NT Fidelity Fund

Capital Management Plan as at 30 June 2025 for the 2025/26 financial year

September 2025

Capital Management Plan

The following is the Capital Management Plan adopted by the Trustees for the Fund as at 30 June 2025. This plan supersedes all prior Capital Management Plans.

Background

Until the start of this Fund in 2013, the Northern Territory of Australia (NTA) had a first-resort scheme, the Home Building Certification Fund (HBCF), covering non-compliance with building standards. That scheme provided unlimited cover for a period of ten years from completion of work. There was no protection against non-completion.

Following a number of insolvencies from 2009 to 2011, the NTA government introduced legislation, to:

- tighten the licensing requirements for builders;
- control contractual arrangements, with particular emphasis on progress payments;
- introduce compulsory residential building insurance (RBI); and
- provide for a residential building fidelity fund (FF), to be managed by the Board of Trustees.

The legislation to introduce RBI and provide for a fidelity fund is the Building Amendment (Residential Building Consumer Protection) Act 2012 (the Act), assented to on 27 April 2012, and amending the Building Act. The associated regulations are the Building (RBI and Fidelity Fund Schemes) Regulations. In accordance with Section 79 of those Regulations, as soon as practicable after the end of the first year of approval and each financial year of the scheme, the trustees must review the capital management plan and, if necessary, amend the plan and submit the plan (whether amended or not) to the Minister for approval.

The RBI provides last-resort protection against both non-compliance and non-completion. It covers houses (BC1) and units (BC2), but not external work, such as landscaping, pools and driveways, nor renovations that do not change the building's floor area. In order to claim, the builder must be unable to fix or complete the work as a result of insolvency, death, disappearance or disqualification. Non-completion requests are limited to the lesser of: 20% of contract value or a maximum amount of $200,000. Non-compliance (warranty) cover runs from completion for one year for non-structural defects and six years for structural defects, subject to a maximum claim of $200,000, less any amount paid under non-completion.

RBI is open to licensed insurers and, while the Act envisages multiple FFs, the consensus is that the market is too small to support more than one FF; and that no insurers will be participating. The FF currently underwrites all the market. This is likely to constrain the ability of the FF to refuse to provide certificates to builders that do not meet its criteria for financial stability and quality of work.

Sources of capital

The principal sources of capital for the Fund are:

- A guarantee by the NTA to pay any cash shortfall on payment of requests, for five years but subject to annual extensions if the Fund does not then have sufficient reserves;
- An explicit capital contribution, built into the contribution rate scale;
- The allowance, within the contribution rate scale, for adverse levels of claim.

This last allowance calls for some explanation. Builders warranty insurance is highly sensitive to the health of the economy generally and of the building industry in particular. Valid requests can only arise under specific conditions, the most important of which is the insolvency of the builder. If the building industry is healthy, then insolvencies are likely to be infrequent and requests to be low. This level of requests comprises "working" claims. In times of economic turmoil, however, a much higher ("adverse") level of builder insolvencies can occur. An example of such turmoil is the Global Financial Crisis (GFC). Because the GFC had only a mild impact on Australia, the level of builder insolvencies only increased modestly at the onset of the GFC, in contrast to what was seen in other parts of the world and, for example, in the Great Depression.

We also consider our allowance for adverse requests to capture the potential for an insolvency of a large builder or an insolvency of a builder with poor work quality and a high rate of defects across their jobs. Both these scenarios will lead to increased claim costs that have not yet been observed in the history of the Fund.

The liability estimates used in this capital management plan include an allowance for adverse requests of approximately twice the level of total working requests. This allowance is determined based on assuming adverse costs as a multiple of working costs separately for non-completion and warranty claims.

While adverse conditions can occur at any time, the expectation is that these will not be spread evenly. Rather, they will be concentrated in periods of a few years, with longer intervals, possibly several decades long, in between. Because accounting and regulatory principles do not recognise a liability for events beyond the expiry of existing certificates, unless an adverse event actually occurs, that part of the contribution flows into surplus over the life of the certificate and must be accumulated as capital against the day that one does occur.

Capital target

In accordance with the Actuary's advice, APRA requirements and NTA guidance, the Trustees have, on 8 February 2013, adopted a minimum capital amount (as required by regulation 79(2)(a)) in the form of a solvency margin (net tangible assets), estimated in accordance with APRA standard GPS 340, of $2 million and an additional capital amount (as required by regulation 79(2)(b)) of $3 million. These, together, give a total capital target of $5 million. This represents the Fund's total capital target for all future years.

The distinction between GPS 340 solvency and the accounting treatment is an important one. The accounting treatment of contributions is retrospective. It releases contributions paid into request liabilities, expenses and profit progressively over the period of coverage, in proportion to the expected cost of coverage. Thus, nothing is released into profit at inception. The GPS treatment of contribution liabilities, in contrast, is prospective. The liability is the expected present value of requests and associated expenses, plus a risk margin. If the contribution exceeds the initial liability, there is an immediate release of that excess into surplus. In the case of the contributions for the Fund, there is a substantial capital contribution, over and above what is needed for the risk margin, and this is released into surplus when a certificate is issued.

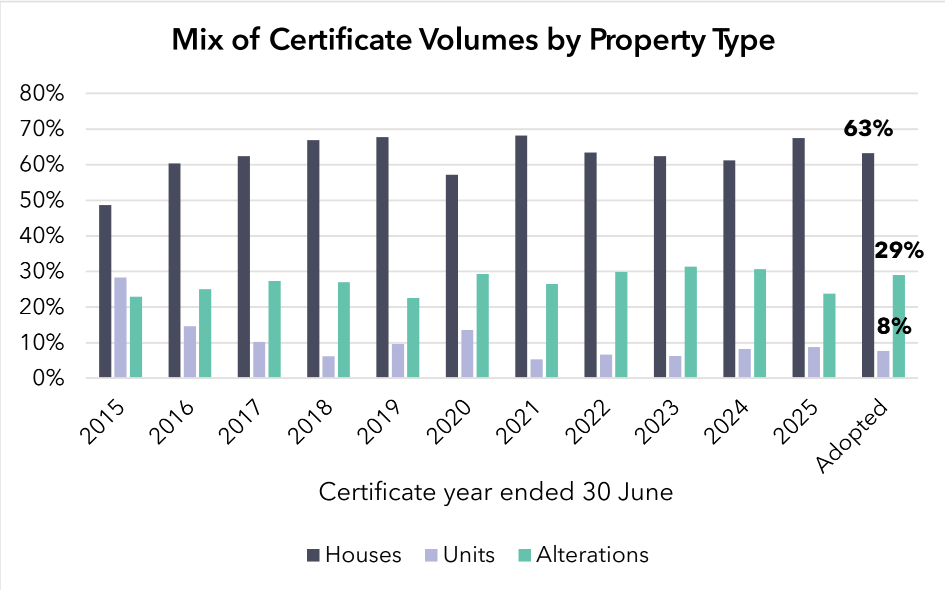
Review of Projection Assumptions

The projection is highly dependent on its key assumptions. To ensure the key assumptions remain relevant, we have conducted a review and altered some of them for the projections in this plan.

The projection reflects an increase in certificate numbers in the next year to 500 and then 550 from 2026/27 as volumes are assumed to return to long-run averages. The composition of Houses, Units and Alterations is assumed to be 63%, 8% and 29%, respectively. These assumptions are aligned to the previous review and closely reflects the five-year average.

The following chart shows the split of property types for the Fund by underwriting year. It shows that, early in the Fund's life, units formed a significantly greater portion of new certificates than alterations, though alterations have now become more common than units. These assumptions affect the projected value of certificates since the projection model assumes a separate average value for each property type.

Figure 1 – Mix of certificates volume by property type over time



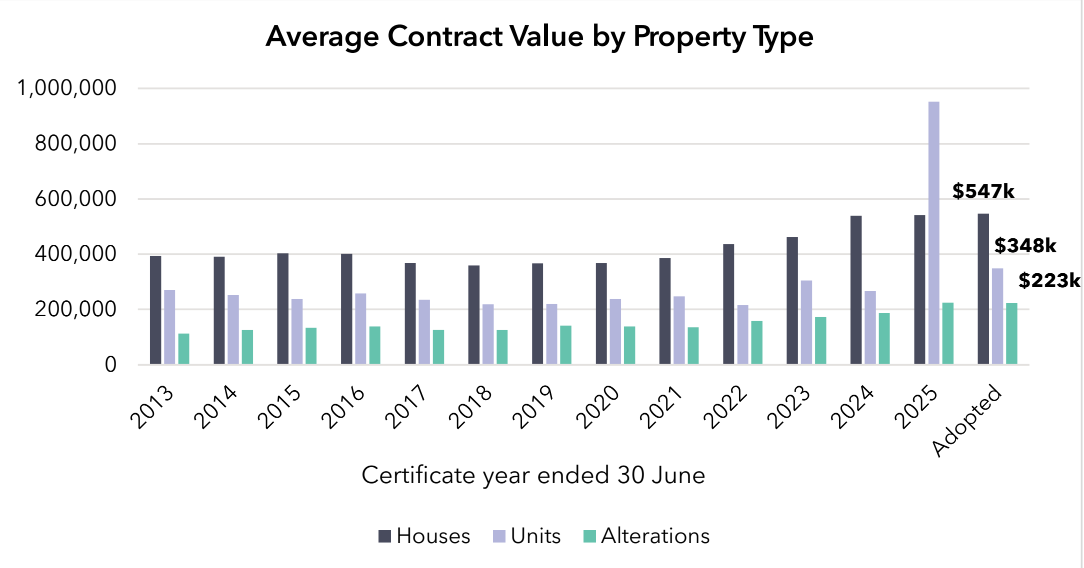
The average value for all property types has increased since the previous review to the following assumptions:

- House: $547k (previous: $509K) to reflect the experience in the last two years;
- Unit: $348k (previous: $291K) to align closer with the five-year average; and
- Alteration: $223k (previous: $216K) to reflect the higher emerging trend in experience.

These adopted values reflect the increasing trend in average values for each property type over more recent underwriting years. There has been a strong and consistent increasing trend over the past four underwriting years in response to the higher inflationary environment in the economy and in particular the building industry. On average over the past five years, there has been a 12% annual increase in contract values.

For units, there has been a notable increase in the average contract value of units in 2024/25, increasing from $266K in 2023/24 to $952K in 2024/25. This has been driven by a high number of certificates relating to developments of multiple dwellings on single titles. Currently our long-run assumption for the projections does not respond to the experience observed in 2024/25 for units but it will be considered going forward if the higher average contract values persist. The following chart shows average contract values by property type and underwriting year for the Fund.

Figure 2 – Average contract value by property type



In our projection, we have incorporated an assumption on the proportion of certificates that relate to speculative contracts. These contracts only provide cover to secondary homeowners and hence are only at risk of warranty claims as any non-completion risk is borne by the home builder/developer. A large proportion of these speculative contracts are for owner builders, where the policy would cover any third party who purchased the house/unit from the owner builder in the event of defective works. As these certificates only provide cover for warranty risk, we expect the average claims cost to be lower.

We assume that 15% of all certificates written in future underwriting years will relate to speculative contracts. This assumption is in line with the observed average proportion of speculative contracts across all underwriting years in the Fund's history.

With regards to expenses, the Fund have agreed a reduction in the fee for service for future years after changes to the services provided by Master Builders. The fee was projected to drop to $752k in FY25, but the actual fee was lower at $689k.

For other direct expenses, we have assumed an increase from $360k p.a. to $500k p.a. for the first projected financial year to reflect the higher expenses observed in the current year ($568k excluding the fee for service). The increase was driven by higher expenses paid for consultant, legal, accounting & audit fees, and builder assessment reports. We note that some of the expense increase is temporary in nature and as such the projection for future expenses is lower than that was incurred in FY25. In total, the projection for expenses and the fee for service is approximately $1.2m per year.

Besides the above, no other projection assumptions have been changed since the previous working paper.

Projection Results

The projection results are shown below. The Actuary emphasises that these are projections, not forecasts or estimates. The probability that these will closely resemble what actually emerges is likely to be small.

In the projection, direct expenses are $500k, increasing at the assumed inflation rate of 3.25% p.a. Fees for service are expected to be $689k and are forecasted to increase each year also by the assumed 3.25% p.a. inflation rate.

The projection assumes that the Fund is subject to Company Tax of 25% of accounting profit.

The accounting projection assumes that the current insurance accounting regime (AASB 1023) remains unchanged. However, we note a new international insurance accounting standard, IFRS 17 "Insurance Contracts" (the Australian version of which is AASB 17), issued by the International Accounting Standards Board (IASB) will replace AASB 1023 and will apply for public sector entities (of which the Fund is considered to be) from 1 July 2026. We will update the projections accordingly when the transition to the new accounting standard occurs.

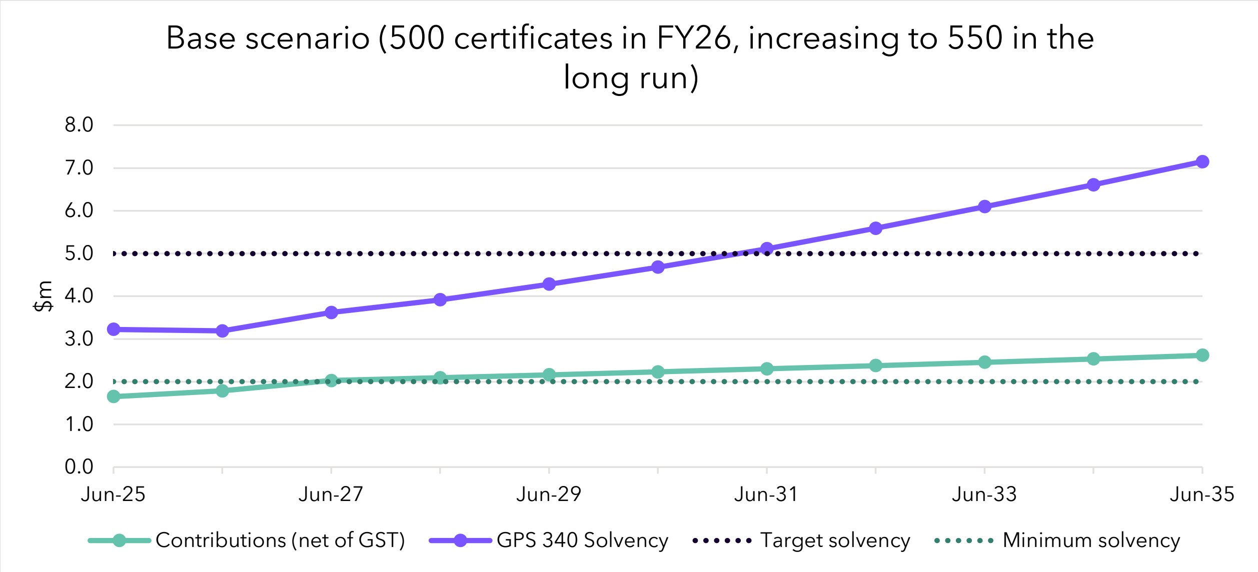
Expected Outcome – 500 certificates for 2025/26, increased to 550 p.a. from 2026/27

The expected outcome assumes working claims, plus the allowance for adverse claims, at the rates assumed in the Actuary's valuation calculations. The figures and the chart below are based on an expectation for a higher number of certificates of 500 in FY26, allowing for a further increase to the amount written in FY25. Certificate numbers then are projected to return to longer-term levels of 550 p.a. in the long run from FY27 onwards. The FY26 and long run projections are unchanged since the previous review as we consider the grants announced by the government on 1 October 2024 (eligible until 30 September 2026), will continue to stimulate investment and support an increased level of activity in the building industry in future years.

The current cash position is about $5.1 million. The cash position at the end of 2034/35 is expected to increase to $10.7 million. The cash position is projected to grow at a slightly higher rate than the previous review mostly due to higher contribution collections. This was partially offset by an increase in annual expenses and lower investment income. Under this projection, there would be no cash call against the NTA guarantee over the next year.

On the GPS 340 solvency basis, the current solvency margin is about $3.2 million. Over the next ten years, we are expecting consistent increases in the solvency position as contributions and investment income are expected to outweigh request costs and expenses, with the projected solvency position returning to $5.1 million, above the capital target, at the end of 2030/31.

Figure 3 – Projection results



Multi-Year Projection	30/06/ 2025	30/06/ 2026	30/06/ 2027	30/06/ 2028	30/06/ 2029	30/06/ 2030	30/06/ 2031	30/06/ 2032	30/06/ 2033	30/06/ 2034	30/06/ 2035
Contributions (net of GST)	1,649,711	1,783,066	2,025,117	2,090,933	2,158,889	2,229,052	2,301,497	2,376,295	2,453,525	2,533,264	2,615,596
GPS 340 Solvency	3,196,860	3,193,348	3,625,359	3,921,255	4,288,887	4,684,771	5,118,484	5,598,106	6,102,570	6,615,850	7,158,468