INNER-CITY WELLINGTON Te Reo Pokapū o Pōneke
VOICE OF TE ARO AND WELLINGTON CENTRAL

Submission to Finance and Expenditure Committee on the

Unit Titles (Strengthening body corporate governance and other matters) Amendment Bill

Background to Inner City Wellington

1. Inner City Wellington (ICW) advocates for the interests of sustainable development and local democracy and seeks to serve as a progressive and influential voice of and for the residential community in the suburbs of Te Aro and Wellington Central.
2. Since ICW's foundation in November 2008, a particular area of focus has been advocating on behalf apartment owners on the earthquake-prone legislation that first appeared with the introduction of the Building Act 2004, and then revised in the Building (Earthquake-prone Buildings) Amendment Act 2016. Body corporates in earthquake-prone buildings have to work under the Unit Titles Act (UTA) to make decisions and fund the investigation and any resulting strengthening project. ICW continues to lobby the Government calling for a review the earthquake-prone legislation to address the impacts of a flawed policy on owners in multi-owner residential buildings.

Liaison with the Body Corporate Chairs' Group

3. ICW works closely with the Body Corporate Chairs' Group (BCCG) on matters that impact on body corporates. The BCCG has taken the lead on advocacy for changes to the UTA.

Submission

4. This submission focuses on issues identified through ICW's research on the earthquake-prone buildings legislation (specifically, on owners in multi-owner residential buildings) and how these impact on governance arrangements and long-term maintenance plans.
5. The requirement for insurance is a core responsibility of the body corporate and the lack of clarity, certainty and flexibility undermines governance effectiveness of a body corporate.

ICW wishes to make an oral submission to the Select Committee.

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Clarification of who the 'building owner' and how it's applied for seismic strengthening work

A definition of building owner and a clearer definition of 'common property' is required to provide transparency for owners and to clarify who should be listed as the 'building owner' in resource and building consent applications.

6. Legal advice obtained by ICW highlights that there is not a clear definition of a 'building owner' with respect to a multi-owner building operated under the UTA. Instead, it relies on an interpretation of various sections of the UTA and taking into account Building Act references.
7. UTA section 54 states that 'the common property is owned by the body corporate', while section 138(1) places the responsibility on the body corporate to manage, maintain common property and any assets, and under section 138(2), all building elements and all infrastructure that relate to or serve more than one unit.
8. The common property definition is not helpful in providing clarity and needs to be expanded to include all building elements and all infrastructure that relate to or serve more than one unit.
9. Owners of apartments in earthquake-prone buildings are communicated with 'as the owner of the building' by Wellington City Council with respect to mandatory seismic strengthening, when the project

must be progressed for the building as a whole and is managed by the body corporate committee. A single owner cannot strengthen their own apartment.

10. Legal advice states that although the Building Act does not explicitly state who the 'owner' is for the purpose of a body corporate wishing to strengthen their building, it considers the body corporate to be the logical owner. The infringement notice in Schedule 2, Building (Infringement Offences, Fees and Forms) Regulations 2007 states specifically that a body corporate has a defence for certain offences of the Building Act, including the offence under section 133AU (if the 'owner' fails to complete seismic strengthening). This needs to be clarified.
11. A clear definition of 'building owner', the 'building', and an improved definition of common property, is needed in the UTA to remove doubt and the potential for variable interpretations.

Implications of current practice

12. Feedback from owners in buildings where building consents have been submitted to undertake seismic strengthening work shows variability on the 'building owner' information being provided.
13. This needs to be clarified to ensure that the information on building work that affects the whole building, but may only take place in certain apartments, is placed on all the appropriate files. This is particularly important for a Land Information Memorandum so owners and potential purchasers have confidence in the information that will be supplied.
14. Some examples of advice on and completion of building consent applications:
    - told to 'pick four owners' as the online form had space for four owners
    - resource consent referred to the applicant as the descriptive building name of the body corporate rather than the legal name, though the code compliance certificate had all the owners listed
    - in one building where the required strengthening work only affected specific apartments, separate building consents were processed for those apartments where the work was being done, with the owner being the body corporate person managing the project.
15. The UTA should make it clear that for all work that requires a resource or building consent for building elements and infrastructure that relate to or serve more than one unit, the body corporate is the 'owner' for the purposes of the building consent application. And the official body corporate name must be used.
16. The UTA also needs to state that where work has taken place in the building elements and infrastructure within one or more units (eg, external walls and columns) the appropriate information is placed on the property files for those units as well as the 'building owner' file.

Decisions on seismic strengthening work must be under a special resolution

Decisions on seismic strengthening work (whether required under an earthquake-prone building notice or not) must be made by special resolution, and all special resolution section numbers identified in the proposed change to s101

17. The proposed change to section 101 simplifies the requirements for special resolutions. ICW recommends that the new s101(1) lists all the relevant sections that provide for a special resolution. This would make it much clearer for owners in a body corporate.
18. ICW argues that making decisions on seismic strengthening projects to respond to mandatory strengthening compliance imposition or voluntary strengthening projects must also be made by special resolution.
19. These projects can cost millions of dollars for the building, be several hundreds of thousands for individual owners' share and place owners in severe financial hardship. These projects can alter an apartment and an individual apartment's value, eg K-frames through rooms, decreasing deck sizes or taking space inside a room. It can impact some owners more than other owners in a body corporate.

20. Other property-related decisions are already decided by a special resolution. The UTA must explicitly provide that decisions on seismic strengthening options, impacts and related costs should be decided with a special resolution as well.
21. We note that the current guidance on MBIE's website states 'There must be a special resolution if there will be a significant effect on unit owners', which is not consistent with the current section 101(1). Nor are the examples consistent with the current section 101(1).

Mandatory seismic strengthening in existing buildings is not R&M or capital improvements

Mandatory seismic strengthening compliance costs, imposed by Government and subject to future change, must be separated out in the UTA from repairs and maintenance, renewal or capital improvement as it is not possible to plan and fund in a long-term maintenance plan for unknown future legislation changes that may be retrospectively applied to buildings.

22. Ministers of Building and Construction in the current and previous governments have stated that mandatory strengthening of existing buildings deemed to be earthquake-prone is a cost of home ownership. ICW disputes this and is calling for a review of the legislation with respect to multi-owner residential buildings. In the interim, this review of the UTA must address this anomaly for home owners caught in the earthquake-prone building regime.
23. ICW considers strengthening costs should be treated separately because:
    - repairs and maintenance, renewal, and undertaking capital improvements should be a choice of the owners rather than imposed by legislation; no other home owners have these activities imposed on them by legislation
    - strengthening costs are imposed in response to a theoretical assessment process undertaken by third parties: there is no evidence of the need for the strengthening work as the work is not being undertaken in response to damage resulting from an earthquake
    - the work is not a capital improvement in terms of how home owners generally view it (eg, installing a new kitchen, installing double-glazed windows); the value of the property immediately decreases once the building is issued with an earthquake-prone notice and the costs incurred may recover lost value but not necessarily
    - future changes to the building standard may result in the building being deemed to be earthquake prone again or having the seismic rating achieved through a previous round of strengthening reduced.
24. Mandatory seismic strengthening of existing buildings must be separated out from repairs and maintenance and renewal activity as it cannot be realistically planned and budgeted for in long term maintenance plans (LTMP). No one knows which building in the future will be tagged as potentially earthquake-prone and subsequently deemed to be earthquake-prone as the building standards keep changing. There is no way of realistically estimating what the costs of remediation could be.
25. When a building is identified as potentially earthquake-prone or earthquake-prone, the investigation work is often carried out using LTMP funds (usually tagged for other maintenance work) and the actual project work is funded by special levies. Special levies may be established in advance to collect funds to use for the investigation and/or project work. In some buildings, the owners will not fund the LTMP due to the costs associated with the investigation of the seismic strengthening options.
26. Legislation changes that require LTMP funding at a certain level are likely to result in many body corporates becoming non-compliant as owners will not be able to afford to maintain the required (and desired) LTMP fund and pay for any seismic strengthening investigation costs, and any subsequent construction work. Apartment owners (like their standalone building home owners) want to maintain their buildings but they cannot afford to budget for long-term maintenance and unknown seismic strengthening work.

27. This is the reality of the current legislation imposing these retrospective compliance costs on owners. The earthquake-prone legislation and its application to multi-owner residential buildings must be urgently reviewed.

Long term maintenance plan peer review

Body corporates must disclose who has developed the LTMP and whether a peer review has been undertaken, rather than impose an additional compliance cost on owners and create another income stream for an industry sector without any controls on quality

28. This compliance requirement (clause 157D) for potentially thousands of buildings is creating a new income stream for providers without any controls on what can be charged or the quality standards expected. While the fees will be driven by the demand in the market, the mandatory requirement will drive demand and consequently price increases.
29. It will result in variability in the quality of the peer review. This variability is already evident for detailed seismic assessments required in response to being deemed potentially earthquake-prone and even after a building is deemed 'earthquake-prone'. The prescribed methodology has not stopped variability in seismic ratings. In response to this issue, Engineering NZ has established a mediation service to help owners (subject to paying the fee) achieve an agreed seismic rating or, if the engineers can't agree, would provide a report in plain English to explain why not.
30. ICW questions why the Institute of Professional Engineers would be considered qualified to provide a peer review of a LTMP that is likely to cover painting, floor coverings, windows, roof, security systems, entry door, garage roller door, stairwells, lifts, electrical, drainage, entry intercom.
31. The large body corporates and many medium body corporates may already employ a member of the NZ Institute of Building Surveyors or the Royal Institute of Chartered Surveyors to develop the LTMP, and may seek specific input from relevant engineers. A separate peer review is unnecessary effort and expense.
32. The requirement should be for body corporates to disclose to the body corporate members and prospective buyers who completed the development of the LTMP, and if it was not by a professional, whether any peer review was undertaken.

Insurance provisions need to provide flexibility

Changes are required to the current provisions on insurance to provide more clarity, certainty and flexibility for body corporates to enable effective governance.

33. The key relevant parts of the current provisions are:

    Section 135(1) The body corporate must insure and keep insured all buildings and other improvements on the base land to their full insurable value

    Section 137(2)(b) Despite section 135(1) … indemnity cover is permitted if full replacement cover is not available in the market.
34. The term 'full insurable value' is interpreted as 'full replacement value' insurance. The term is not defined in the UTA, and the lack of clarity is driving up insurance costs and creating severe financial hardship among current owners. This needs to be urgently addressed.
35. The insurance sector in Wellington for apartment buildings is at capacity and there is no longer a 'market' to gain competitive tenders. The cost of the full replacement value insurance cover that is available is so high that in some cases body corporates have agreed not to take out earthquake cover as the resulting per owner cost would place owners in severe financial hardship. This is in breach of the UTA and mortgage conditions, but that is the current reality. An owner paying $7,000, $8,000, $10,000 for one apartment is not sustainable.
36. Currently only owners of earthquake-prone buildings have an option, sometimes the only option, to take out indemnity insurance for earthquake cover. Such cover usually has a condition that renewal of

the policy is subject to progress being made on the strengthening projects. Progress can be very difficult to achieve in the space of 12 months.

37. Body corporates of all multi-owner residential buildings need to have the option to take out indemnity insurance for the building for earthquake cover. The indemnity value would be the current market value of the building.
38. The purpose of full replacement cover (which currently is the only option for most apartment buildings) is to enable a new building to be built. For a wholly or predominantly residential apartment building this is an unrealistic expectation. The owners in an apartment building are co-owners of the building as a result of moving into an apartment in a multi-owner environment. These owners would not undertake a construction project as a collective to rebuild the building. We know that this is the likely scenario as several body corporates in earthquake prone buildings have considered a full or partial development option, but owners do not want to progress these options.
39. Current owners should have the option of paying a lower annual premium for indemnity insurance and accepting a lower pay-out in the event the building is destroyed in an earthquake. Indemnity cover would pay out for repairs due to earthquake damage to the standard before the earthquake, which might leave a shortfall to complete repairs to the current standards. This should be owners' choice to accept that risk and having to fund (through savings or borrowings) any shortfall.
40. The interests of any lenders would be protected as any mortgage would not be greater than today's value. So, in the case of total destruction those holding the mortgage would not be out of pocket.
41. Legal advice is that the UTA already enables the potential to not take out earthquake cover as the current legislation does not identify the perils that must be covered. The 1972 UTA did specify the perils. It is arguable that full replacement value for other perils (eg, fire and general) could satisfy the requirements of the UTA. However, this is open to interpretation and as owners generally want to be covered, this approach has not been tested. Clarity is needed for lenders, borrowers, owners and potential owners.
42. Legal advice is that it could be argued that lack of affordability of full replacement value insurance could result in insurance not being available in the market. As most owners want to be fully insured to protect their largest asset, and decisions on whether or not to opt out of earthquake cover may only require an ordinary resolution (rather than a special resolution), this would not be frequently used. However, this is also open to interpretation and such a decision may be challenged in court by an owner who did not vote for it or by a future owner.
43. The cost and availability of insurance for apartment buildings, particularly in medium and high seismic risk areas, is likely to be a barrier for owners buying into medium and high-density developments. The cost of insurance is known to be a reason why some current apartment owners have had to sell their homes as it was no longer financially sustainable. The UTA needs some clarity, certainty and flexibility.