



2009 Victorian Bushfires
Royal Commission

Response to Discussion Paper – cover sheet

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Response
2009 Victorian Bushfires Royal Commission
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FIRE SERVICE LEVY AND INSURANCE
Discussion Paper

DECEMBER 2009

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THE VICTORIAN FARMERS FEDERATION

The Victorian Farmers' Federation (VFF) is Australia's largest state farmer organisation and the only recognised, consistent voice on issues affecting rural Victoria.

Victoria is home to 25 per cent of the nation's farms. They attract neither government export subsidies nor tariff support. Despite farming on only three percent of Australia's available agricultural land, Victorian's produce 30 per cent of the nation's agricultural product. The VFF represents the interests of our State's dairy, livestock, grains, horticulture, flowers, chicken meat, pigs and egg producers.

INTRODUCTION

The Victorian Farmers' Federation appreciates the opportunity to comment on the current funding model for the Fire Services. The VFF have been an advocate of reform to the Fire Service Levy for a number of years. While we are grateful the Bushfire Royal commission is taking this issue seriously and are conducting their own investigations, we feel it is disappointing that it has taken a disaster of this magnitude to force the Victorian Government to move towards addressing this ongoing problem. We see this as a genuine opportunity for the Victorian government to change a fundamentally flawed system of funding the fire services and look forward to working with the Bushfire Royal Commission and State Government on this issue.

The VFF will address the ten questions posed the best we can with available data and anecdotal evidence provided by our members. Our policy on fire services funding is democratically determined by our membership and is a culmination of their collective experiences. You will find that the VFF is in opposition to the current funding system and have a preferred alternative to the current system that can be found as an annex to this document.

FUNDING FIRE SERVICES – DISCUSSION QUESTIONS

QUESTION ONE

1. *What are the advantages and disadvantages to requiring insurance companies to fund a major part of the fire services?*

This question refers to the status quo. The VFF will be able to provide many disadvantages to the current system but struggle to find advantages. In fact, as insurers and CFA volunteers we cannot think of an advantage other than it is adequate in funding the needs of the fire service, although anecdotally there are shortfalls in some truck maintenance in regional areas.

However, there are several disadvantages to the current system.

- ***FSL is grossly unfair*** as it discriminates against people and businesses that take responsibility for their own property risk by arranging insurance cover. It was widely reported in the weeks following Black Saturday that the insurance companies believed that non insurance levels in the affect areas would reach 30%. If this is the case, it is proof that a proportionally higher percent of individuals in the highest risk areas are not contributing to the fire services.
- ***Rural Victorians are seriously disadvantaged*** by the current funding system because FSL rates in CFA area are significantly higher than for the metropolitan area serviced by the MFESB. Rural communities in Victoria pay the world's highest taxes (around 122%) on their insurance policies.
- ***Poorer members of the community are discriminated against*** by the current funding system because state taxes reduce the affordability of insurance by significantly increasing the total premium charged. Recent surveys indicate around 70% of people in rental accommodation do not insure their contents.
- ***The FSL system is non-transparent.*** Surveys have shown that few insurance policy holders are aware either of the level of tax they are paying or that they are funding the bulk of the fire services' budgets.
- ***Property insurance premiums are triple taxed in Victoria.*** FSL costs consumers an additional 20% to 84% on the risk premium. On top of the fire services tax, the Government receives GST and then applies a further stamp duty on the insurance, on the fire services levy and on the GST. Property policy holders in Victoria therefore pay a tax on a tax on a tax.

QUESTION TWO

2. *What are the advantages and disadvantages of applying a levy to non-insured and under-insured properties (while maintaining the FSL on other properties)*

A number of the options raised in the discussion maintain a link between funding the fire services and insurance levels. There are some fundamental problems with this approach, but before we discuss the problems, the advantages to this approach as viewed by the VFF would be:

- Reducing the average burden of insurers since the collection stream will be more broad based, and
- Encourage insurance.

However, it is not the role of government to regulate or force property insurance. Insurance levels are the personal decisions of Victorians and should not be affected by government policy. When it comes to insurance, the government should only ensure that its own policy does not create a disincentive to insurance.

Applying a levy on non-insurance has some significant disadvantages, which include:

- Defining, measuring and monitoring of under-insurance would be extremely difficult. There are different levels of insurance that a property owner may determine is proper for their home or business and it will be difficult for the government to assess actual under-insurance.

- Considerable additional administrative burden. Beside the actual assessment of insurance levels there will have to be completely new processes established to support the billing and collection of the levy. If this new process has to happen anyway, it should be used to support an equitable property based model proposed by the VFF.
- This will create an additional tax for Victorians. This should not be seen by the State Government as an opportunity to create an additional revenue stream, while maintaining the unfair FSL that attracts stamp duty and GST. It is probably tempting for the State Government to create a new tax but each additional charge assessed to businesses and homeowners reduce business competitiveness and Victoria's liveability.
- Maintains the Fire Service Levy. The premise of the Fire Service Levy is flawed as mentioned earlier. Any funding system linked to insurance level should not be continued. A strong message that we have preserved from the interim recommendations from this Royal Commission has been the importance of protection of life with many of the recommendations focusing on ways to prevent the tragedies experienced on February 7, 2009. If the emergency response to fire in the future will focus on preserving life, then there is an even more tenuous link between property insurance and CFA activity.
- Also, this is basically the system that is in place at the moment. There is the option to assess a charge on uninsured homes however this does not happen in practice, as the decision after the Black Saturday by the State Government admits.¹

QUESTION THREE

3. *What are the advantages and disadvantages of funding fire services through a property-based levy on all Victorian property and vehicle owners? Are there any factors that make a property-based levy more or less practicable in Victoria than in other states?*

In the absence of funding fire services through consolidated revenue, a property/vehicle based charge is the most equitable way to fund the fire services. If this model was used to fund the fire services the property based component should be based on the building asset value (Capital Improved Value minus Site Value), not the entire property value. This information is available from the Valuer-General of Victoria.

There are several advantages to this approach, including:

- Equitable – All those who benefit contribute
- Broad-basing – One of the fundamental principles of taxation is broad-basing to ensure all the potential benefactors of the service are contributing. A charge on property and vehicles are a positive step to ensure a more broad contributing base, lightening the load for all contributors.

¹ Media release, NO CHARGE FOR DEFENDING HOMES FROM RECENT BUSHFIRES, Office of Premier and Cabinet, March 12, 2009

- Vehicle charges pay for their use – In 2001/02 financial year, 15% of incident responses were related to vehicles fires or accidents.²

From the Victorian government perspective, there may be disadvantages to this approach, but those disadvantages are an advantage to insurers. The 2009/10 budget indicates Insurance contributions to be 452.1m, which would translate into 45.2m less in Victorian State revenue from stamp duty charged on that amount.

Overall, funding the fire services through a levy on property and vehicles is the most transparent, equitable, broad-based and simple option for Victoria. A form of this approach to funding is used in Queensland, Western Australia, and South Australia. It is only NSW and Victoria that has maintained the antiquated system of a fire service levy on fire insurance.

QUESTION FOUR

4. *What are the advantages and disadvantages of all Victorian property owners contributing to one fund for the funding of both the MFB and the CFA?*

There are several advantages to creating one fund for all fire services in Victoria. Most would agree that the provision of fire services is similar to law enforcement. When any resident in Victoria is requiring police action, they expect a local response, similar to fire services. Whether you insure your property, or are in a car accident you will expect the police and fire service to attend and assist.

Related to this issue is the question of if risk should play a part in the amount one contributes to the fire services. There is an argument condoning a risk based approach, but if you consider fire services similar to police services then risk should not affect the contribution. The residents of areas in Melbourne where there are considerable higher levels of crime and police activity are not asked to contribute higher taxes to help pay for the additional police presence and enforcement activities. As fire services is a similar public service, the high risk areas should not be asked to contribute more.

All fire service funding will also force added transparency and accountability in the pursuit and expenditure of funds for the fire services. CFA and MFB will then have to compete on efficiency for allocation of a set amount of funds.

The only disadvantage to this approach the VFF can identify is the vastly different business models between the two organizations. One of the major differences is the employee structures. The MFB employ a large number of permanent fire fighters and staff while the CFA rely heavily on volunteers to fight fires. CFA employee benefits expenses are approximately 49% annually³ while MFB employee benefits account for nearly 72% of annual expense.⁴ Due to structural and cultural differences between the two organizations, there may be difficulties in allocating the funds. However, as long as the budgeting process and allocation of funds is done in a transparent and objective manner the added difficulties will most likely lead to greater efficiency and accountability.

² <http://www.cfa.vic.gov.au/about/whatwedo.htm>, CFA Website

³ Based on 2008 annual report (Total expenses = \$281.7m, Employee benefits = \$136.7m)

⁴ Based on 2007/08 Annual Report (Total expenses = 266.838m, Employee benefits = \$190.901m)

QUESTION FIVE

5. *What are the advantages and disadvantages of introducing compulsory property insurance to address issues associated with the FSL?*

The only advantage to this option is a broader collection base which should translate into a lower amount paid per insurer.

While the insurance companies may see this as a favorable option as it will increase the size of the insurance market in Victoria, there are considerable problems with this approach. The uncertainties associated with Question Two of this paper (levy on non- and under-insured) will still arise. It is uncertain what will be sufficient insurance and there will be additional administration in ensuring all homes are insured whether they are mortgaged or owned outright.

In many cases, mortgages are required by the mortgage lenders to take out property insurance. However ABS reports the level of home ownership without a mortgage in Victoria at nearly 50%⁵. Therefore currently at least 50% of homes do not require insurance and the remaining may or may not have up-to-date fire insurance. There is no guarantee that the property insurance is maintained for the life of the mortgage.

As mentioned previously, it is not the government's role to legislate a particular risk management practice.

INSURANCE – DISCUSSION QUESTIONS

QUESTION SIX

6. *Is non-insurance and under-insurance a problem in Victoria? Do we have accurate data on this issue?*

Anecdotally, levels of insurance are a problem in Victoria. It was reported that as much as 30% of homes lost in the Black Saturday fires were not insured Reports show approx.

We believe that the levels of tax on insurance do affect the decision to and level of which to insure. With taxes adding 122% to the premium price, the prospect of having insurance becomes half as valuable. The VFF also has substantial anecdotal evidence, provided by our membership, stating that the level of tax on insurance creates a disincentive to ensure and has impacted on their level of asset coverage. For example, below is a quote from one of our members on the subject:

⁵ Cat. No.4102.0, Australian Social trends, Table 2.2 Housing, Vic. Summary 1997-2007

"I have deleted the woolshed and the piggery buildings from insurance cover to save the cost of the premium. If they burn down, I'll just have to hope for State Government support to rebuild them."

While there is some data available from the insurance industry, the State government is taking the prudent step to conduct a data collection exercise to answer this question. The VFF is supportive of this approach but feel that the data and process should remain as transparent as possible and be subject to external review as well.

QUESTION SEVEN

7. *What reason, if any, are there for the government to ensure residents in bushfire prone areas are adequately insured? What form should any government involvement take?*

It is not up to the state government to ensure adequate insurance in bushfire prone areas. It is not the role of government to regulate or force property insurance. Insurance levels are the personal decisions of Victorians and should not be affected but government policy. When it comes to insurance, the government should only ensure that there are not non-market barriers or disincentives to insurance.

An approach such as this then naturally leads to more questions than providing solutions. There is more to fire risk than merely bushfires. There are generally two accepted sources of fire risk. Bushfire risk, which is related to a properties environment and building fires that is related to the building use. It is not appropriate for government to force insurance on building owners based on the building use it is equally inappropriate for the government to be involved in insurance decisions in bushfire prone areas.

QUESTION EIGHT

8. *What effect would removing the FSL and stamp duty on premiums have on the uptake of property insurance?*

This is a difficult question. The obvious answer is that demand for any goods or services are inversely related to price, therefore as price increases demand decreases. Based on a report commissioned by the Insurance Council of Australia (ICA)⁶ as insurance costs become a smaller percentage of annual household income, insurance levels increase. 60% of non insured homes in Victoria were owned by families with a household income within the two lowest statistical groups⁷.

⁶ Insurance Council of Australia (2007) "The Non Insured: Who, Why and Trends" prepared by Dr Richard Tooth and Dr George Barker from the Australian National University, Centre for Law & Economics.

⁷ The two lowest statistical groups (quintile 1 and 2) are defined as weekly income less than \$412 and between \$412 and \$727, respectively.

As income levels increased the proportion of non insured decreased with the three remaining income level groups (weekly income greater than \$727) only making up 40% of the uninsured.

Interesting, the highest income group (over \$1,691 weekly income) contributed %18 of the non insured. The decision of this high income group to not insure highlights the free-rider problem in the current funding model.

The other aspect to this question relates to elasticity of demand for insurance products. The ICA attempted to address the dearth in Australian data and analysis on this issue. This report indicated that there is price sensitivity on property insurance but is relatively inelastic.⁸

QUESTION NINE

9. *Are there better tools, for example web sites, ready reckoners etc that could be made available to property owners to assist them in accurately calculating the replacement cost of their property? Would the availability of such tools reduce under-insurance?*

A website to help estimate replacement cost would be helpful, if people are choosing to insure at replacement value. If homeowners have been out of the building industry for a while it is probably that their own estimate will not reflect current replacement values. Also, with new building requirements in bushfire risk areas there can be considerable added expense that a non-builder may not be aware of.

QUESTION TEN

10. *Would it be practical for insurers to rate houses in bushfire prone areas for fire safety? If so, would this affect premiums? What are the practical advantages and disadvantages of involving the CFA (or persons accredited by the CFA) in reporting a property's fire readiness for insurance purposes?*

In theory, individual assessments of property bushfire readiness is a good idea if it leads to reduced insurance costs, creating an added incentive to protect your home. If the assessment was done free to the home owner it may be worthwhile, but if there is a charge for the assessment then the offsetting reduction in insurance premium would have to be substantial.

However there are some very practical problems with this approach. The first impracticality is the sheer number of assessments that would be required. For example, in the Yarra Ranges Shire alone there are over 37,000 detached and semi-detached homes.⁹ So, there would have to be over 100 assessments done daily to complete the properties in Yarra Ranges in a year. Also, a home's 'fire readiness' can change from year to year, either through removal or overgrowing of surrounding bush, investment in additional protective measure measures (sprinklers, etc.), or just inaction by the

⁸ Elasticity of demand indicates the percent change in demand for a good as a percentage change in price. The ICA report indicated demand elasticity for insurance between -.06 and -.13.

⁹ ABS, Cat. No. 2068.0 - 2006 Census Tables

property owner. Since a properties' risk profile could change dramatically over a year, many homes will have to be assessed on a yearly basis.

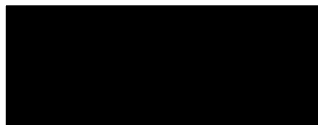
Another complicating factor is that one property fire readiness is affected by a neighbour's bushfire readiness activity (or inactivity), even if that neighbor is the State Government.

CONCLUSION

There are a number of issues and alternatives raised in this discussion paper. Many of the questions raised in this discussion paper further explore a link between insurance and fire services through mandatory insurance or levies on non-insurance and under insurance. It put into place a system that reinforces this link will be flawed and administratively onerous.

It make more intuitive sense to change the system to be based on a property and vehicle charge to ensure that all who are potential benefactors contribute to the fire services.

The Victorian Farmers' Federation appreciates the opportunity to comment on the funding of fire services in Victoria. We look forward to continuing to work with the Bushfire Royal Commission on this issue.



Andrew Broad
VFF President

APPENDIX ONE - VFF FIRE SERVICES FUNDING POLICY

The VFF advocates that *the fire service levy be removed from property insurance and be replaced with a more equitable funding arrangement*. The principles of a more equitable system include:

- **Charge based on Building assets value (CIV-Site Value):** The majority of the funding should come from a charge applied to building assets owners. The charge will be based on the building asset value which can be determined from the Capital Improved Value of the property subtract the Site Value.
- **Calculation includes a risk component based on the geographical location and/or building use:** To ensure added equality in the assessment of the property based charge there should be a risk component in the calculation of the charge. There are a number of models used in other states, but this approach can either use a geographical assessment of bushfire risk, an assessment of fire risk due to the building use, or a mixture of the two approaches.
- **Partially funded through a levy on motor vehicles:** Motor vehicle accident are a significant contributor to CFA activity comprising anywhere from 15%-22% of the annual call-outs. There are 3.8m cars on Victorian roads and a small additional charge on registration will provide the means to recover the costs associated with vehicle accidents.
- **Broad based as possible:** There is an expectation that when there is a fire that the relevant fire authority will attend, and rightly so. A broad based approach to funding the fire authorities will reflect the potential benefactors in a much more equitable way than the current FSL approach.
- **Maintains Government contribution for Fire Authorities:** The government has significant assets in Victoria, from land assets to road and other infrastructure. The current contribution should not be reduced in the future as fire authorities' resources are also used to protect government assets.
- **Collected by the State Revenue Office using VGV information:** The Valuer-General Victoria (VGV) holds information of all the private property values in Victoria whether it is residential, commercial, industrial or rural. This information can then be used by the State Revenue Office to collect the charge from the individual property owners. This approach will ensure that there are no additional costs imposed on Municipal Shires.
- **As transparent and simple as possible:** The new way to fund the fire authorities needs to be as transparent and understandable as possible. The current system, using a series of complicated formulas makes it difficult to understand the funding mechanism. A simple levy on each property will create equity and understanding of the value and cost of the fire authorities.
- **Stamp duty would not apply:** Under the current system there is stamp duty that is applied to the FSL. This is not appropriate and under this proposed system it would be inappropriate to apply Stamp duty.

APPENDIX TWO - FINANCIAL IMPACT OF VFF POLICY ON PROPERTY

OWNERS

It is well established that the current Fire Authority funding model is an inequitable system. The provision of fire protection service is a public good that everyone expects, but is only paid for by those with fire insurance, creating a free rider problem.

The VFF policy, to create a broad based funding method based on property asset value and car registrations will remedy this inequity. The VFF, using valuation data, have analysed the impact of this policy shift.

According to this analysis, adoption of our policy to fund fire authorities will translate into an annual, transparent charge of 1.03 cents for every \$1000 of building asset¹⁰. Calculations Below:

<u>Charge on Building Asset for Fire Protection</u>		
MFESB and CFA Budgets (308.4m + 402.6m)	\$	710,949,257.00
Contributions from Insurance companies (206m+303m)	\$	509,302,347.00
Less: Car registration (3.8m x \$20)	\$	76,000,000.00
Remaining	\$	433,302,347.00
Total 2008 assessed Victoria CIV-Site Value	\$	421,009,000,000.00
Fire Authorities Charge/\$1000 of building asset (a/b)	\$	1.03

Based on this information, our policy will translate into a lower contribution from the average insurer. Below is a list of selected shires across Victoria with average values for that particular shire that could be expected to pay to fund the fire Authorities.

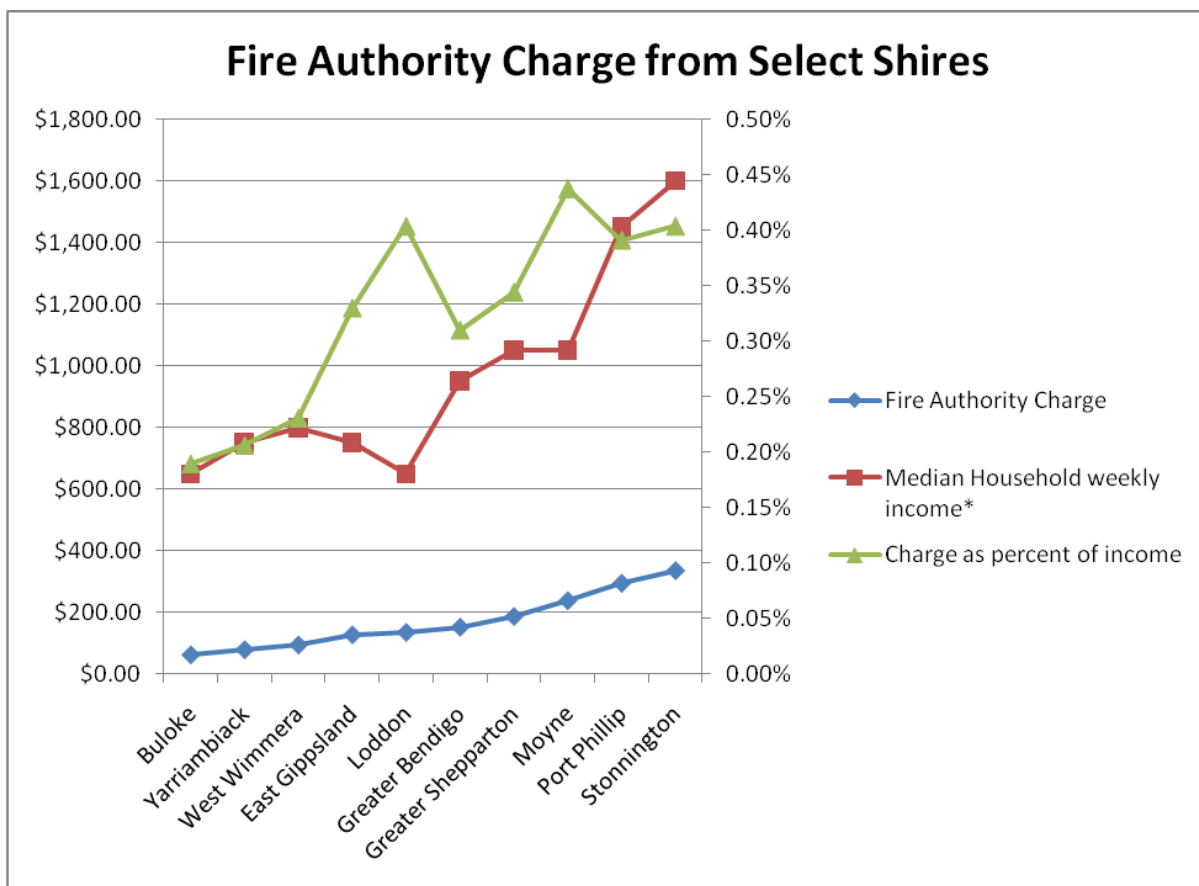
Shire	Average asset Value	Fire Authority Charge
Buloke	\$62,203.20	\$64.07
East Gippsland	\$124,984.76	\$128.73
Greater Bendigo	\$148,791.17	\$153.25
Greater Shepparton	\$182,495.90	\$187.97
Loddon	\$132,473.88	\$136.45
Moyne	\$232,012.45	\$238.97
Port Phillip	\$286,476.24	\$295.07
Stonnington	\$326,234.46	\$336.02
West Wimmera	\$93,175.41	\$95.97
Yarriambiack	\$78,084.38	\$80.43

¹⁰ This is in addition to a \$20 charge placed on car registration as outlined in our policy statement.

A progressive Charge

The VFF in the past have argued that property values do not relate to one's ability to pay, especially in the case of local government rates. However we do advocate for a system on rates that is based on house and curtilage as we feel that is a much better assessment of ability to pay.

This proposed system to fund fire authorities does prove itself to be a progressive charge when applied to building asset. Using the information from the table above and from Census 2006 data, it is easy to show that there is a direct relationship between home asset value and income making our policy even more equitable.



Assessing the Risk

The figures presented previously do not have a weighting based on bushfire risk. This is a possible inclusion that could, for example, use bushfire assessed risk from insurers data and attributed at a shire or even postal code level. This will address concerns that those with a lower bushfire risk would not be contributing a potentially disproportionate amount.

By placing a bushfire risk overlay on geographical locations will not increase the total sum received, but will redistribute the cost burden to weight those areas with a higher bushfire risk.

The other option for adding a risk component is on building use. The VGV information classifies property to be 1 of Residential; commercial; industrial; or rural. If building use is a form of risk these broad classifications can be used.