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PROJECT LAWYERS

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Geraldine Murphy
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By email

Dear Geraldine

General Advice – Unit Title Buildings and Seismic Issues

1 You have asked us to provide legal advice on the current status of the law governing body corporates, particularly in relation to earthquake strengthening.

1.1 Specifically, you have asked us to consider:

(a) Who is the "owner" for the purposes of a building consent for a strengthening project that affects the whole building in a body corporate environment?

(b) In the event that a building was not strengthened by the deadline, does the definition of owner mean that the Wellington City Council (*WCC*) would have to prosecute each "owner" under s133AU(1) of the Building Act 2004 (*BA*) with potential for a fine up to $200,000 for each owner?

(c) Is the approach taken by the WCC in relation to owners for resource consents and building consents for seismic strengthening work for multi-unit, multi-owner buildings ultra vires?

(d) Would a definition of "building owner" for the whole building in the Unit Titles Act 2010 (*UTA*) enable a body corporate to borrow on behalf of all owners?

(e) Can a body corporate agree to sell a whole building without cancelling the unit plan under the UTA?

(f) If not, can the body corporate agree to demolish or strengthen the whole building?

(g) Can a body corporate elect to have indemnity insurance only, noting that it is often uneconomic to have full replacement insurance?

1.2 This letter seeks to clarify the law on the aforementioned issues and to assist you in advising body corporates and lobbying for legislative changes.

2 Who is the "owner" for the purposes of a building consent for a strengthening project that affects the whole building in a body corporate environment?

2.1 Although the BA does not explicitly state who the "owner" is for the purpose of a body corporate wishing to strengthen their building, we consider that the body corporate is the owner of the building and is the entity responsible for applying for building consents for seismic strengthening work that affects more than one principal or accessory unit.

2.2 As you have noted, section 133AU of the BA states that the owner of a building commits an offence if they fail to complete seismic strengthening, by the deadline, on a building subject to an earthquake prone building notice.

2.3 The infringement notice provided in Schedule 2 of the Building (Infringement Offences, Fees, and Forms) Regulations 2007 (*Regulations*) states specifically that a body corporate has a defence for certain offences of the BA, including the offence under section 133AU.

2.4 Logically, for a body corporate to have a defence to this infringement, a body corporate must have to be capable of committing the offence in the first place. As an "owner" must fail to complete seismic strengthening for an offence under section 133AU to occur, it follows that a body corporate must be capable of being the owner for the purposes of a building consent for a strengthening project.

2.5 Furthermore, for a body corporate to satisfy all their obligations under the UTA, a body corporate must need to be able to act as the building "owner". For example, section 138(1) of the UTA requires a body corporate to repair, maintain and renew the common property and any building elements and infrastructure that relate to or serve more than one unit. Renewing in this context is replacing like for like but in a manner which is code compliant and which ensures a building is not only weatherproof but also is not earthquake prone. Renewal works may involve new product or material replacement such as for cladding systems and may require owners and occupiers to vacate the building for the duration of the renewal works for health and safety reasons. Therefore, if a body corporate could not initiate an earthquake strengthening process under the BA, the body corporate would be in breach of section 138 UTA.

2.6 Further, section 54 of the UTA states that all common property is held in the ownership of the body corporate albeit held on behalf of individual owners of principal and accessory units. As you appreciate, common property typically comprises the exterior areas of buildings, thus reinforcing the prominent role held by body corporates.

2.7 We conclude, therefore, that a body corporate is the "owner" for the purposes of applying for a building consent and for other general purposes under the Building Act 2004. It would, however, be advantageous for this position to be more clearly made by future legislative changes.

3 **In the event that a building wasn't strengthened by the deadline, does the definition of owner mean that Wellington City Council (*WCC*) would have to prosecute each owner under s133AU(1) of the BA with potential for a fine up to $200,000 for each owner?**

3.1 As we are confident that a body corporate can be the "owner" for the purposes of section 133AU(1), it is very likely it is the body corporate who would be liable for a fine up to $200,000, not each individual owner, if the building was not strengthened by the deadline.

3.2 In most cases, the fine issued for breaching section 133AU(1) would be significantly lower than the $200,000 maximum. Schedule 1 of the Regulations states that the infringement fee for breach is minimal ($1000). The amount of the fine is only likely to escalate to extremely high amounts in cases of deliberate and extensive breaches of section 133AU(1).

4 **Is the approach taken by WCC in relation to owners for building consents [and resource consents[1]] for seismic strengthening work for multi-unit, multi-owner buildings ultra vires?**

4.1 For the WCC to act ultra vires, they must exercise powers they do not possess or extend the use of their given powers beyond their allowable scope. The process of body corporates applying for a building consent does not involve the WCC, except for being the eventual recipient, and does not require the use of any WCC power. Section 45 of the BA places the onus on the applicant to lodge and application in the prescribed form. It follows that the WCC cannot be acting ultra vires in this scenario.

4.2 We note that the Regulations prescribe the form that applications for building consent must be in and state that applications for consent must include the name of the owner. A correct application should have the registered name of the body corporate, e.g. Body Corporate 12345. The individual who signs the application should be the chairperson of the body corporate committee.

4.3 You have described multiple situations where the WCC has caused the body corporate to not complete the application correctly. While the process followed by the WCC is in our view incorrect, it does not mean the WCC has been acting ultra vires.

4.4 Conversely, the WCC granting of building consents does involve exercising statutory power. In exercising this power, section 51 requires the building consent issued to be in the "prescribed form" which, as set out in the Regulations, includes stating the name of the owner.

4.5 If the WCC does not correctly state the body corporate's name, this would not likely amount to the WCC acting ultra vires, as they would be still operating within their statutory power of being able to grant a building consent to a body corporate, it would merely be a technical breach. If WCC acted without jurisdiction, they would be acting ultra vires, however, as the errors are occurring while the WCC is exercising their authorised function, the errors are within their jurisdiction and not ultra vires.

[1]We have not conducted research into the requirements for resource consents as they are not as relevant for the purposes of earthquake strengthening. If a resource consent is required, we are comfortable that the same process would likely be needed to be followed as for building consents.

4.6 Legislative change to clarify the correct method for body corporates and councils to follow would be effective in ensuring proper compliance with the prescribed forms and consistency in the approach taken by councils.

5 Would a definition of 'building owner' for the whole building in the UTA enable a body corporate to borrow on behalf of all owners?

5.1 Section 130(1) expressly allows body corporates to borrow money. However, under section 130(2) body corporates cannot take out a mortgage against the common property held in the name of the body corporate.

5.2 Body corporates do still have some available avenues to borrow. A body corporate could take out a charge against any bank account of the body corporate. Alternatively, the body corporate could extend their overdraft credit. Further, owners whether as a group or otherwise may grant personal guarantees based on several liability which may convince a bank to lend funds. Despite having these borrowing options available, we note in most cases they are unlikely to be extensive enough to fund a major strengthening project.

5.3 You have referred to a body corporate borrowing the amount required for strengthening work and having the amount borrowed secured against the record of title of each individual unit comprising the unit title development, requiring repayment of the loan by current and future owners. This alternative funding model is similar to the "user-pays" model slowly gaining momentum with central and local authorities for major infrastructure projects.[2] This proposed funding model is not very pragmatic as it would require 100% of existing owners to agree to the loan and the registration of an encumbrance (which is a form of a mortgage) on the title of their unit. The encumbrance would set out the terms and conditions of repayment, including the frequency and the amount, and would attach to the land rather than to the then-current owner. The body corporate may find it difficult to find a bank or mezzanine funder (which is a secondary funder that sits behind the primary funder) willing to lend the funds because the security would rank in priority behind the owner's primary mortgage. To our knowledge this model is untested in the seismic strengthening works context.

6 Can a body corporate agree to sell a whole building without cancelling the unit plan under the UTA?

6.1 The UTA contains no direct provision on the sale of a whole building. In order to sell the whole building without cancelling the unit plan prior to settlement, the purchaser will need to become the sole owner of the of the existing body corporate structure.

6.2 It is therefore readily apparent that a body corporate would need 100% support from the individual owners to go to the market for the sale of the whole building, since all the owners would inevitably need to agree to sell their own units as part of the sale of the overall body corporate complex.

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[2] For example, the government (through Crown Infrastructure Partners') funding of the infrastructure required to support the Milldale development north of Auckland (approximately 4,000 dwellings and ancillary civic amenities) by establishing a "special purpose vehicle" which raised the funds required to finance the relevant infrastructure from ACC, Crown Infrastructure Partners and Auckland Council. The Infrastructure Funding and Financing Act 2020 introduces a statutory alternative infrastructure funding model to the Local Government Act 2002.

6.3 If a body corporate was able to obtain 100% support from the owners, then all of the owners could enter into a deed that appoints an agent (we would suggest the chairperson of the body corporate committee) to act on behalf of all owners to advertise the sale of the whole body corporate complex on the market (or privately). The agent would then negotiate a sale and purchase agreement for the whole body corporate complex with the prospective purchaser. Each owner would need to act individually when selling their principal and accessory units to the purchaser. For example, each owner would need to sign an authority and instruction form authorising the transfer of their units to the purchaser. We note this process can be followed by any number of majority owners should they wish to sell their individual properties as a collective.

6.4 If a body corporate was unable to obtain 100% support from the owners, then there is a mechanism available under section 339 of the Property Law Act 2007 which enables co-owners to seek the sale of a property and the division of proceeds among the co-owners.

6.5 There have been a couple of high profile High Court cases[3] which have permitted the sale of the whole body corporate complex. In order to achieve a High Court order there would need to be a reasonably high threshold to convince a High Court of the necessity of sale. Panckhurst J in *Lakes Hayes Holdings Limited v Petherbridge* said this on the section 339 threshold:

> [64] …an order requiring the purchase of the share of an unwilling co-owner will not be lightly imposed, given that a proprietary interest in land is at stake.
>
> [87] …I accept that imposing an order which defeats the property rights of a co-owner should not be done lightly. It is a step of last resort.

6.6 In that case there were 9 units in total and the High Court ordered the owner who was refusing to sell her unit (which represented 9.15% share of the unit title development) to sell her unit so that the majority could cancel the unit title plan and sell the development as a whole.

6.7 There is a strong argument that if in situations where it is totally uneconomic to raise funds to save a building then the Courts may well be sympathetic to a total sale scenario supported by a great majority of owners (perhaps 80 or 85%), where it is demonstrated that owners are not able to fund remediation works.

7 If not, can the body corporate agree to demolish or strengthen the whole building?

7.1 A body corporate is entitled to demolish or strengthen the whole building. Strengthening work constitutes building renewal, which is a mandatory duty for body corporates under section 138 UTA. The required level of approval from body corporate members to proceed with demolition or strengthening work varies depending on the extent and implications of the work done and depending on whether the body corporate has delegated the exercise of powers to the body corporate committee.

[3] see Lake Hayes Property Holdings Limited v Petherbridge [2014] NZHC 1673.

7.2 A decision for a body corporate to commence strengthening works which are limited to works that constitute repair, maintenance and/or renewal under section 138 which do not impact the existing unit plan or raise a levy for such works can be initiated:

(a) through ordinary resolution of the body corporate committee, where the body corporate has delegated its duties and powers to a body corporate committee by special resolution at a general meeting; or

(b) through ordinary resolution at a general meeting (per section 101(2)) or, in the absence of a general meeting, a resolution in writing signed by a simple majority of the eligible body corporate members (per section 104).

7.3 If the body corporate has not previously delegated the powers and authority of the body corporate to the relevant committee, the decision on whether to levy funds for strengthening works is arguably to be made at a general meeting of the body corporate by special resolution in accordance with section 101(1). However, we favour the view that an ordinary resolution is required, as section 101(2) provides that "except as otherwise provided in this Act [(i.e. except where the Act specifically requires a special resolution)], all other matters to be decided by the body corporate at a general meeting must be decided by ordinary resolution". If section 101(1) is interpreted to mean that all duties and powers are to be exercised by special resolution (either by the body corporate delegating to the committee to exercise the duty or power, or the body corporate exercising that duty or power itself), then the application of section 101(2) requiring an ordinary resolution has very limited application. The Unit Titles (Strengthening Body Corporate Governance and Other Matters) Amendment Bill amends section 101 to clarify that a matter to be decided by the body corporate must be decided by ordinary resolution at a general meeting unless the UTA specifies a special resolution is required, such as in section 117 (which we discuss further below).

7.4 The UTA specifically states the circumstances where special resolutions are required. For example, section 117 requires a decision made by special resolution if the body corporate does not wish to establish and maintain a long-term maintenance fund. Conversely, section 118 (optional contingency fund) and 119 (optional capital improvement fund) do not specify that a special resolution is required, implying that only an ordinary resolution is required to establish a contingency fund or capital improvement fund respectively.

7.5 If the nature and extent of the strengthening works to be undertaken amounts to a "redevelopment" (defined in section 8 UTA) that will result in changes to the existing unit plan, section 68 UTA requires, before making an application to deposit the new unit plan, that the body corporate must:

(a) ensure that **all of the owners** of the units materially affected by the redevelopment have consented in writing to the new unit plan; and

(b) agree, by special resolution (approval of 75% of body corporate members), to the new unit plan.

7.6 If the nature and extent of the strengthening works require demolition of the existing building structure, the body corporate will likely require 100% support from body corporate members where all owners are materially affected (section 68(3)(a) UTA).

7.7 Therefore, before commencing works, the body corporate needs to establish the nature, extent and implications of the work to be done and ensure they have the necessary level of approval from body corporate members.

8 **Can a body corporate elect to have indemnity insurance only, noting that it is often uneconomic to have full replacement insurance?**

8.1 In accordance with section 135 of the UTA, body corporates must insure and keep insured all buildings and other improvements on the base land to their "full insurable value". In the current legislation, ambiguity exists in the precise meaning of "full insurable value".

8.2 Section 137(2)(b) of the UTA assists in clarifying the meaning of section 135, stating indemnity cover is permitted if full replacement cover is not available in the market. This strongly implies the default position under section 135 requires insurance for full replacement value.

8.3 However, unlike in the old 1972 Unit Titles Act, the current UTA does not identify perils, e.g. fires, earthquakes and explosions, which body corporates must insure against to their full replacement value, leaving a gap in the current legislation. It is arguable that insuring against one form of damage to its full replacement value could be enough to satisfy the obligations on body corporates under section 135.

8.4 Further, we believe there is a strong argument that "not available in the market" includes the situation where insurance is uneconomic or which is not affordable, such as the earthquake insurance spikes in premiums in Christchurch and Wellington following the recent earthquakes. We again note that opting to not get insurance because you have relied on this argument may be risky and would need to be tested in court, without appropriate legislation changes to clarify the situation.

8.5 Curiously and troublingly, there is no offence provision in the UTA for when body corporates breach section 135. This results from the UTA having no offence provisions which is a glowing omission. However, if, for example, a body corporate did not insure against earthquakes to reduce the insurance premium and an earthquake caused damage to the building, the body corporate committee may arguably be exposed to be sued by any disgruntled owner of a principal unit.

8.6 We note that private agreements, such as bank loan agreements, could still require body corporates to obtain more extensive insurance cover than the legislation requires. This is due to the contractual freedom parties have to (generally) agree to whatever terms they wish.

8.7 Furthermore, we note that any insurance obtained by the body corporate must not put the unit owners in default of their obligations to their mortgagees (which will be set out in the unit owners loan agreements with their banks).

8.8 The insurance provisions in the UTA need urgent reform to provide better options and much greater certainty for owners.

8.9 We trust the advice above assists. Please let us know if you have any questions.

Yours sincerely

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Consultant / Senior Associate