The Impact of Landlord Insurance Policies on Tenants

Landlord Insurance Practice Interim Report
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About the WEstjustice Landlord Insurance Practice

AboutWEstjustice

WEstjustice (formerly the Western Community Legal Centre) was formed in July 2015 as a result of the merger of the Footscray Community Legal Centre, Western Suburbs Legal Service, and the Wyndham Legal Service. WEstjustice is a community organisation that provides free legal assistance and financial counselling to people who live, work or study in the Cities of Maribyrnong, Wyndham and Hobsons Bay.WEstjustice works with a range of disadvantaged clients, and has a particular focus on working with refugee and newly arrived clients.

About the West Justice Tenancy Program

WEstjustice's tenancy program provides legal advice, casework and representation to vulnerable and underprivileged tenants who live in Melbourne's West. In the past five years WEstjustice's tenancy program has assisted over 1,100 clients with almost 1,800 tenancy matters.

In addition to our more general tenancy law work, for the past 12 months, WEstjustice has undertaken specialist casework that has focused on the impact of landlord insurance policies on tenants. This report summarises the issues that we have identified as a result of that casework, and makes six recommendations aimed at ensuring that tenants are not unfairly disadvantaged by the increasing prevalence of these policies.

Introduction

What is landlord insurance?

Landlord insurance is an insurance product that generally provides landlords with cover for:

- Loss or damage to a rental property;
- The contents that are provided by the landlord for the tenant's use; and/or;
- Loss of rent.

Our casework experience demonstrates that the number of landlords taking out landlord insurance policies is rising. A number of real estate agents have advised us that they will not manage a property that is not covered by a landlord insurance policy, and Terri Scheer Insurance, one of the leading landlord insurance providers, has advised us that they have seen a 20% growth in their landlord insurance over the past year.

How does the rise in landlord insurance impact tenants?

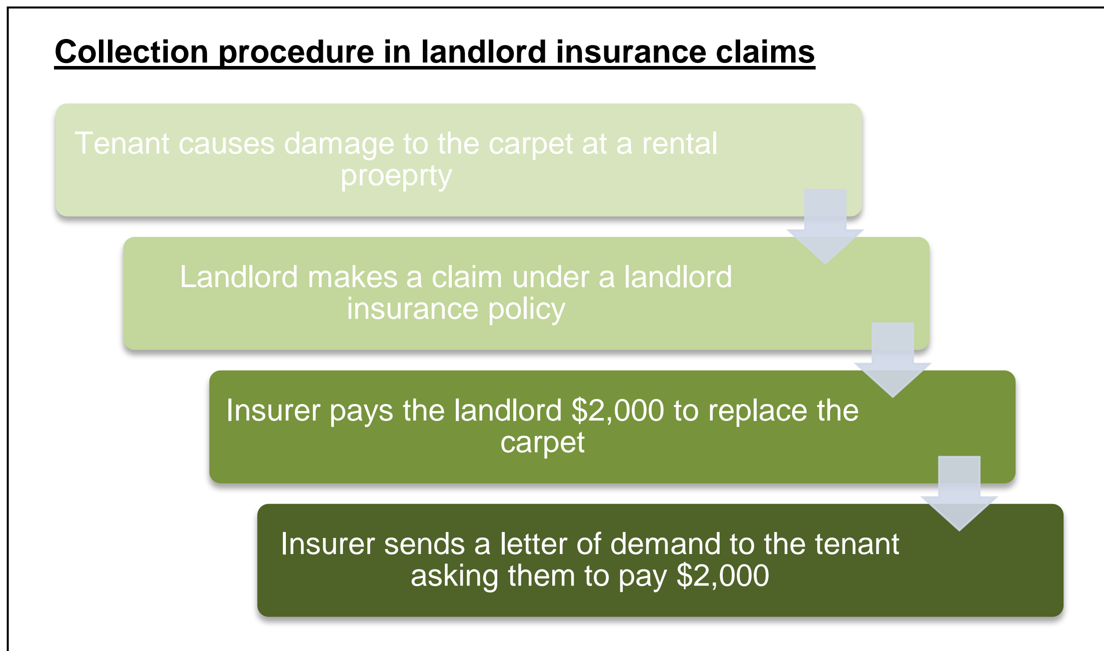
At first glance, the rise in landlord insurance policies doesn't necessarily negatively impact tenants. Insurance payouts for damage to the property by previous tenants may mean that landlords are more likely to carry out repairs to rental properties. Policies requiring landlords to maintain the rental property in good repair also provide further impetus for landlords to comply with the relevant residential tenancy laws.[1]

However, through our specialist landlord insurance casework, WEstjustice has identified a number of ways in which landlord insurance policies, and the collection practices associated with them, negatively impact on tenants.

The primary reason that landlord insurance policies impact on tenants is that most insurance contracts give the insurer the right to pursue tenants who have caused loss or damage. When a landlord makes a claim on the insurance policy for damage caused by a tenant or for loss of rent, assuming that the claim is

[1] See for example Terri Scheer Landlord Preferred Policy: Product Disclosure Statement and Policy Wording, p 61.

valid under the policy, the insurer will pay out the landlord. While many tenants and landlords falsely believe that this is where the insurance matter will end, insurers usually then have the right to pursue the tenant for recovery of the monies paid to the landlord. Known as the right of subrogation, most insurance contracts give the insurer the right to "step into the shoes" of the insured landlord to take legal action against the tenant who has caused the loss or damage.



The most common issues that we see with landlord insurance policies are:

- Claims against tenants where there is no basis for asserting liability;
- Potential breaches of consumer protection legislation;
- Double-dipping by landlords; and
- Policy issues in relation to recovery against un-insured renters for accidents.

Claims against tenants where there is no basis for asserting liability

One of the discoveries from our specialised casework on landlord insurance is that insurers are regularly pursuing tenants in cases in which there is no legal basis for claiming that the tenant is liable. We routinely see cases in which a landlord makes a valid claim under the insurance contract for damage to the property and/or loss of rent, which subsequently results in a payout to the landlord. The insurer, usually by way of debt collector, then initiates collection activity against the tenant to recoup that money. Importantly, though, neither the insurer nor debt collection staff have been aware that an obligation to pay out the landlord under the insurance contract does not automatically mean that the tenant is liable for that amount.

Tenants' liability under residential tenancy laws

Tenants' liability to landlords in relation to residential tenancies is governed by specific state-based residential tenancy legislation. While this report will focus on the Victorian legislation, equivalent legislation operates in all States and Territories across Australia.[2]

In Victoria, tenants' liability to landlords in relation to residential tenancies is governed by the *Residential Tenancies Act 1997 (Vic)*(**RTA**) and disputes under the RTA are adjudicated at the Victorian Civil and Administrative Tribunal (**VCAT**). The RTA clearly prescribes the circumstances in which a tenant will be liable to pay compensation under the Act, and landlord insurance policies often give landlords cover for compensation that is in excess of their rights under the RTA and not recoverable from the tenant under that legislation. In such circumstances, while the landlord may properly be compensated under the insurance contract, there is no basis for undertaking collection activity against the tenant.

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[2] *Residential Tenancies Act 1997 (ACT), Residential Tenancies Act 2010 (NSW), Residential Tenancies Act 1999 (NT),Residential Tenancies and Rooming Accommodation Act (2008), Residential Tenancies Act 1995 (SA), Residential Tenancy Act 1997 (Tas), Residential Tenancies Act 1987 (WA).*

Recovery for "rent default" or "loss of rent"

A number of landlord insurance policies provide landlords with cover for rent default or loss of rent. This means that if a tenant vacates the property and the landlord is without paying tenants for a period, the landlord can claim the loss of rent from their insurer. While the insurer may be legitimately required to pay the landlord for loss of rent, however, this does not necessarily give rise to a cause of action against the vacating tenant.

Terri Scheer's landlord insurance policy, for instance, will compensate a landlord for up to six weeks' rent if a tenant vacates, even if the tenant vacates after giving the required notice in accordance with their lease.[3]This means that even where a tenant has complied with the RTA and/or their lease by giving the required notice that they intend to vacate the property, the landlord may still be able to claim lost rent if they are unable to re-tenant the property promptly. Problematically, we have identified cases in which insurers, in this circumstance, have then sent a letter of demand to tenants for the amount of lost rent paid to the insurer. In such cases, tenants clearly have no liability for the rent beyond the date on which they vacate.[4]

Tessa: pursued for "loss of rent" after giving notice that she was moving out

Tessa was living in a rental property with her two children.Tessa's initial 12-month fixed-term lease had lapsed and she was on a periodic lease.

In March 2015 Tessa was offered a new job in rural Victoria. Tessa gave her landlord 28 days notice that she was moving out, as required by the RTA, and gave the keys back on the agreed date. Tessa was five weeks ahead in her rent, and after she moved out her landlord refunded her the rent that she had overpaid.

(continued on next page)

[3]Terri Scheer Insurance, Landlord Preferred Policy: Product Disclosure Statement and Policy Wording, p 20.
[4]*Residential Tenancies Act 1997* (Vic) s 235.

Three months after moving out, Tessa received a letter from a debt collector on behalf of her landlord's insurance company. Tessa's landlord had been unable to find new tenants for two weeks after Tessa had moved out, and so they had made a claim under their landlord insurance policy for the period of lost rent.

While the insurance company may have been contractually obliged to compensate Tessa's landlord for the period for which they did not have tenants in the property, Tessa had given the required period of notice that she was moving out, and could not be held liable for that amount.

New for old replacement

Many landlord insurance policies offer new for old replacement. For instance, AAMI's landlord insurance PDS states "we will replace with new items or new materials that are available at the time of replacement".[5]This means that in the case of damage to the property, the item will be replaced as new. This includes items such as stoves, carpet and window coverings. We then see insurers pursuing tenants for the full cost of replacing the replaced item.

Under the RTA, however, a claim for damage to the property or contents provided by the landlord, the Tribunal is required to take into account:

- Claims under the RTA are subject to depreciation as per the Australian Tax Office's Rental Properties Guide.[6] For instance, items such as carpet and blinds have an effective life of ten years. This means that if an item is five years old when it is damaged, the landlord will only be able to recover 50% of the cost of replacement from the tenant.
- Claims under the RTA must also take into account whether damage was caused by "fair wear and tear".[7]

[5]AAMI, Landlord Insurance: Product Disclosure Statement 18/10/2013, p 2.
[6]Australian Taxation Office, 'Rental Properties 2015: Guide for Rental Property Owners', at https://www.ato.gov.au/uploadedFiles/Content/MEI/downloads/Rental-properties-2015.pdf.
[7] Pursuant to section *Residential Tenancies Act 1997* (Vic) s 419(a), the landlord may apply to obtain the bond for damage caused to the rental premises by the tenant or their visitor, other than fair wear and tear.

Biljana: claim for 'malicious damage' after a 21-year tenancy

Biljana lived in a rental property in Melbourne for 21 years. Over the years that Biljana lived there, the property had become quite run down. The blinds had broken and the paint was peeling off the walls, but the landlord had refused to do repairs.

After being made redundant from her garment manufacturing job in 2014, Biljana could no longer afford to pay the rent. By December 2014, she was one month behind in the rent and was evicted from her home due to rent arrears.

A few months after moving out of the property, Biljana received a letter of demand from a debt collector on behalf of an insurance company. According to the letter she needed to pay$2,000 for "loss of rent" and $3,300 for "malicious damage". Biljana was reliant on a Centrelink pension and had no savings, and was distressed about the prospect of owing such a large amount of money.

WEstjusticecould see no basis on which Biljana could be held liable for the alleged damage. The claim included costs such as the replacement of the broken blinds that were more than 20 years old and the cost of repainting walls that had not been painted for at least 20 years. If the matter proceeded to VCAT, almost all the claimed amounts would be disallowed on the basis that they were damaged as a result of fair wear and tear, or because they had been fully depreciated.

Similarly, there were problems with the insurer's claim for unpaid rent. Biljana agreed that she owed one month's rent. However, because the landlord had not been able to find a new tenant for six weeks, the insurance company had paid the landlord six weeks' rent under the policy, and pursued Biljana for the same.

No proof of causation

We have also identified a number of cases in which tenants are pursued for damages despite the fact that the insurer does not have any evidence that the tenant caused the loss that is claimed.

In order to successfully claim compensation for damage to the rental property under the RTA, the landlord must be able to show that the property has been

damaged, and that the current tenant has caused that damage.[8] In cases that proceed to VCAT, the landlord must provide a copy of the condition report to VCAT.[9] The condition report is then taken as conclusive proof of the condition of the property at the commencement of the tenancy.[10] In recognition of the fact that any subsequent litigation against a tenant will take place at VCAT, it is our view that the insurer should request a copy of the condition report prior to payment of a claim for property damage.

We have acted for tenants in a number of cases, however, in which the insurer has sent a letter of demand to a tenant for property damage without having obtained a copy of the condition report or any other proof of the condition of the property at the commencement of the tenancy. It is our view that such cases could not succeed at VCAT and that therefore the insurer should not pursue the tenant in such circumstances.

Bikash: claim for damage that existed prior to his tenancy
Bikash moved in to a rental property in April 2012 with his wife and two young children. When he moved in to the property, Bikash noticed that the carpet was badly worn, one of the window blinds was broken, and the fly-wire covers on the windows had holes. Bikash noted these things on his condition report.

In 2014, Bikash and his family moved out of the property. Bikash gave the required period of notice, and cleaned the property thoroughly.

Bikash was then shocked to receive a letter from a debt collector, demanding that he pay $3,500 for "malicious damage" to the property.

When WEstjustice contacted the debt collector, we were advised that the claim was for damage to the carpet, a window blind and fly-wire window covers. We asked the debt collector to supply us with a copy of the condition report but were advised that they did not have a copy on file. It was concerning to us that the insurer and debt collector had sent Bikash a letter of demand without proof that the damage to those items was caused by him. WEstjustice sent a letter to the debt collector outlining our concerns about their claim. The claim against Bikash was subsequently withdrawn.

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[8] *Residential Tenancies Act 1997* (Vic) s 210.
[9] *Victorian Civil and Administrative Tribunal Rules 2008 (Vic)* r 7A.07(14).
[10] *Residential Tenancies Act 1997* (Vic) s 36.

We note that Section 5.1 of the 2014 General Insurance Code of Practice says that the insurance industry will "provide (employees and authorised representatives) with appropriate education and training to provide their services competently." We believe that the insurance industry has failed to meet the standard set out in the Code in relation to the sale, and administration of claims and collections for landlord insurance.

Recommendation 1:
That insurer's consider the need to ensure that the benefits included in landlord policies are consistent with landlord entitlements under relevant RTA's. Alternatively, where benefits exceed the RTA entitlements insurance staff are instructed that tenants cannot be pursued in relation to the additional benefits.

Recommendation 2:
That insurance staff involved in the underwriting, claims and debt recovery in relation to landlord insurance policies receive training in the relevant residential tenancy laws.

Consumer law implications of pursuing tenants without a clear basis for asserting liability

It is our view that asserting liability against a tenant without having a clear legal basis for doing so may amount to a breach of Australia's consumer protection legislation and/or debt collection guidelines.

In Australia, a range of legislation and guidelines bind the behaviour of companies, such as insurers and debt collectors, who undertake collection activity in the course of their business. In particular:

- Section 18 of the *Australian Consumer Law* prohibits misleading and deceptive conduct in trade or commerce. In the context of insurance collection practices, it is our view that asserting liability in relation to a residential tenancy without having reasonable grounds for making that representation will be taken to be misleading;

- Section 12DA(1) of the *Australian Securities and Investment Commission Act 2001* (Cth) prohibits misleading and deceptive conduct in relation to financial services;
- The ASIC and ACC Debt Collection Guideline for Collectors and Creditors (**debt collection guidelines**) note that if liability cannot be established when challenged that debt collection activity should be ceased, and note that continued collection activity without proper investigation of claims that the debt is not owed creates a significant risk of breaching the law;[11] and
- The debt collection guidelines also state that a debt collector must not state or imply that legal action will or may be taken where a defence at law applies[12].
- Clause 8.12 of the 2014 General Insurance Code of Practice states that insurers and their agents will comply with the ACCC and ASIC Debt Collection Guideline when taking any recovery action.

Importantly, insurers and debt collectors that send a letter of demand to tenants alleging liability without having a plausible claim at law, or where the tenant has a legislative protection against the claim, may be in breach of the prohibitions on misleading or deceptive conduct.

Recommendation 3:
That insurers develop procedures to ensure that staff assess the merits of a potential claim under the relevant residential tenancy laws before commencing collection activity against tenants.

Double-dipping by landlords

WEstjusticehas identified numerous instances of landlords ‘double-dipping’ by making a claim for 100 cents in the dollar from the insurer and also making a claim against the tenant (by way of the bond or an order of compensation). Under the right of subrogation, tenants may then be pursued twice for the same amount; the insurer will often pursue the tenant for amounts paid out under the

[11] Australian Securities and Investments Commission and the Australian Competition and Consumer Commision, *Debt Collection Guideline for Collectors and Creditors*, 2015, s 13.
[12] ASIC and ACCC, above n 9, s 20.

policy, unaware that the landlord has already claimed the items from the security deposit of the tenant.

Michelle: pursued by her landlord and an insurance company

Michelle* is a single mother who was living in a private rental property. At the end of her tenancy, Michelle's landlord made a claim on the bond for unpaid rent. There was a VCAT hearing, and Michelle did not contest the landlord's claim. The unpaid rent was settled by way of an order that the whole bond be paid to the landlord.

A year after the VCAT hearing, Michelle received a letter from a debt collector demanding that she pay $3,300 for unpaid rent. Upon investigating the issue, WEstjustice found that the landlord had received both the tenant's entire bond and made a successful claim under an insurance policy for unpaid rent.

A landlord who has made a claim on the insurance policy cannot also succeed in claiming against the tenant for the bond. Where a tenant is put on notice that there has been a successful insurance claim, it is our view that the landlord will not be able to establish that they have suffered loss, and therefore could not be awarded further compensation by the Tribunal.[13] However, we have seen numerous cases in which VCAT did not enquire about whether an insurance payout had been made, and therefore awarded compensation to a landlord who had already recovered their loss from the insurer.

The primary ways that double-dipping could be avoided would be to:

- Amend the VCAT application form so that landlords must state whether they have made a claim under their insurance policy; and
- Require VCAT Members to consider whether a landlord has made a claim on an insurance policy when determining whether that landlord has suffered loss or damage.
- Require insurers to amend their claim form to ask whether the landlord has also made a claim for compensation for alleged losses against the tenant under the RTA.

[13] *Residential Tenancies Act 1997 (Vic)* s 210.

- Amend landlord policies to exclude claims where compensation has been recovered for the losses through the RTA.

Shwe: taken to VCAT for her bond despite an insurance claim being on foot

Shwe* was living in a rental property with his young family. One night, while his wife was cooking dinner, the stove exploded and started a large fire. The family was lucky to escape without injury, and the house suffered significant damage. The family lost all their personal belongings.

A week after the fire, Shwe received an application by his landlord for his bond. The application claimed that the fire was the fault of the tenants, and that the landlord needed the bond to start works on the property. The matter was set for hearing at VCAT.

Before the VCAT hearing, WEstjustice asked the real estate agent whether the landlord was making a claim on an insurance policy. We were advised that they were, and that the agent believed that the insurance company had approved the claim, but that they did not have any further information.

On the basis that the landlord had successfully claimed the cost of repairs on their insurance policy, WEstjustice could not see any basis on which they could argue that they had suffered loss. Consequently, we could see no basis on which the landlord could claim the bond. We made this argument at VCAT, and the landlord's application was subsequently dismissed.

Recommendation 4:

That the relevant stakeholders, including tenancy advocates and insurance companies, liaise with VCAT to ensure that processes are implemented that ensure that VCAT is made aware of whether an insurance claim has been made before determining compensation matters. These may include:

- Amending the VCAT application form so that landlords are required to state whether they have made a claim under an insurance policy; and
- VCAT Members should be required to consider whether a landlord has made a claim on an insurance policy when determining whether a landlord has suffered loss or damage.

Recommendation 5:

That the Insurance industry takes steps to prevent multiple claims and double dipping by training staff and amending documents to make clear that landlords cannot claim on the landlord policy if compensation has already been recovered under the provisions of the RTA. Document changes could include:

- Amend landlord policiesto exclude claims where compensation has been recovered for the losses through the RTA
- Amend the claim form to ask whether the landlord has also made a claim for compensation for alleged losses against the tenant under the RTA.

Public policy considerations

Finally, we have identified a number of cases in which insurers may have a cause of action against a tenant, but where there is a public policy basis for choosing not to seek recovery.

Financially vulnerable tenants

The first relevant public policy consideration is that many tenants are financially vulnerable. Where clients are reliant on a Centrelink payment for income and do not have any assets that may be subject to seizure by the Sheriff, they will be classified as 'judgment proof'.[14]Such tenants will qualify for assistance under the provisions of Clause 8 Financial Hardship in the 2014 General Insurance Code of Practice, and will, in all likelihood, be eligible for a waiver of debt from the insurer.

We have acted for tenants in a number of cases, however, where the tenant is not strictly 'judgment proof', despite being low-income and having few assets. These tenants include those who are working, but who earn a low income and are financially unstable; many have indicated that unless an insurer is willing to waive the significant debt (we have assisted clients in cases involving figures in excess of $100,000.00) the tenant will have no choice but to file for bankruptcy. It is our view that it is inappropriate to pursue such tenants, even though a legal right to do so may exist.

[14] *Judgment Debt Recovery Act 1984 (Vic).*

Uninsured tenants

A second consideration is that, in our experience, tenants are unlikely to hold insurance for rented premises. Research conducted for the insurance industry has demonstrated that the majority of tenants do not hold contents insurance for their rented properties.[15]We support the need for landlords to take out building and landlord insurance on tenanted properties. However the RTA provides protection for the landlord's property by way of a security deposit, usually about 4 weeks rent. The RTA does not mandate that tenants should insure the property of the landlord. Nor is it likely that State Governments would support such a requirement in view of the role of the private tenancy market as a major provider of low income housing.

Accidents and negligence

Finally, we are greatly concerned by cases in which we have seen tenants pursued for large debts in circumstances of negligence for genuine accidents. In our experience, these claims usually arise as a result of significant damage due to fire or flood caused by the negligence of the tenant. In a number of cases, we have seen tenants pursued for claims over $100,000 even though the landlord accepted that the damage was accidental and did not want the tenant pursued.

It is our view that it is inappropriate for insurers to pursue uninsured tenants for claims of negligence arising out of a genuine accident or rental default brought about primarily by poverty. We believe that pursuit of these claims by insurers may put pressure on state governments and tenant advocates to propose legislation which removes or limits the right of subrogation in pursuit of tenants in these circumstances. We also note that an increase in these cases may put pressure on state governments to reassess the role of the private rental market as a major contributor to low income housing.

It is also worth noting that in cases in which we identify any doubt about causation, we will encourage the tenant to dispute liability and rely on pro bono

[15] GIO, 'Renters feather nests but don't protect their property', http://www.gio.com.au/news/renters-feather-nests-dont-protect-their-property

legal assistance for court proceedings, with advice to bankrupt in the event of a loss. Thankfully, to our knowledge, none of these cases has proceeded to hearing; the potential cost of disputed legal proceedings against a tenant without significant assets has appeared to result in claims for recovery being discontinued or waived by the insurer.

Hamdiya: facing $100,000 in debt after an accidental housefire

Hamdiya* was living in a rental property in rural Victoria. She lived in the property with her 18-year-old daughter Fatima. Hamdiya worked at her local fruit shop and earned approximately $59,000 per year in income. Hamdiya was supporting her daughter while she studied, and was living hand to mouth. She had no assets and owed $8,000 on a credit card.

In February 2014, there was a fire at the property. Fatima had a pan of oil on the stove when the phone rang. Fatima got distracted and the pan caught on fire. The house suffered significant fire damage, worth approximately $100,000.

Hamdiya's landlord had always had a good relationship with Hamdiya, and understood that the fire was an accident. She made a claim on her insurance policy and was compensated for the cost of repairing the house. After the house was fixed, she offered Hamdiya first option on moving back in.

A year after the fire, Hamdiya received a letter from debt collectors demanding that she pay more than $100,000 for the repairs. Hamdiya did not have insurance of her own, and could not afford to make any substantial contribution toward the repairs. The insurance company offered her a repayment plan, but she realised that it would take the rest of her life to pay off. She felt upset that she could be chased for so much money from a genuine accident.

Hamdiya's landlord was also upset about Hamdiya being pursued for such a large amount of money. Hamdiya had always been a good tenant, and she had no idea that her insurance claim would impact Hamdiya in this way.

Recommendation 6:

That the Insurance Council of Australia develops a policy to ensure that uninsured renters are not pursued for damages for negligence that result from genuine accidents.