

<p>Financial assistance and advisory support for owners undertaking seismic strengthening</p> <p>Position paper from the Body Corporate Chairs' Group (BCCG) and Inner City Association (ICA, Wellington)</p> <p>30 January 2017</p>		 <p>INNER CITY ASSOCIATION</p> <p>Representing Wellington Inner City Residents and Businesses</p>
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Problem Statement

There are three components to the problem.

First, a significant number of building owners and Bodies Corporate (BCs) are unable to undertake mandatory strengthening of their earthquake-prone buildings due to impediments that they are unable to resolve on their own. The largest obstacle is financial, but lack of skills and knowledge that would enable them to negotiate the complexities of the engineering and bureaucratic processes play a major role.

Second, market pressure and increasing insurance costs are driving more BCs of buildings rated between 34%-67% New Building Standard (NBS) to undertake further strengthening to regain some lost capital value. The financial and process challenges outlined above, will apply to some of these BCs and their owners.

Third, private owners are funding the achievement of public good outcomes of increased public safety, and for Wellington city, economic resilience to minimise lost productivity arising from seismic events.

Who needs the support?

- Owners who cannot raise money through commercial lending channels. These include retirees, either as owner/occupiers or as small-scale investors (eg with a single rental property as their retirement savings) and small business owners already with inadequate assets, significant debt and small profits. There is evidence that banks will not lend to older workers, retirees or those with low equity even if they could afford to service the loan.¹
- Older owners who have to use all their retirement savings to fund their share as banks will not lend to them.
- BCs who cannot get owners to agree to plans for strengthening for reasons other than financial (e.g. the detrimental impact of a given strengthening solution on an individual's home)
- Owners who do not know how to proceed; both initially and throughout the often complex process.

¹ This group excludes owners with multiple rental or commercial properties against which loans can be secured.

An owner's share could range anywhere from tens of thousands to several hundreds of thousands of dollars for projects that could range through to many millions of dollars. It only takes one owner in a Body Corporate who can't afford to pay to stall the entire process. Other owners are seldom inclined to force owners out of their homes, especially if they are elderly. Legal action under the Unit Titles Act would be expensive as it is based on the total value of the works to be done and so would likely be a matter for the High Court with high costs and long delays.

The need exists primarily for owners in buildings with earthquake prone building (EPB) notices (ie, are required by legislation to strengthen). However, it is increasingly likely to become a requirement in buildings between 34% and 67% NBS as market forces drive other owners to strengthen buildings.

The need for this support is not just a Wellington issue, and will affect owners who are in potentially earthquake prone buildings. This is particularly for high seismic risk areas with the 15 year timeframe.

For Wellington affected owners, financial and advisory support is a priority. The 15 year timeframe is already assigned and will be halved for buildings identified as priority buildings. There is a greater mix of residential and small, medium and large commercial property owners. In other urban centres and regional towns it will predominantly be small and medium size building owners who are affected.

The package available to owners of unreinforced masonry buildings with parapets and/or facades in high traffic areas is a step in the right direction. But they are only a subset of all the owners that are facing significant compliance costs.²

Recommendations for Financial Assistance

1. Central or local government to act as a 'lender of last resort', with no or low interest to individual owners. A lien on the individual owner's property could form part of this. It is important to note that in a BC environment the loan would be to individual owners. Other owners in the BC who are able to raise the funds would not want to incur a share of the interest costs nor to have a lien on their title.
2. Allowing both engineering assessments and seismic strengthening work to be tax deductible. This needs to be accessible for both commercial and residential owners. The tax credits/deduction support owners able to access funding, recognises the private funding to achieve public good outcomes and has the potential to motivate these owners to undertake further strengthening and/or go to a higher seismic rating.

There are owners that have already strengthened, in some cases placing the owner in severe financial constraints (eg, where the funding has consumed retirement savings). These owners should be able to access some form of assistance if they would have been eligible for a 'lender of last resort' loan. Tax deductibility or tax credits should be available to all owners who have completed strengthening projects under the 2004 Building Act provisions.

² New regulations announced on 27 January 2017 requiring strengthening of facades and parapets within 12 months, with a financial assistance package of \$3m from central and local government capped at \$15,000 for facades and \$10,000 for parapets.

The potential number of owners who may require access to a 'lender of last resort' is unknown. ICA and BCCG are aware of buildings where 1-2 owners who could need this facility, or where 10 out of 25 owners would struggle to fund their share, or where the majority of owners in a small body corporate (12 owners) were on fixed incomes. The actual number will depend on how much each owner had to fund. The territorial authorities need to take steps to understand and quantify the impact on their affected ratepayers. Appendix 1 provides some data collected by ICA in 2014.

Tax deductions or tax credits do not resolve the main obstacles outlined in the problem statement for the following reasons:

- a. They do not resolve the issue of owners not being able to raise funds up front through commercial channels
 - b. They do not currently apply to owner/occupier residents
 - c. They are only advantageous if the landlord/business is making a profit. With the high operating costs in EPB (largely due to very high insurance premiums, which are due to significantly rise after the 2016 earthquake and the proposed fire levy increases) and the difficulty of finding commercial tenants prepared to be in an EPB, some landlords are making losses. This particularly applies to the small-scale investor who purchased a single rental property as part of retirement savings prior to its status as an EPB.
3. Providing a mechanism for BCs to obtain a loan on commercial terms, given that they usually do not have any saleable assets to use as security.³ This would apply to BCs that wish to avoid placing the entire financial burden on current owners, particularly where all of the owners face raising loans anyway. Future owners would also contribute to repayment of the loan. This is a different situation to 'lender of last resort'. At this time, it is unclear how many BCs would wish to take this approach, and the BCCG will endeavour to identify possible numbers within Wellington as an indicator. This mechanism will require the support and input of the banking sector to develop and implement, such as occurred with the escrow arrangements for seismic strengthening work.

Further work is necessary to develop the detail for any financial support mechanisms (eg, to ensure it is only applied to earthquake strengthening work and not deferred maintenance and/or added value work such as installing double glazed windows) and ICA and the BCCG will develop proposals to assist. The support of the engineering and construction sector will be needed as there is evidence of an unwillingness to even separate out the additional added value work sufficiently to allow owners to determine whether to proceed with it or not.

Recommendations for Advisory and other Assistance

To ensure national consistency, MBIE should provide the authoritative source of guidance and toolkit materials to support the territorial authorities as part of its responsibility for the successful implementation of the legislative changes. This guidance should not just focus on what the territorial authority must do, but also be targeted at owners and BCs to increase knowledge about the requirements, processes and options.

³ Bodies corporate can borrow money under the Unit Titles Act 2010, but this is rare given the lack of security. This mechanism would provide flexibility in situations where private property is required for a strengthening solution and it may need to become common property to allow this to occur.

For Wellington owners the need for an advisory service has been evident since the Christchurch earthquakes in 2010 and is now urgently needed to assist BCs struggling to progress strengthening projects. The new requirement to strengthen facades and parapets in certain buildings within 12 months merely worsens this problem.

There are also specific issues that will relate to each territorial authority. In Wellington, for example, constraints imposed by local heritage listings limit options and increase costs; policies that restrict the use of exoskeletons limit options and increase costs. Given the Wellington City Council (WCC) drive on these new policies, the WCC must progress this support ahead of any service that MBIE may provide.

4. National advisory support (at no cost to BCs) includes provision of:
 - a. a 'toolkit' of guidance, templates, checklists that help BC Chairs, their committees and their owners to progress through the seismic strengthening project, including the decision making processes under the Unit Titles Act and what to look for when selecting engineers
 - b. an explanation of, and indicative range of costs for the parts of the methodology that must be followed (eg, ISA, DSA, geotechnical assessment) reflecting the different sizes/types of buildings. This would streamline the commissioning process for owners
 - c. a central point (perhaps the MBIE website) containing a layperson's guide to different strengthening technologies and jargon
 - d. regular forums for information sharing to build the understanding of what is involved and an opportunity to ask questions of professionals.

5. In Wellington (and potentially other territorial authorities) – in addition to the advisory support listed above, WCC must:
 - a. proactively contact BCs with an EPB notice to understand the current status of the strengthening work the constraints to progress, and what information or action is required to initiate or progress the strengthening project
 - b. facilitate mediation where BC Chairs are experiencing difficulties with the separate business units in WCC involved in progressing strengthening projects (eg, where heritage constraints are forcing unreasonable costs on owners)
 - c. proactively identify topics where guidance is required and liaise with other agencies and professionals to develop associated guidance materials
 - d. provide regular forums for information sharing to build the understanding of what is involved and an opportunity to ask questions of professionals and Council officials
 - e. liaise with MBIE to update them on barriers to progressing strengthening projects and ensure there is alignment with whatever guidance is provide nationally
 - f. provide a coordination role where multiple buildings need a collaborative strengthening solution, such as buildings with common or touching walls.

6. A mediation service (or funding for mediation) when a Body Corporate is unable to reach agreement with an owner (to avoid lengthy, expensive legal processes), with professionals (eg, where there are concerns the methodology has not been followed) or with the TA (eg, where local constraints, such as heritage or district plan policies, are increasing costs to owners)

Why should central and local government provide advisory and financial support for private owners?

The legislative requirement to strengthen exists to achieve the following public good outcomes:

- Public safety – this is the primary driver for the legislative requirement for both central and local government.
- Fast track strengthening – owners of identified priority buildings on key pedestrian streets and/or emergency transport routes will have reduced timeframe (7.5 years in high/medium seismic risk areas) to increase public safety and aid recovery in emergency event. This is also a driver for both central and local governments.
- Economic resilience of city – completing strengthening projects and strengthening to as high a percentage of the NBS as possible increases the economic resilience of the city. This is a priority for local government to maintain the future ability to gather rates and pay bills, and has a flow-on effect for central government through payment of taxes.

Completing the strengthening work sooner than the legislated time frames, and strengthening as much as possible beyond 34% NBS, will increase the benefits of these public good outcomes.

Private owners will also benefit but do not gain all the benefits. For many owners, the costs of the strengthening may not increase the value of their asset nor recoup the cost incurred. It may increase saleability or be more appealing to tenants, but not necessarily. For some owners, at best, they may minimise the loss on their investment. Others will be trapped in a property they can't afford to sell due to negative equity. For owners who are forced to sell their homes or business premises, they will have lost their asset and indeed their home in order to achieve public good outcomes.

Conclusion

Balancing the costs and benefits of earthquake resilience legislation against public good outcomes and private property rights is a complex policy problem. There is not a simple answer or a 'one size fits all' solution. But there are solutions that recognise the costs to private owners to help achieve the public good outcomes.

ICA and the BCCG are keen to help develop these solutions further with central and local government and other stakeholders.

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Appendix 1: Data on impacts of seismic strengthening on owners

Source: ICA Survey 2014 (55 individual respondents)

The focus of the survey was on the impact on individuals rather than providing a 'building' response. Not all respondents completed all the questions.

- Owners: 21 self-employed, 13 employee; 9 own a business that employs others; 9 retired
- Age:
 - <40 years 8
 - 41 – 60 years 28
 - 61 – 80 years 15
 - 80+ years 1
- Type of building: 15 in residential only; 2 in commercial only; 21 in both residential and commercial
- Earthquake prone: 28 had been issued with a s124 notice at that point, 27 had not
- Heritage listing: 19 had WCC heritage listing; 19 had no WCC heritage listing; 8 had a Heritage NZ listing
- Target seismic rating once completed: 18 responded over 67%NBS; others did not complete
- Likely individual share of the strengthening costs:
 - <\$50k 9
 - \$51k – \$100k 4
 - \$100k - \$150K 5
 - \$151k (heritage) 1
 - \$250 - \$300k (heritage) 4
 - \$400k+ (heritage) 3
- Expected source of financing:
 - Savings 7
 - Retirement savings 5
 - Increased mortgage 10
 - Business loan 3
- Experienced difficulties in obtaining mortgage/loan:
 - Yes 8
 - No 20
 - Comments:
 - banks extremely slow, unmotivated to help us. Unclear requirements re documentation to prove likely costs. We have quite complex situation
 - banks required early repayment of some of our loan to reduce their risk. We no longer have earthquake insurance.
- Considered selling?:
 - Yes 20
 - No 13
 - Comments:
 - Brought at 2010 prices, post Christchurch don't have an option but to strengthen and hope to get back to pre-Christchurch prices

- Apartment is considered valueless now. Or only land value, so low would be too huge to take
 - Little point, no interest, would love to; others in building have tried in past year with no success; no market for earthquake prone apartments, unsaleable, need to get to 67%NBS
 - Considering selling to a developer
- Other comments:
 - We're unlikely to be able to get a bank loan for sum required. BC is looking at options of new development to fund strengthening. Very high risk. Feeling is that this will bankrupt us.
 - Because of high costs, BC and all owners are considering demolition and selling land to developer.
 - Strengthening issue is way out of hand. Nonsensical to pour millions into buildings (totally over-capitalising them) with no guarantee that the Council will not then say more work is required.
 - Entirely possible that I might not be able to purchase a satisfactory alternative place to live, which is rather sad, considering that I am over 70 years old, worked hard to pay my mortgage and had hoped for a relaxed old age.
 - Uncertainty and being trapped in our apartments is a big issue. People moving into retirement and fixed incomes are freaking out. Finance is a big uncertainty. Finance is already a big issue because of insurance increases, etc. What happens once people can no longer pay BC fees is yet unclear but looming. What happens when one or several owners cannot pay for strengthening is also looming if not already existing in some apartments. The impact on the Wellington economy is unknown and hidden except for empty spaces.
 - We have potentially lost commercial asset worth \$700,000.