22 February 2022
Minister for Building and Construction
Minister of Finance

Tēnā kōrua

We are a group of 51 owners/representatives of Residential 'Earthquake-Prone' Buildings (REPBs), from 9 buildings and 43 apartments, and Inner City Wellington. We are supported by 14 other individuals.

We request the Government provide grants to owners to support the strengthening of REPBs. This letter and its appendices explain why:

- The requirement to strengthen residential earthquake-prone buildings is neither reasonable nor affordable for homeowners.
- The current financial assistance scheme does not address all the issues needed to make the earthquake-prone building provisions reasonable and affordable.
- Providing targeted grants (in addition to the loan scheme) will be the best mechanism to address these issues.

We also suggest some high level criteria for the grants.

The requirement to strengthen residential earthquake-prone buildings is neither reasonable nor affordable for many homeowners.

In 2013, Cabinet discussed proposals to encourage strengthening of earthquake prone buildings, including incentives to do so. Cabinet agreed that "revised proposals will result in expectations on building owners to strengthen earthquake prone buildings that are generally reasonable and affordable."[1]

The earthquake strengthening requirements are not reasonable or affordable for owners of REPBs. Both Cabinet and officials knew this in 2013[2] and should not have agreed to, or recommended, the changes made. Details of why the requirements are not reasonable or affordable are provided in the Appendix to this letter. In summary, this is for the following reasons:

1. The earthquake prone requirements are contrary to the rest of the Building Act.
2. Values of REPBs dropped due to the legislation and have been made difficult to sell.
3. Affordability is a barrier to strengthening.
4. Strengthening REPBs involves a significant transfer of wealth from private property owners to the Government's consolidated fund.
5. Decisions regarding earthquake-prone buildings were based on calculations of cost that were too low.
6. Even with the low estimate of costs, the costs are far greater than the benefits.
7. The reason for these requirements is the wider resilience they provide. This is a public benefit.
8. Owners already provide significant and increasing support for this resilience through insurance.

[1] Cab Min EGI Min (13) 17/6
[2] Cab Min (13) 26/8 3.2

9. New Zealand is out of line internationally by not having a proper funding/incentive programme.
10. These requirements compel owners of REPBs to take on complex, technical, high-risk construction projects with very little support.

The current financial assistance scheme does not address all the issues needed to make the earthquake scheme reasonable and affordable.

The Residential Earthquake-Prone Building Financial Assistance Scheme could provide important assistance to some owners of REPBs. It is not effective in its current form. However, we understand a report on the outcomes of the 12 month review is with Ministers for decisions.

The Scheme will generally be fit for purpose when:

- All owners of REPBs who cannot afford to service a loan, or cannot access bank lending, can use this scheme to borrow funds to cover the costs of strengthening their REPB. In the current scheme only those who are owner occupiers are eligible for the scheme. It therefore excludes ‘reluctant landlords’ who cannot sell their apartments because of their ‘earthquake-prone’ status. This undermines the usefulness of the scheme.
- Access to the loan does not impact owners’ income or outgoings. Currently the scheme allows interest to be capitalised and only paid when the apartment is sold. In these instances the interest does not impact the owner’s regular outgoings. However, under this scheme you must not receive an Accommodation Supplement from Work and Income and receive a loan. This affects the owner's income and undermines the intention of the loan scheme. The restriction on access to the Accommodation Supplement is inconsistent with the approach taken to the First Home Partner scheme.

However, even if changes were made to address the above points, the loan scheme cannot address all the hardship issues that owners of REPBs face, for the reasons outlined below:

- It requires owners to incur an interest-bearing debt to comply with a law for which the government’s own cost/benefit analysis does not stack up.
- The loan scheme does not reflect the public benefit from the strengthening of REPBs.
- There is a transfer of wealth with this borrowing from private owners to the Government via the tax it receives from this work. The tax it receives includes:
    - GST at 15% of all expenses
    - Income tax. At an average construction wage of $60,000, this would be 18% of those wages. All projects will require advice from professional services who will be paid a much higher salary. The government will receive a higher percentage of their higher income as income tax.
    - The business tax on the earnings of all businesses involved in the work. The business tax rate is 28%.
    - The building levy. The rate of this levy is $1.75 per $1,000.

  While not experts in this area, we would estimate the amount of tax received by the government to be between 20% and 30% of the cost of the project. The Inner City Wellington (ICW) survey found an average cost of strengthening of $300,000 per apartment. 20-30% of this is $60,000 to $90,000 per apartment. This would result in

estimated revenue for the government of $4.56m to $6.84m for just the owners of the 76 apartments who responded to the ICW survey. This is just a small percentage of owners of REPBs. With the increase in construction costs since the survey, it is likely to receive more if all these buildings were strengthened.
- In addition, there has been a loss of wealth from owners since the buildings have been declared earthquake prone, due to the requirements of the Building Act. This loss is based on the REPBs being labelled earthquake-prone and the deadlines set for buildings to be either strengthened or demolished.
- Owners end up with significantly reduced options because of this debt. Many owners will not be able to purchase another similar home if they sell their apartment, once strengthened due to their weaker financial position because:
    - their debt is too high and therefore equity is low and
    - the cost of their additional borrowing would be too high.

Providing a grant scheme (in addition to the loan scheme) is the best mechanism to address these issues.

A grant scheme would complement the loan scheme in that it would reduce the amount an owner would need to borrow. We see no other mechanisms that would effectively address the affordability issues facing owners of REPBs. This includes tax incentives, which are unlikely to help those owners who most need it. Tax incentives are unlikely to reduce the amount that owners would be required to borrow to strengthen their REPBs.

REPBs should be removed from these requirements. However, that will not solve the problem.

The government should remove non-reinforced masonry/concrete REPBs from the requirement to strengthen. The requirement to strengthen REPBs by a certain date should not have been introduced in the first place.

However, as the requirement does exist, simply removing them is unlikely to address all the issues brought about by these current Building Act requirements. For example, it is likely that banks would continue to be reluctant to lend to potential owners of REPBs and to potential owners of apartment buildings that may potentially become earthquake-prone due to changing building standards. Therefore, REPB owners with no deadlines would continue to have difficulty in selling their apartments, like their leaky building counterparts.

Initial high level criteria for the grants.

We have done some initial high-level thinking on criteria for grants. While not exhaustive, we request the government provide owners of REPBs with grants that reflect the following key points:

- The amount of the grant would be based on a percentage of all costs necessary for the strengthening of the building, including the engineering assessment and investigative work required. They would exclude any work done as part of any strengthening project that is not part of the requirement to strengthen (for example, other more cosmetic changes).
- The amount of the grant would cover the tax (including GST, personal income, building levy and business tax) the government is to receive from earthquake strengthening.
- In addition, the amount of the grant would cover the public benefit from the wider resilience the requirements provide.
- The cost of administering the grants could be minimised by administration being undertaken by Kāinga Ora under the Residential Earthquake-Prone Building Financial Assistance Scheme.
- The grants would have the same 'unit and building eligibility criteria'[3] as the current loan scheme.
- To encourage owners to strengthen, grants would be available for a limited time but would need to reflect any delays in the investigation stage or construction work due to capacity issues and/or other factors such as the Covid-19 pandemic or lack of suitable capacity or capability among owners to progress the project.

In addition, we recommend the government consider how the significant investment in earthquake resilience through the EQC can be used to support grant funding and strengthening of REPBs.

The Building Act 2004's earthquake-prone requirements have had a significant and unreasonable impact on owners of REPBs over the last 14 years. While there are other significant issues with the REPBs requirements, we consider the lack of suitable grants is the biggest hurdle to having a regime that is even close to being 'generally reasonable and affordable' for owners of REPBs.

We would welcome an opportunity to discuss our proposal further with you. In particular, we are happy to provide further clarification and answer any questions you have on this proposal.

If you have remaining concerns about our proposal, we request you seek independent advice. We suggest this because this letter and its appendices are critical of decisions and recommendations of previous Governments and officials.

[3] See the Unit and building eligibility at https://kaingaora.govt.nz/working-with-us/residential-earthquake-prone-building-financial-assistance-scheme/

Speed is critical in addressing the issues outlined in this letter as costs keep going up, deadlines are looming and owners are facing difficult decisions. Owners of REPBs have experienced too much hardship over too long a period, and need improvements and certainty urgently.

We look forward to hearing from you in the near future.

Ngā mihi

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This letter is supported by the following 51 apartment owners/representatives in 9 REPB and 14 other individuals who have an interest in this issue.

Note: the letter to Ministers included a statement in the tables of names and buildings (where provided for REPB) that this information was provided in confidence to Ministers and officials.

Appendix: Why the requirement to strengthen residential earthquake-prone buildings is neither reasonable or affordable for homeowners

Background

Apartment owners in Wellington have been working on issues surrounding earthquake prone buildings since 2007. This is when Wellington City Council (WCC) established its own earthquake prone building policy under the Building Act 2004. WCC had completed a previous round of earthquake strengthening notices under the earlier 1991 legislation.

Under the 1991 Building Act only unreinforced masonry or concrete buildings were covered by the earthquake prone provisions. The 2004 Building Act substantially expanded the provision to cover all building construction types and established the concept of ‘34% of the new building standard’ being the threshold for determining a building to be earthquake prone.

No data on the number or types of buildings that would be covered by the expanded criteria was provided to Cabinet. The Regulatory Impact Statement (RIS) referred to the public safety benefits of the changes. Parliament was not advised of the expanded scope as the explanatory note of the Building Bill 2003 did not refer to this change. Consequently, there was no public coverage of the proposed substantive change and apartment owners who would be affected by this change did not have an opportunity to submit on the impacts of this change.

The costs, challenges and risks of this legislation were already becoming evident to many Wellington apartment owners prior to the Christchurch earthquakes in 2010-2011 that led to further legislative changes.

In 2012, “Cabinet directed the Ministry of Business, Innovation and Employment in consultation with the Treasury, the Inland Revenue Department (IRD), and other relevant agencies, to investigate the issue of financial incentives for building owners to undertake earthquake strengthening work”[4]

“In response, the Ministry commissioned a report which evaluated the relative effectiveness of various financial (and non-financial) incentives on building owners to address (strengthen or demolish) earthquake prone buildings.”[5] “The report was prepared with input from MBIE, IRD, the Department of Internal Affairs and the Ministry for Culture and Heritage. No consultation with stakeholders was undertaken.”[6]

[4] EGI Min (12) 28/15 refers

[5] ‘Financial Incentives to Encourage Strengthening or Demolition of Earthquake Prone Buildings’, from the Minister for Building and Construction to the Cabinet Economic Growth and Infrastructure Committee, 2013, pg 1,para 4

[6] Ibid, pg 3,para 15

In 2013, Cabinet “agreed that the revised proposals will result in expectations on building owners to strengthen earthquake prone buildings that are generally reasonable and affordable.”[7] The RIS clarified that the ‘policy settings and standards’ sought to “adequately balance life and safety considerations against economic, heritage and other considerations.”[8]

Why the requirement to strengthen is not reasonable or affordable for owners of REPBs.

1. The earthquake prone requirements are contrary to the rest of the Building Act

The requirement to strengthen earthquake prone buildings is contrary to the tenets of the rest of the Building Act. The Act is not retrospective and does not require the performance of buildings to be upgraded as standards increase[9]. The Building Act requires that “all building work must comply with the building code”. The only exception to this are the requirements for earthquake prone buildings. Most buildings/structures are excluded from these. The only buildings covered are either commercial or public buildings, or certain types of residential buildings. These are residential buildings which have two or more stories and are either:

- a hostel, boardinghouse, or other specialised accommodation; or
- contain 3 or more household units.

The only other general requirements for buildings are that they are not dangerous (or near a dangerous building) or an unsanitary building. Unlike REPBs, these conditions are most likely to occur when proper maintenance has not occurred. This is not the case with most earthquake-prone buildings. The effect of this is that:

- only a small percentage of residential buildings in New Zealand need to meet these requirements
- these requirements are onerous on owners in a way that no other requirements in this Act are. It is contrary to the fundamental principle of the Act that the only time the building code applies is when building work is being done.

2. Values of REPBs dropped due to the legislation and have been made difficult to sell

REPBs lost value when they were labelled as such. The experiences of those selling shortly after 2010 compared to similar apartments selling before 2010 was a reduction of 40% to 50% of value. This loss was caused by two factors:

- The labelling of the building as being ‘earthquake prone’
- The subsequent requirement to strengthen by a certain date.

Currently, to calculate the value of REPBs, valuers have typically used the following process:

- Requested the information on any plans/ proposals/options to strengthen the building (for example, a plan to strengthen the building to achieve a New Building Standard (NBS) of 70%

[7] Cab Min EGI Min (13) 17/6
[8] Improving the system for managing earthquake-prone buildings: RIS (RIS) pg 12, para 35
[9] RIS, pg 4, para 10.

- Estimated the value of the apartment if that work was done by comparing it to current sales of apartments in buildings with similar NBS ratings
- Reduced the value by the estimated cost of the strengthening
- Reduced the value to reflect a buffer covering increase in strengthening costs and the inconvenience of strengthening.

However, estimating/determining the value of a strengthened building is not straightforward as:

- solutions will still need to be signed off for building consent by a Territorial Authority and changes may need to be made
- there can be a difference between a quantity surveyor's estimate and the tendered prices when buildings go to market
- there are real risks/issues with increases in costs/supply of materials and labour/ expertise to do the work for these projects.

Banks have stopped providing potential new owners mortgages to purchase REPBs, reducing the market for them significantly and therefore putting downward pressure on any sales price.

3. Affordability is a barrier to strengthening

In all engagement with owners regarding the changes to the legislation and the loan scheme, Government has received a consistent message: Affordability is a barrier to strengthening REPBs.[10] The 2021 evaluation of the earthquake-prone building system states that "...estimated costs of remediating through seismically strengthening earthquake-prone buildings may not be economically feasible for many owners."

Cabinet has known since 2013 that some owners cannot strengthen because they cannot afford the cost. Cabinet noted "...some building owners will face relatively weak incentives because … they are owner occupiers in multi-storey apartment blocks who do not consider the benefits of strengthening are great enough to offset the costs, and/or where some owners may 'hold out' from agreeing to necessary strengthening work because they cannot afford the costs."[11] This statement is disingenuous as 'holding out' indicates a choice to strengthen where owners who 'cannot afford the costs' have no choice to strengthen.

In addition, 'Analysis of submissions from respondents to the Ministry of Business, Innovation and Employment's consultation document also showed that almost one in four respondents mentioned funding as a barrier to strengthening Earthquake Prone Buildings (EPBs).'[12]

However, despite a recognition that many owners could not afford to pay for the cost of strengthening, officials did 'not recommend that any general financial incentives be provided to owners of EPBs.'[13] The only exception was heritage buildings. The heritage status of a building is not pertinent to the desired outcome of strengthening, which is to save lives.

[10] RIS, pg 27, para 88
[11] Cab Min (13) 26/8 3.2
[12] Cabinet Paper pg 4, para 22
[13] CAbinet Paper pg 5, para 27

4. Strengthening REPBs involves a significant transfer of wealth from private property owners to the Government's consolidated fund

Strengthening work provides income to the Government via GST, income tax from those employed on this work, the building levy and business tax. Despite this, we have seen no evidence that officials have considered this, sought to calculate it, or provide any advice to Ministers on this matter.

5. Decisions regarding earthquake-prone buildings were based on calculations of cost that were too low.

Cabinet was advised that "Insufficient and poor quality information means that it is difficult to precisely estimate the size and importance of these problems and the various costs and benefits that would be associated with options to address them."[14]

As stated in the 2013 RIS, "A key limitation of the analysis in this RIS is that, overall, there is poor information about the seismic performance of New Zealand's existing building stock".[15] "It is difficult to quantify all of the cost impacts of the proposals at this time. In part, this is because many of the cost impacts will depend on detailed design of many aspects of the system which is yet to be undertaken (this process will attempt to mitigate these costs as far as practicable).[16]

In particular the costs used to make decisions are significantly lower than the actual costs that would be incurred by many owners. The survey by ICW in 2020 indicates an average cost of strengthening 76 apartments in Wellington at just over $300k per apartment with an average size of 100m^2 per apartment. This is therefore a cost of $3,000 per m^2. The report from Martin Jenkins in 2012, commissioned by MBIE and used in the RIS indicated a figure of $300-$416 per m^2 in 2012. Therefore, the ICW report indicates the actual cost is likely to be 7-10 times more than indicated in the 2012 report that provided the basis of advice to Cabinet.

6. Even with the low estimate of costs, the costs are far greater than the benefits

The MBIE commissioned cost benefit analysis concluded that "In all cases, even with extreme sensitivity scenarios, costs substantially exceed benefits. This is mainly because large earthquakes that cause significant damage are very rare, and smaller more common earthquakes don't cause very much damage".[17] "The CBA alone does not support higher levels of strengthening - or shorter timeframes."[18]

[14] Cabinet Paper pg 1, para 7
[15] RIS, pg 1
[16] RIS, pg 25, para 74
[17] Martin Jenkins. Indicate CBA Model for earthquake prone building review: summary of methodology and results: final report. Sept 2012, p43.
[18] Ibid, p45

7. The reason for these requirements is the wider resilience they provide. This is a public benefit.

The changes came out of the Government's response to the Canterbury Earthquakes. Following these earthquakes, concerns were raised regarding the country's wider resilience when another big earthquake hits. This is not a benefit for owners but a wider public benefit. Therefore, it is not appropriate that private individuals solely pay for the cost of this strengthening.

The 2018 MBIE commissioned report on potential funding support options for earthquake strengthening concluded that "... if the administrative costs and long term risks of a suspensory loan were considered onerous, and the Crown was satisfied with the considerable transfer of wealth to private owners (which can be justified to some extent by the public good aspects of strengthening the buildings), then a grant scheme would be the preferred option."[19]

The evidence provided by responses to ICW surveys shows that the costs and risks are onerous and there is not a 'considerable transfer of wealth to private owners'. In fact, there are considerable financial benefits to the Crown.

8. Owners already provide significant and increasing support for this resilience through insurance.

Owners have significantly increased their contribution to our country's earthquake resilience through insurance. Apartment owners must insure their building. In most cases, this must be for the full value of the building. This insurance supports the country's recovery when an earthquake hits. The cost of this insurance has increased significantly since the Canterbury earthquakes.

Therefore the current regime requires REPB owners to pay twice for this resilience. Once through insurance and secondly through the requirement to strengthen. This strengthening work is intended to reduce the reliance on that insurance (both private and EQC) in the event of an earthquake. However, current experience is that insurance costs have not reduced significantly once strengthening has been completed.

9. New Zealand is out of line internationally by not having a proper funding/ incentive programme

'Other jurisdictions apply a range of funding and incentive programmes, and most with mandatory requirements have some kind of programme or funding assistance mechanism available to building owners.'[20]

NZ's policy is out of line internationally. Italy has a national policy (similar approach to NZ) but it is not mandatory for all buildings - only for strategic buildings such as hospitals, schools, police stations. Private owners do not have to strengthen. Despite this Italy provides

[19] Martin Jenkins. Potential funding support for earthquake strengthening: options for the design of loan schemes to support owners of multi-unit, multi-story residential properties: final report. 30 Nov 2018, p37.

[20] RIS, pg 10, para 32

tax incentives to private owners to encourage strengthening. Other jurisdictions such as the United States only require certain building types to be strengthened (i.e. UnReinforced Masonry Buildings) and make grants/incentives available for those.

10. They require owners of REPBs to take on complex, technical, high risk construction projects.

The expectations force a targeted group of homeowners to take on a complex, technical, high risk construction project when, if it wasn't for the legislation, it wouldn't be in their interest to do so.

Planning for this work takes a huge toll on building leaders. Many are working for little or no remuneration from their fellow owners. However, other owners do acknowledge and appreciate the responsibility they carry and the complexity of the work they are doing.

These projects rely heavily on multiple professionals over several years. Owners are very dependent on these high-cost professionals, and the design process is rarely a 'one and done' experience - it often involves rethinking and rework - all of which must be paid for by owners before the building work even starts.