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**INNER
CITY
ASSOCIATION**

Representing
Wellington
Inner City
Residents and
Businesses

This submission is made by the Inner City Association (ICA)¹

Response to the exposure draft

ICA does not agree that the capital limitation applies to costs in obtaining a detailed seismic assessment. ICA is concerned about the government's piecemeal approach to the policy analysis for the financial impacts of seismic strengthening when these costs affect both residential and commercial² owners.

Costs resulting from the issue of a s124 notice impose mandatory compliance costs on owners driven by public good outcomes. This pushes the issue beyond the 'is it a maintenance or capital improvement' debate. The financial and economic impact of the policy decision made through the Building Act 2004 (and being further compounded by the Building (Earthquake prone Buildings) Amendment Bill) requires full policy analysis, not a category by category of property/owner approach.

The extensive construction work involved in seismic strengthening is beyond the scope of regular maintenance as it is driven by periodic changes to the Building Code that are then retrospectively applied to buildings. But the nature of the work is not conducive to regular 'maintenance' given the substantive and invasive impact on the building and occupants. The options to complete the work are not incremental. That is, it is impossible to decide to spend \$x to get to x% of the New Building Standard based on what is affordable and the risk thresholds of the owners.

The options are determined by the building itself and firstly, what is feasible and then secondly, what is affordable for the owner(s). Capital improvement decisions are usually driven by the owner(s) determining how much they are willing to spend to receive a satisfactory return on their investment. The capital value of the building will not reflect the cost of the strengthening in the short to medium term for many buildings. Some strengthening options result in the loss of usable floor space that will reduce the future value in terms of useability and saleability, which does not make it a capital improvement.

Many owners bought prior to the s124 notices being issued and face a significant capital loss due to falling values and reduced sale prices due to likely strengthening costs. These owners will not benefit from capital improvement; at best they will recover some of the lost value.

Many of the buildings in Wellington that have s124 notices have already been strengthened under previous Building Code changes. And the Bill proposes that any future changes to the Building Code could again be retrospectively applied. A cost of a recurring nature (such as replacing a roof) is

¹ Appendix 1 provides background on ICA.

² This includes individuals with rental properties.

generally maintenance. Many buildings being strengthened are well over 50 years, so the building asset cannot be depreciated.

Many owners bought prior to the s124 notices being issued and face a significant capital loss due to falling values and reduced sale prices due to likely strengthening costs. These owners will not benefit from capital improvement; at best they will recover some of the lost value.

The costs of seismic strengthening cover professional fees (engineers, project managements, geotechnical assessments, architects, lawyers), local authority (resource and building consents), construction work, reinstatement work (ie, getting the property back into a useable state once strengthening is completed), alternative residential or business accommodation costs while work is underway. Reinstatement of a perfectly good kitchen is not capital improvement or maintenance but these reinstatement costs are a substantial part of seismic strengthening.

The mandatory seismic strengthening affects residential and commercial owners. Many buildings will have multiple owners of both types. In Wellington, approximately 21% of earthquake prone buildings are residential. Owners of residential and commercial buildings face the same costs. Financial assistance mechanisms or incentives do not have to be the same for the different types of owners, but they need to be equitable. This will not occur in piecemeal approach to the issue.

ICA has lobbied central government through submissions to undertake policy work to address the financial and economic impact of these mandatory compliance costs.³ In March 2014, the Minister for Building and Construction, in response to an OIA for documents on options for financial assistance or incentives for strengthening buildings, advised that 'The issue of financial incentives was raised during consultation and the Government has agreed to look at the matter in more detail. The issue is still under active consideration and decisions have not yet been made'. ICA has submitted a further OIA to obtain this information.

³ Appendix 2 includes an extract of ICAs submission to the Local Government and Environment Select Committee on its interim report on the Building (Earthquake prone buildings) Amendment Bill.

Appendix 1

About the Inner City Association (ICA)

ICA was incorporated as the Wellington Inner City Residents and Business Association in November 2008, and referred to as Inner City Association or ICA. ICA represents residents and businesses in Wellington's inner city. The relevant objects of ICA are to:

- Promote, develop and improve the services and facilities for the residents and businesses and
- Represent the views of residents and businesses to the appropriate authorities.

Many of our members are directly affected by the provisions of this Bill. They either own property in a building that has been issued with a s124 notice (strengthen or demolish) under the current Building Act 2004 or their property falls under the definition of an EQP building and could be affected by any change to the definition of an EQP building (ie, ultimate capacity or moderate earthquake) via regulation in the future.

Appendix 2 – Extract from ICA’s submission to the Local Government and Environment Select Committee on its interim report on the Building (Earthquake prone buildings) Amendment Bill

Financial support mechanisms – an implementation issue

ICA members are not asking for the government to pay the costs; they are asking for assistance mechanisms that enable owners to pay. Some owners cannot pay: cannot obtain a loan or cannot service a loan; have insufficient savings or would have to use retirement savings; cannot sell for a price that would enable them to repay the mortgage owed or buy another property. Bodies Corporate cannot commit to contracts until the funds are available. The option for Bodies Corporate is to force the sale of the units where owners cannot confirm their share of the funds by the required date.

The Government has said there will be ‘... no or little money ... what there is will be for heritage buildings ... owners must maintain their properties’. (Minister for Building and Construction, Morning Report, 12 May 2015).⁴ The government is likely to bear the costs of owners forced to sell through at basement prices or having to use retirement savings through increased demands on other benefits and societal upheaval.

This policy is driven by ‘societal risks concerns’: a public good. The proposal to halve the timeframes for private corridor buildings is to create an additional public good. For other public goods (eg, roading) government pays the market value of the property. For other legislation-created problems (eg, weathertight homes), government has established legislation to share the costs of remediation. For natural disaster and weather-related problems (eg, flooding, droughts), government provides assistance packages.

Yet, for EQP buildings there is nothing. The RIS for the original Bill stated that financial assistance/incentives are out of scope and will be considered separately. When will this happen? The inability to pay is an obvious regulatory impact. The Select Committee requires this information to inform its report to Parliament.

The financial challenges facing members in buildings with s124 notices will expand to buildings that have seismic risk ratings of between 34 and 67% NBS. This is happening now through market pressures and will increasingly be an issue in mixed-use buildings where commercial owners cannot get tenants but residential owners cannot afford to fund the costs.

ICA supports the Property Council of NZ’s position on financial supports.⁵ Any financial support mechanisms must be equitable (but not necessarily the same) for commercial and residential property owners. The media coverage on the financial challenges generally talks about commercial property owners; 21% of the buildings assessed as earthquake-prone in Wellington as at 30 November 2013 are residential or mixed use. Residential owners must comply with the same legislation as commercial owners.

Options for residential and small business owners include:

⁴ ICA understands that the government is restricting funding support to Category 1 heritage buildings, which account for 18% of all Heritage NZ’s listing.

⁵ Proposals include ability to depreciate the cost of strengthening and tax relief to recognise the public goods. These would not be available to residential owners.

- Effective loan arrangements for Bodies Corporate: Government needs to work with the banks to investigate options to allow a Body Corporate to take out long term loans, with agreement of their owners. Such an arrangement could allow owners not able to finance their share directly to contribute through Body Corporate levies that are spread across current and future owners
- ESCROW facilities: ICA and BCCG have already approached the NZ Bankers Association (NZBA) requesting the expansion of the ESCROW arrangement set in place for bodies corporate dealing with weathertightness issues. The NZBA agrees that seismic strengthening projects have the same need and it will investigate the expansion, but has not given a timeframe. Government needs to actively support that work to ensure it proceeds in a timely manner.
- Ability to obtain loans at reduced rates attached to the property, with the repayments collected via the rating system
- Loan guarantee schemes provided by central government, collected via the rating system
- Suspensory loans provided by central government
- Earthquake bonds offered by central government to fund guarantee schemes.

ICA submits that the Government and Parliament must provide financial assistance mechanisms to Bodies Corporate to enable them to progress seismic strengthening projects without having to force owners who are unable to pay, out of their homes and create downstream social impacts. These includes:

- Realistic lending arrangements for Bodies Corporate doing seismic strengthening
- Guaranteed suspensory loans attached to the property collected through rates for owners that cannot fund from other sources
- Consistent escrow arrangements across all banks for seismic strengthening projects.