construction industry return to normal before a catastrophic event hits? An event such as flooding, or fires, or earthquakes occur where you would actually be looking at a full insurance claim.

Lack of materials, extended construction times, inability to get tradespeople, building companies folding into liquidation, it is almost impossible to construct a building right now.

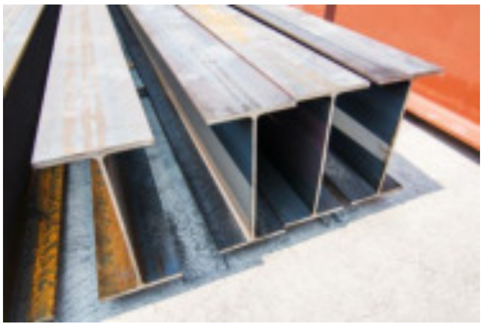
That insurance replacement valuation you had done 3 years ago, will mean almost nothing right about now. When Covid hit and the world turned sideways, many businesses put everything on hold to see how things would play out. Many businesses reduced workforces, spending and operations, cutting production … and then the outbreaks hit!

Consequently, supply chains have been crippled around the world as reduced factory production output collides with a surge in demand from construction economies around the globe. This surge in demand is the result of every country shifting focus from a conservative, constrained economy under covid lockdowns to a stimulus backed drive to increase economical spending, provide jobs and generate taxes without great consideration for the logistical issues unfolding. With a very heavy reliance on overseas products and materials, the Australian construction industry has been heavily affected at a time when the government has encouraged huge construction spending with building grants and stimulus packages.

Given that over 60% of Australian Construction materials originate overseas, particularly in China, the impact of the pandemic on the supply chain has been phenomenal. As international manufacturing plants are hit with outbreaks, the machinery stops moving and production sits idle for weeks at a time, all whilst demand around the world only continues to increase.

According to Corrs Chambers Westgarth, (Sept 2021) ocean freight costs have increased by up to 50% due to factors such as shipping container shortages, port worker covid outbreaks, increase in purchases during stay-at-home orders, and heavy competition from US and Europe as each world economy tries to stimulate spending once again. Even the very simple fact that containers around world ports are taking longer to unload, due to a lack of healthy workers, has a flow on effect to the time delay of these (finite) containers moving around the world. With less container traffic around the world, the price of shipping increases, and the highest bidder gets their products first. The port of Shenzhen, one of the largest in the world, dropped to just 10% capacity during 2021, affecting product delivery around the world (Merricks Capital). Essentially only one in every ten containers are being unloaded on time creating lengthy delays down the supply line.

The Cordell Construction Cost Index (CCCI) rose by 7.1% nationally in the year to September 2021 with QLD seeing the highest rise at 8% indicating the sharpest index increase since March 2005. The CCCI is responsible for tracking and monitoring the costs associated with construction in Australia, both in terms of building products and services as well as labour costs. Many developers and builder are advising that certain material costs have risen by as much as 40% with some builders advising reviewed contracts are coming back double the price against pre-covid predictions.



The international index of over-the-counter Steel Rebar prices on the Shanghai Futures Market rose by 71% in the year 2020-2021. Rolled steel on a number of markets rose by as much as 250% and worse still lumber prices on the Chicago Mercantile Exchange (CME) market rose an eye-watering 300% in the year 2020-2021.

The Primary Commodity Price System (PCPS) tracked by the International Monetary Fund and responsible for calculating all non-fuel commodity prices, rose approximately 54% during the period 2020-2021 on the steepest climb the system has seen. This is markedly different from the Consumer Price Index (CPI) rating projected by the US Bureau of Labor Statistics that is often represented in the media and in publishing's as the benchmark metric for tracking inflationary costs. The trouble however with CPI and the way it is analyzed is the methodology in which it is calculated. Whilst once CPI was tracked by a 'fixed' basket of goods spanning two periods, the decision was made (to understate the severity of inflation) to switch to a dynamic "cost of living" index whereby the index tracks consumer spending reflecting a particular standard of living. The problem with this is that the Cost of Living (COL) index used to mark CPI is dictated by consumer spending patterns. As consumers make budget conscious decisions such as changing red meat for white meat or changing brands of coffee or choosing locally sourced versus imported products, the COL index model doesn't account for this consumer decision and consequently the index does not reflect the true inflationary costs of goods and services between two points in time.

P > 1300 136 036 F > 1300 136 037
W> www.solutionsinengineering.com E > enquiry@solutionsinengineering.com
ABN 77 079 173 194

What does all this mean for you, your strata scheme and the construction industry?

It likely means that you have not fulfilled that legal obligation to insure your building for full replacement value without even realizing it. Regardless of which state or region your building is in, the fundamental legislation of each state makes it mandatory to have the building insured for full replacement value. Not 80% and allow the owners to pay the rest. Not banking on the value it was 3 years ago. The legislation is very specific that the building must remain insured for its full replacement value. Whist CPI does not appear to be skyrocketing in the news, the reality is that costs of most construction related products have increased significantly since the beginning of the pandemic.

Closer to home, construction data collected by the Australian Bureau of Statistics (ABS) indicates that construction cost indexes rose by an average of 12% in just 2020-2021. Specific indices rose even steeper within the year 2020-2021 with Timber and joinery rising 18% and staggeringly steel product indices rising by around 30% in Australia.

The hardest hit supplies are timber products, windows, glass, steel and doors all vital for construction projects from a freestanding house through to a 500 lot high-rise development.

Current Tier 1 and Tier 2 contractors/ builders are still able to source materials with extended lead times but the small and medium size projects are being affected by the lack of availability of products and limited labour force and consequently are folding. At the turn of 2022 we have seen a number of large construction companies fall into receivership as they are unable to progress projects already underway with indefinite material supplies, limited labour forces and financiers calling. And these were the planned construction projects….

Whilst 2020 to 2021 saw unprecedented index rises, the year 2021 to 2022 has seen these compound again. The square meterage costs estimate guide provided by Rawlinson's (a construction data industry giant) has increased by between 5.9% and 8.5% (2021-2022) depending on region and construction type. This is a significant year to year increase on what was already a huge jump from 2020, that could see a number of buildings further under insured even in the simplest fashion by using a square meterage rate of insurance.

However, these figures are dwarfed by some of the linear meterage rates for steel beams in Australia that have increase 2021-2022 by as much as 24%. Reinforced concrete columns, another key element in multi-level developments, have seen an increase in cost by as much as 12.4%. Structural steel and reinforced concrete are two of the largest components involved in the superstructure of a strata title development.

And don't think that you have been spared from the construction cost hike because you have a single level or townhouse style scheme. Ground floor timber framing has increased by an incredible 20% within the last 12 months.

Just like any facet of economics, when demand exceeds supply, prices will undoubtedly rise, and this time around ironically demand has skyrocketed at the same time that supply output has plummeted. What it cost pre-covid to build a house, it now costs x amount more for the exact same house. The x amount will be determined by the materials that went into the construction and the labour to build it. It is no different for strata buildings. In a strata scheme, the larger the scheme, the greater the discrepancy between the previous construction cost and the realistic cost to construct the same building to the same standard today in the event of complete destruction.

If your policy has your building insured for $40 million dollars from 2019, where are you going to find that extra $8 million or so dollars and who will be left liable?

Dakota Panetta

Business Development Manager Australia & New Zealand

BA. International Studies. Maj Int’l Business, Maj Int’l Politics, Min Marketing

Solutions in Engineering