

Regulatory Impact Assessment

Building Act review: Proposals and options for reform Agency Disclosure Statement

This Regulatory Impact Assessment (RIA) has been prepared by the Department of Building and Housing.

It draws together the high level arguments and the options that have been considered as part of the Building Act review. The recommendations have been made after significant consultation and analysis of options.

The critical success factors for the package are whether the proposed changes actually result in positive changes permeating throughout the industry, including positive behavioural changes amongst consumers, building practitioners and building consent authorities. It is the changes to incentives and the dynamic effects that are important. First principles can be drawn upon to inform possible outcomes, but ongoing monitoring and assessment of behaviours are important. The Department is confident that the proposed package will be beneficial overall, even though there is some uncertainty about scale and timing of the net benefits.

Much important detail is not fully developed at this stage. For example, the accessibility and usefulness of planned improvements to the Building Code are important enablers of other parts of the package. Similarly, the regulations to be promulgated (planned to be in 2012) pertaining to stepped consenting are also important. Making progress in areas such as these will determine the ultimate success of the package. Further, and importantly, there is an interaction between various processes. For example, it is important to make sufficient progress on consumer protection (the consumer package) and the development of understanding of the Building Code prior to the promulgation of regulations regarding stepped consenting.

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Background

The Building Act 2004 was introduced in response to widespread weathertightness failure in the residential housing sector, which resulted from systemic problems including:

- lack of responsibility and accountability for building quality (due to fragmentation, sub-contracting and use of corporate and other tools to avoid risk)
- poorly articulated standards interpreted by poorly skilled regulators
- questions regarding the desirability of competition in the provision of building consent services
- inadequate regulatory oversight by the Building Industry Authority, the then central regulator
- inadequate focus on consumer interests.

The government's response was to tighten regulation of the sector by introducing a series of reforms, notably reinforcing and introducing new input controls, that have progressively been implemented since 2004. Key elements of the reforms included:

- strengthening the role of the central regulator
- reviewing the Building Code, increasing the amount of support of the Code, and providing for bans or particular ways of building in particular circumstances
- ensuring that there is a base of capable (qualified and knowledgeable) people to undertake building design and critical elements of building work and inspection, notably by providing for the licensing of building practitioners and requiring accreditation and audit of building consent authorities
- strengthening the independent scrutiny that plans and construction work receive in the building consent and inspection process
- strengthening support for consumers through mandatory warranty terms implied in all contracts for building work, making builders liable for latent defects in their work (although the reforms did not mandate the means of delivering on warranties).

Key aspects of the 2004 reforms are still being implemented, notably the licensing of building practitioners, accreditation of building consent authorities and the statutory product certification regime. The full impacts of the 2004 reforms are, therefore, yet to be felt. In part due to the reforms, and as a result of changes within the sector, there has been a general improvement in building quality since 2004.

- With regard to weathertightness, there have been significant changes in building design and construction practice such that most new dwellings are constructed with a good prospect of performing well (for example drainage cavities within the external wall are a common feature of new dwelling construction). There have

been few claims through the Weathertight Homes Resolution service for houses built since 2004¹.

- Since 2004, volume builders have increased their market share from around 22% in 1997 to approximately 35% in 2009. While all builders have incentives to ensure quality construction, volume builders have a particularly strong interest in maintaining their brand. Further, most volume builders are members of the Registered Master Builders Federation or the Certified Builders Association, and offer home warranty insurance products that provide limited 'first resort' cover. These insurance products, which have been estimated at covering around one third of residential building work, help to ensure these builders face the economic consequences of poor building work subject to the scope of cover provided.

Nevertheless, there remain significant issues with the economic performance of the system of building controls (described further below), which impacts negatively on productivity in the construction sector, ultimately raising the costs of building work. Because the construction sector is large (representing approximately 4% of GDP) and is an important intermediate input into other sectors of the economy, the economic performance of the sector is important for the performance of the wider economy.

Concerns with the status quo

Information gathered during the course of this review, supported by previous research and analysis, highlights a number of concerns.²

1. Institutional characteristics of the market for building services

While consumer support was emphasised in the Building Act 2004, through a purpose statement and implied warranties, no specific measures were included to assist consumers to understand their rights, enforce their rights, or hold practitioners to account other than through the disputes tribunal (for small claims) and the courts.

Some non-regulatory initiatives have been undertaken since the passage of the Act to strengthen consumer support, notably the provision of consumer guidance and information through, for example, the ConsumerBuild website.

However, consumers continue to face considerable risk and there is a gap between what was intended by Parliament in the 2004 Act and the outcomes that have resulted in practice. This gap is a function of several factors.

- Building is a complex process – it is characterised by a large number of small firms, extensive sub-contracting arrangements, and sometimes ill defined supply chains – and consumers therefore face difficulties in making informed decisions.
- Residential consumers contract infrequently for building work and lack experience in contracting relative to building contractors.

¹ Pricewaterhouse Coopers recently reported that homes constructed after 2005 have a low failure rate of 0.2%, implying less than 150 homes built between 2006 and 2008 are likely to be leaky.

² There is perceived to be an underlying weakness in the skill levels of many building practitioners (e.g. this was commented on in many submissions). This is a problem in terms of effect on building quality and efficiency of the sector – and is a symptom of a policy problem. The policy proposals are designed to mitigate (and ideally eliminate) the policy problems.

- Frequently there is no formal written contract setting out the nature of the agreement and the rights and obligations of each party – many consumers and builders are unaware of implicit warranties.
- It is difficult and costly for consumers to hold practitioners to account – the consumer has little leverage over the practitioner once building work has been paid for.
- There is little incentive for a practitioner to repair defective work or pay compensation, as doing so is costly and practitioners often face little risk of sanction.
- Residential consumers have limited access to timely, cost effective mechanisms to help them resolve disputes.
- Residential consumers have limited knowledge of risks, and limited options for managing their risks through products such as home warranty insurance (although such products are increasingly available).

These issues are exacerbated by the fact that some developers, designers and builders actively manage or mitigate (and in some cases avoid) their risks, for example through the use of ‘development specific’ and ‘limited life’ company structures.

2. *Allocation of risk and responsibility in the market for building services*

A combination of the above factors means that there is an unbalanced allocation of risk and responsibility in practice.

- Residential consumers and building consent authorities bear the brunt of the risk associated with building work that fails to perform, despite having the least control over the quality of that work.
- Building practitioners, on the other hand, are able to manage and mitigate risks through the quality of their work, and in some cases have tools to avoid risks, for example, through the use of limited life companies.
- While building consent authorities face high risk they do not realise any benefits from risk-taking within the context of a building project, thus creating incentives for building consent authorities to be risk averse.

As a result:

- a negative dynamic is created whereby those best placed to manage risk (i.e. building practitioners) are less likely to actively manage it
- incentives for good practitioner performance are relatively weak with potential implications for the rate of defective building work, the costs of the inspection process, and incentives for practitioners to improve skill levels
- risk averse behaviour on the part of building consent authorities, which has been exacerbated by their liability for legacy weathertightness issues, adds direct and indirect costs to the building process which are ultimately borne by consumers
- rates of innovation are likely to be lower because the costs associated with the building control system are higher where new, novel or innovative products, systems or designs are used.

Despite the above problems, the overall conclusion reached by this review is that the building regulatory system is broadly aligned with international best practice and is not 'broken'. Although the system is not missing critical elements, there are weaknesses in certain parts of the system, and the relationship between certain system components is 'out of balance'.

3. *Matching effort with implicit risks*

Current regulatory settings are based on a low tolerance for risk and a strong emphasis on the role of government in protecting home owners from risks of building defects and failures.

There is a heavy reliance placed on the building controls system in protecting consumers from defective building work. This heavy reliance results from a combination of:

- the statutory role played by building consent authorities (i.e. issuing consents, undertaking inspections, and issuing code compliance certificates)
- the duty of care imposed by the courts on local authority building consent authorities in respect of residential homeowners combined with the rule of joint and several liability, which increases building consent authorities' exposure to losses where building work is subsequently found to be defective
- the use of risk avoidance techniques by developers and builders (eg. limited life companies), and
- the fact that local authority building consent authorities are 'deep pockets' backed by the power to rate with limited options to effectively manage that risk.

The heavy reliance on building consent authorities is misplaced because their control over final building quality is limited and because it has a number of perverse effects.

- Building consent authorities take an unduly risk-averse approach to regulatory decision making, which has resulted in a general increase in compliance costs (e.g. documentation requirements, number of inspections etc) and over-regulation of low-risk building work. Common concerns relate to:
 - perceptions that documentation requested to support consent applications is onerous and excessive
 - a large number of on-site inspections that are required in the course of construction, and time wasted arranging inspections and waiting for building officials to complete inspections before work can proceed.
- While around 83% of building consents are issued within statutory timeframes, there is a widespread perception amongst builders and developers that timeframes are not always met, and that there are significant costs associated with delay due to stopping the clock while additional information is sought.
- Innovation is also hampered by this approach because there are lower compliance costs associated with low-risk building designs and building systems that comply with Compliance Documents (acceptable 'stock' solutions rather than alternative 'design-led' solutions). There is also productive-efficiency enhancing innovation, in

the form of standardisation and mass production, which can be hampered by inconsistent interpretations across local authorities.

4. *Implications of a multiple-jurisdiction building control system*

Currently, 75 local authorities process around 70,000 consents per year, representing an average of less than 1,000 per authority. Further, the average annual number of consents processed outside of the metropolitan territorial authorities is considerably lower than this.³

Each authority must be accredited by International Accreditation New Zealand (IANZ), and registered and monitored by the Department of Building and Housing (DBH). Almost all separately establish and manage their own systems and processes, and they compete in the labour market to maintain sufficient capacity and capability to carry out their functions. Each must also meet any costs of litigation. All of these costs are passed on to building consent applicants and recovered through a system of fees and charges, with any shortfall borne by ratepayers.

While efforts have been made to consolidate building consent functions in some areas, overall the pace of consolidation is slow. Given the low volume of consents processed in some centres, and the nationally standardised process involved, there may be significant economies of scale in a more consolidated approach. That is because the consenting and inspection workload at a local level is likely to be lumpier than at a national level. The economics of investing in productivity-enhancing technologies, systems and processes may also improve with scale. These potential efficiencies are being forgone under the status quo.

There are inconsistencies in the interpretation of regulatory requirements across building consent authorities, which can cause frustration to consumers and building practitioners and increase the costs in doing business on a national basis. While in absolute terms the incidence of these costs are relatively low, they are borne disproportionately by individuals and firms that deal in new or novel products, building systems, and designs. This may also result in a potential loss of innovation, by encouraging businesses to rely on acceptable or prescribed means of construction.⁴ Inconsistencies can also be a barrier to increased standardisation, factory production and national-scale operations.

³ Based on data for 2008/09, 17 building consent authorities issued less than 500 consents, 21 building consent authorities issued between 500 and 1,000 consents, and 26 building consent authorities issued between 1,000 and 2,000 consents. Only nine building consent authorities issued more than 2,000 consents.

⁴ Inconsistency was a strong theme in submissions, particularly a lack of clarity in the Act and the Building Code. Some submitters noted a lack of guidance and no provisions for national forms, processes and overall systems, to support consistency.

Problem Definition

The foregoing discussion suggests that the market for building services is characterised by market failure due to:

- limits to and asymmetries of information
- misallocation of risks and responsibilities, and the level of effort undertaken not being commensurate with the level of risk involved, and
- institutional (both private and government institutions) failure to efficiently correct these imperfections.

The combination of these factors means that there is suboptimal competition on quality and price from suppliers, and hence suboptimal consumer welfare. There is, therefore, a prima facie case for intervention.

Objectives

Specific objectives of the package are therefore to:

- ensure that owners can make informed and effective choices in purchasing building work
- ensure that building contractors can efficiently be held to account in practice
- ensure that defects are effectively and efficiently identified, reported and repaired as quickly as possible
- increase the number of owners who obtain financial redress
- assist subsequent owners to hold contractors to account
- improve the efficiency of the building consent and inspection process

Regulatory impact assessment: Key elements of the package

The reform package identified falls into two categories, being:

- provision of a more balanced accountability model with a supporting consumer package (the consumer package), and the
- introduction of a more efficient approach to consenting (a stepped system).

The first of these key elements is needed for the second although the opposite is not true. Ultimately, the package will be successful if the dynamics in the industry adjust and the overall workmanship and professionalism of the industry improves.⁵ The consumer package is pivotal to this. The introduction of a more stepped consenting approach is primarily a streamlining and compliance reduction exercise, although productivity benefits are also expected to ensue.

Further work is planned to explore a preferred approach to achieving improvements in the administration of the building regulatory system, including potentially consolidating or centralising building regulatory functions. The work would be subject to an impact assessment if a decision is made to make changes in this area.

These elements are designed to address (or set in train processes that will address) the problems that have been identified, and contribute to the objectives outlined above.

The material in the Regulatory Impact Assessment is split into 3 sections. Section 1 discusses the consumer package (this deals with consumer support and allocation of risk) while Section 2 discusses other parts of the policy initiative, with most focus being on the streamlining of consents. Section 2 also discusses ongoing work around improvements to the Building Code (Part 2) and possibilities to centralise or consolidate consenting functions (Part 3). These items are not part of the package analysed in this RIS (decisions on these items are not being sought at this stage) but are included for context and completeness. Section 3 draws together the package overall and discusses consultation and implementation issues and the like.

⁵ It is worth noting that submissions suggested near universal concerns about current industry skill levels.

Section One: The consumer package

Options to rebalance risk and responsibility and address weaknesses in the system of residential consumer support

Building consent authorities currently face significant risks associated with building regulatory decision-making but none of the benefits from risk-taking within the context of a building project. As such, they tend to be unduly risk averse. The risk averse approach adopted by building consent authorities manifests as compliance costs in the form of:

- significant documentation requirements and frequent requests for further information
- over-inspection of relatively low-risk work
- a general reluctance to approve novel building designs, systems and products
- slower processing of consents, with consequent indirect costs for consumers

In terms of analysing the issue, options considered, effects, benefits and costs of those options, this section:

- identifies the proposed package (Table 1 below)
- discusses the effects of the proposed approach
- discusses net benefits, costs and impacts of the proposed approach; and
- discusses, at a high level, alternative options and the balance of the package.

The proposed package

The composition of the proposed package is based on a comparison between the elements of the package and options. Department of Building and Housing used the criteria set out above under 'Objectives' to assess alternative options, as well as standard economic criteria including impacts on static and dynamic efficiency. Our comparisons were informed by New Zealand and overseas experience. The proposed package consists of those options expected to provide the highest net benefit.

Table 1: Outline of consumer package

Item	Proposal	Comment
Information provision	Significant initiatives to better inform consumers, including requiring building contractors to give the consumer a published checklist with questions to ask, information on the risks of paying ahead of completion, various parties' legal obligations, dispute resolution options and sources for further advice.	There is no perfect amount of information to provide but, in this case, more is better than less. A high level of understanding is necessary to ensure stakeholders are aware of their rights and responsibilities.
Disclosure and specific information	Mandatory	Disclosure with specific information such as building history is critical to ensuring consumers can make well-informed choices.
Complete written contracts	Mandatory	Written contracts are essential to ensure rights and responsibilities are clear, and disputes can be resolved more promptly and easily than at present. Mandating this is critical to ensuring that written contracts are forthcoming.
Dispute resolution	<p>Mandatory process for dispute resolution set in contract. Make clear that Construction Contracts Act applies to residential building.</p> <p>New conciliation and mediation services to fill gaps to complement existing public and private services.</p>	<p>Research suggests the importance of specific dispute resolution advice (with an emphasis on early resolution).</p> <p>The costs and duplication of effort of developing a specialist tribunal hard to justify. As such, ensuring that parties are made aware of relevant services, and that there are mediation services actually available, is considered most desirable.</p>
Surety	Mandatory disclosure of whether there is surety	A requirement to disclose whether there is mandatory surety will (most likely) lead to increased take-up of surety products, but will also assist consumers in making informed choices. An alternative option of mandating surety is still on the table for consideration (see below).

The package of options is intended to reduce these costs by addressing the underlying cause of this risk aversion including the high exposure of building consent authorities

to financial liability, and improving the performance of the building industry. Relevant changes are:

- clearer contracts between consumers and building contractors with written warranties and an expectation that 'first resort' will be speedy resolution of defective building work by building contractors
- where a building contractor defaults, next resort would flow from the financial backing of warranties through any requirement for private insurance or a surety provider/fidelity fund
- It is also likely that the courts may reinterpret the duty of care owed by building consent authorities to home owners in light of their lesser role and increased provision for disputes to be resolved through contract and warranties
- building consent authorities being involved in fewer consents and inspections and, hence, being a 'lesser party' to building work transactions.

Building consent authorities would still face appropriate incentives to perform their statutory functions well, as they will still be able to be sued in tort for negligence.

Effects of the proposed approach

The proposed approach, and its desired effects, is set out in Table 2 below.

Table 2: Matching desired objectives, proposed measures and desired effects⁶

Objective	Proposed measures	Effects
<i>Ensure that owners can make informed and effective choices</i>	Building contractors to disclose critical information Building contractors to give the owner a simple checklist	Owners can distinguish between building contractors' and practitioners' records Over time, more difficult for poor performers to get work and stay in the market. Leads to improved building quality
<i>Ensure that build contractors can efficiently be held to account in practice</i>	Mandatory written contracts Information on the risks of paying for work ahead of completion Advice on dispute resolution An 'early intervention' dispute resolution service - mediation by telephone or face-to-face	Fewer disputes - as both parties have clear expectations and the same understanding of what has been agreed Disputes that do arise are resolved quickly Less court litigation Stronger incentives on building contractors to perform
<i>Ensure that defects are efficiently and effectively identified, reported and repaired as quickly as possible</i>	New legal remedies available to the owner A new legal obligation for build contractor to fix any defects within 12 months after completion Reciprocal obligations on owners Guidance to help owners, build contractors and adjudicators to understand the new remedies and obligations	Defects are identified quickly Builders are not accountable, where the owner caused (or contributed to) the problem Early defects (within 12 months) are fixed promptly Latent defects are more likely to be remedied by the building contractor The extent of damage (resulting from building defects) is lower The costs of repair are lower
<i>Increase the number of owners who obtain financial redress</i>	Disclosure by building contractor of whether financial backing is available (such as a guarantee or insurance) An appropriate regulatory framework for guarantee products and services	A greater number of owners purchase a guarantee or insurance product More owners obtain financial compensation when there is a defect and the building contractor defaults The choice of products in the market increases over time Owners can make an informed choice among

⁶ If these objectives are met then the overall result should be improved buildings. The incidence of the last of the objectives (managing defects, financial redress and assisting subsequent owners) should not be frequent.

		guarantee or insurance products, and owners are protected from purchasing unsound guarantee products
<i>Assist subsequent owners to hold contractors to account</i>	Ensure that critical information is available to subsequent owners on the Land Information Memorandum	Subsequent owners are protected Accountability is reinforced

Net benefits and costs, and the impacts of the package on key parties

Although the package is perceived to be beneficial overall, there are clear benefits and costs on various parties (and uncertainties implicit). These are discussed below, along with impacts.

Benefits and impacts - consumers

The package is intended to better equip consumers to recognise risks associated with building work and to take responsibility for the decisions they make to contract for building work, while simultaneously strengthening mechanisms for their protection.

The benefits to consumers are expected to include:

- Consumers will be better supported, and face stronger incentives, to make informed decisions about building work and to properly contract for that work
- The provision of explicit warranties in building contracts will make consumers more aware of their rights and obligations, better able to seek remedy for warranted defects, and will make consumers more aware of legal remedies
- Access to a more effective dispute resolution service would further enable consumers to enforce a producer's obligation to perform warranty service and thereby support prompt remedy of defect, as well as providing an efficient mechanism for resolving disputes outside the scope of the warranty
- Any provision for surety arrangements as a financial backstop would cover the risks of non-performance of the producer's warranty service obligations
- Better decision making by consumers, since possible limits on warranties and reduced recourse to councils when things go wrong will incentivise a more careful selection of building practitioners and, potentially, greater use of agents who are qualified to manage risk on their behalf.⁷

Stronger consumer supports are expected to strengthen building practitioners' incentives to perform work right first time and to quickly remedy defective work without cost to the consumer. If a building practitioner defaults on those obligations, or dies,

⁷ There are likely to be limitations on surety products, as there are with all surety products. Possible limitations may involve time as well as scope limitations. Having said that, the consumer package is intended to raise awareness and increase demand for surety which in turn is likely to contribute to development of this market in terms of both providers and the products on offer.

disappears or becomes insolvent, the strengthened mechanisms provide more effective and efficient means of remedy for consumers.

These benefits will involve some additional costs in the short-run, as warranties, dispute resolution mechanisms, and surety arrangements all involve costs. The net impact of the package on consumers depends on the interaction of a number of factors including:

- The reduction in compliance costs associated with simplifying, streamlining and consolidation the building controls system
- The extent to which building producers take responsibility for the quality of their work, including promptly fixing defective work under warranty without cost to the consumer
- The cost of purchasing warranties and obtaining surety backing
- The costs associated with dispute resolution where necessary

Benefits and Impacts - building professionals and trades people

The package of options would be expected to result in building professionals and trades people facing greater risk overall (than at present). This is efficient since they are best placed to manage the risk that building work fails to perform and they have a range of options for managing those risks.

As a consequence of facing greater risk, we would expect building professionals and trades people (and insurers and surety providers) to react cautiously, and it is expected there may be up front increases in costs to consumers with medium to long term benefits from improved quality and performance by building producers.

Over time we would expect building professionals and trades people to adapt to the changed conditions by:

- taking a risk-based view about what work they undertake to do, taking into account their knowledge and level of competency
- a stronger focus on their contracting practice, both with consumers and suppliers (e.g. sub-contractors)
- More explicit recognition of the costs of standing behind their work, and pricing accordingly
- investing in their own professional development to extend their scope of work and overall level of competence

It is likely that the changes will affect different classes of building professionals and trades people in different ways. One class that will be particularly impacted is licensed building practitioners. Many of the reform options will either only apply where licensed building practitioners are involved (e.g. streamlining consent processes where simple buildings are involved) or may advantage licensed building practitioners over non-licensed practitioners (e.g. where licensed building practitioner status results in lower surety premiums). The package of changes is therefore expected to further encourage

the take-up of licensing. Greater uptake of licensing would have additional benefits including:

- preventing and discouraging insufficiently skilled practitioners from carrying out critical building work without adequate supervision
- sharpening incentives to put work right if it is not done correctly
- strengthening incentives to upgrade and maintain knowledge and skills
- creating better conditions for improvements in building quality and labour productivity
- improving signalling of builder quality in the market for building practitioners.

Ultimately, the building stock of New Zealand will be improved by an improvement in the dynamics within the building industry.

Anecdotally, the building control system deters and raises the costs of innovation and risk-taking in the building sector, although gathering hard evidence on this is difficult. Innovation is a key means of improving welfare, whether through improving building quality or the introduction of productivity-enhancing new building designs, systems and techniques. It is difficult to estimate the impacts of changes on the rate of innovation, but theoretically, by better allocating risk and responsibility to those best placed to manage it, overall rates of innovation should increase.⁸

The package is designed to increase incentives for building professionals and trades people to upgrade and maintain the relevance of their skills. This is critical since the overall skill level of the workforce is central to the achievement of the ultimate goal of the reforms, namely to reduce the costs of the building regulatory system without compromising quality.

Benefits and impacts - building consent authorities

The package of options is intended to reduce the reliance on building consent authorities in the building regulatory system and, by reducing their exposure to liability in the event of building failure, enable them to take a less risk-averse approach in performing their statutory functions. This is expected to improve the efficiency and quality of regulatory decision making, while ensuring building consent authorities continue to face appropriate incentives to perform their statutory role well.

Costs and uncertainties

The package of options to rebalance risk and responsibility and address weaknesses in the system of residential consumer support will result in costs as well as benefits.

⁸ Innovation in building can refer to the types of materials used, or alternatively, to the ways in which buildings are designed. It also has a productivity element in that builders innovate to build quality product more efficiently. It is possible that there is some move towards conservatism in regard to things like types of building materials as some practitioners seek to reduce their risk exposure. While this may result in some lack of innovation around building products, this is not necessarily a bad thing.

- Requirements for written contracts between consumers and building producers for residential building work, and producer disclosure requirements, will impose compliance costs – even though it is expected that standard contracts and disclosures will become common and will be incorporated into standard business practice. The costs to individual consumers and building producers are therefore expected to be insignificant, although there will be one-off and transition costs associated with these changes.
- The clearer legal remedies proposed are designed to motivate contractors to repair defective work and to produce higher quality work in the first place. The result could be an increase in costs to affected producers, a decrease in costs to affected consumers
- There should be a decrease in overall system costs (because the remedies will reinforce incentives for good building quality and performance, and because defects will be repaired more quickly), even though there is an increase in initial costs faced by consumers (as producers pass on costs of surety products etc).
- While consumers will have increased information available to them, there will be increased costs – including compliance costs – on consumers.
- There will also be costs associated with the implementation of regulation of private surety funds, the operation of an alternative dispute resolution service, and providing consumer education and information.
- To the extent that a new dispute resolution service makes it easier for consumers to seek remedies for defective work, the direct costs associated with such disputes may increase.
- Costs will be involved in providing more clarity and guidance in becoming familiar with changes in systems and regulatory tools.

A key cost – were it to eventuate – would be if the building sector were to adopt particularly risk-averse building practices, and / or, if there were to be significant and unproductive changes to the industry as a result. It is not clear that this will be the case; the building industry is already exposed to risk and liability and while the package proposed includes some re-balancing of the risks and accountabilities, much of the package merely formalises existing practices. As such, it is not clear that there will be large and unintended consequences – but it does mean that monitoring programmes are important.

There is an element of uncertainty about whether all of the benefits and costs that have been estimated (and discussed) will materialise. As noted, the key issue is the dynamic that is created, and it is not possible to fully predict how different groups will react in the face of changes to their operating environment. Having said this, officials are confident that the proposed package will result in an improved set of incentives at the very minimum.

It is also worth noting that some of the benefits that were anticipated earlier in the process are now somewhat smaller due to changes in the proposals as a result of feedback from consultation etc. This is most obvious in the area of stepped

consenting where – upon further analysis – the proportion of building activity that is proposed to be classed as “simple” is smaller than previously anticipated.

Alternative options and the balance of the package

The consumer package essentially consists of a balance of information provision, mandating certain practices and information sharing, facilitating more effective dispute resolution, and ensuring better contracting procedures. It is a package with various elements designed to work together to achieve the desired result.

It would be possible to construct a package with less onerous contracting and disclosure requirements around both the ‘history’ of the building contractor, and the surety involved (more of a ‘tweak to’ than an ‘enhancement of’ the status quo).

Such an approach is not favoured. The requirement for written contracts to be in place – with strong disclosure provisions – is seen as a key element in ensuring that the right incentives are in place for the behavioural changes in the construction industry to occur. It is also seen as being an important plank in ensuring that consumers make better choices.⁹ Mandatory written contracts – with disclosure provisions – are unlikely to occur in all cases in the absence of a regulatory requirement.

Alternatively, it would be possible to design a package that is tougher (i.e. a stronger regulatory intervention). Such a package would imply a change to the joint and several liability framework to a proportional liability framework, combined (most likely) with a move to mandatory surety.¹⁰ At this stage, this approach is not favoured.

Mandatory surety was considered in some detail and significant costs and risks were identified including:

- likely increases in the upfront direct costs of building in the order of 1% of the total cost of building
- risks of provider failure, as evidenced by recent experience of insurer failure as well as providers exiting the market for home warranty insurance in Australia
- the potential to erect barriers to entry, which would potentially come at a high economic cost because of the need for industry capacity to respond to changes in demand
- risks of curbing innovation in the sector, as surety providers may take very cautious approach when writing and pricing surety products
- risks that surety providers may act as de facto regulators of builder competence and building quality, overlapping with the role of building consent authorities and licensing boards.

⁹ It is worth noting that in the case of areas that potentially have a high cost to the Crown and wider economy (dispute resolution and surety), the package proposes a ‘middle way’ rather than the strongest possible intervention.

¹⁰ Currently, approximately 50% of new builds are covered by the surety products available in the market. It is likely that proportion will increase assuming the proposed policy changes are promulgated.

In addition, certain critical precursors to full market provision of surety are not in place:

- comprehensive licensing of building practitioners
- a building regulatory environment that continues to change, increasing uncertainty for potential product providers
- the absence of good data on practitioner competence and building quality, making it difficult for surety providers to design and price product, and
- the absence of an effective framework for prudential and market conduct regulation for surety products.

Officials have also considered arguments for shifting to proportionate liability, which would be a major change to the liability framework. While not without benefit, it would also have drawbacks including likely requiring mandatory surety (see Box 1 below).

In terms of the final element of Table 1, the provision of information, there is no 'perfect amount', although a significant effort is warranted. It is important that there is sufficient funding to ensure that all parties involved have a clear understanding of their respective rights and obligations (noting that it is not practicable, for example, to ensure every consumer is fully informed).

Box 1: Joint and Several vs Proportionate Liability

Under joint and several liability all of the parties who contribute to any given building defect through their negligence are jointly and severally liable to the plaintiff for the costs of the defect. When more than one party has contributed to the defect, the costs of the defect are initially apportioned taking into account the role each party played in contributing to the damage.

In the event that one or more of the negligent parties is unable to meet its share of the costs, these costs are apportioned between the remaining parties. Some parties, such as local authorities, can become 'deep pockets' when other parties cannot be held to account, because of their key roles in building work and their strong capital positions or (in the case of local authorities) because of their statutory presence and power to rate. In practice in weathertightness cases, this has seen local authorities carrying between 40 and 70 percent of the total cost of settlements. It has also seen other parties pursued and found liable for amounts that they perceive as out of proportion to their actions.

The following comments were received through submissions concerning the operation of joint and several liability:

- i) That it is incompatible with the general principle that each party should be accountable for what it does
- ii) That it is contributing to high costs and restricted supply of professional indemnity insurance that professions and others consider critical to managing their risks if they are to be held accountable. This is because a person with professional indemnity insurance can become a 'deep pocket'; in the event that other parties have ceased to trade
- iii) That it is creating perverse incentives for building professions, contractors and trades to structure their affairs and operate in ways that minimise their exposure to the costs of joint and several liability, by for instance the use of project specific companies or by limiting the scope of their roles and exposure to building work, and that these practices are not to the general benefit of consumers
- iv) That it is contributing to defensive and risk averse behaviour by local authorities, because they are deep pockets, that is resulting in more inspections and greater compliance costs than are necessary.

The issue in replacing joint and several liability with proportionate liability is that while there can be greater certainty for designers, builders, regulators and others involved in building work, there is less certainty and potentially greater costs for consumers when things go wrong. In Australia, home warranty insurance has been mandated as the states changed from joint and several to proportionate liability. Recent experience with mandatory insurance in Australia indicates that mandatory home warranty insurance is expensive and that direct government underwriting or provision can be necessary to ensure continued supply.

Section Two: Streamlining consent procedures, setting clear rules and expectations (improving the Building Code) and improvements to the effectiveness and efficiency of how the system is administered

Part 1: Streamlining consent procedures

The proposals are to exempt some building work from consenting and inspections completely – through the addition of particular building activities to Schedule 1 - and to introduce a stepped risk-based system that would see consenting and inspection effort by building consent authorities more tightly focussed on that building work where the greatest risk exists.

The key elements of the proposed stepped consenting system involve:

- no building consent requirements for a broader range of the most low-risk work with consequential benefits in terms of reduced compliance costs
- a streamlined building consenting process for some low-risk work that checks that certain conditions are met (for example the work is undertaken by a licensed building practitioner) but involves almost automatic consent and no inspections
- a simplified and more prescribed consenting process for certain simple residential building work at the lower-risk end of the spectrum (e.g. simple single-storey buildings with low structural and weathertightness risks), putting more reliance on the skills and experience of licensed building practitioners but retaining some limited involvement of building consent authorities in compliance checking
- existing consenting and inspection requirements for moderate- to high-risk residential building work, and for lower-risk building work not involving a suitably qualified building practitioner, until such time that it is clear that regulatory oversight could be further reduced without compromising quality, and
- new building consenting processes and requirements for commercial buildings, to provide for reliance on third-party (non-building consent authority) review and quality assurance processes as an alternative to the current consenting and inspection requirements provided certain conditions are met.

Increasing the scope of exempt building work, through Schedule 1, is (very) conservatively expected to reduce consenting volumes by approximately 5%.¹¹ Streamlining the consenting process for non-Schedule 1 simple buildings is also expected to generate a significant reduction in the consenting and inspections workload of building consent authorities.¹²

¹¹ Schedule 1 refers to construction of relatively basic structures for example carports and low decks).

¹² It is not entirely clear how many buildings will fall into each category. It is estimated that of the 70,000 building consents issued annually for works of more than \$5,000; 3,000 fall into Schedule 1, 20,000 are simple buildings, 16,500 are commercial buildings, and 30,500 fall into the other category. There are also approximately 20,000 consents issued per year for work of less than \$5,000. These will predominantly fall into either the simple building category or Schedule 1.

A reduction in consents and inspections not only reduces the direct costs of building work, in the form of reduced fees and charges, but also reduces the indirect compliance costs associated with time delays caused by the consenting and inspection process. Modelling by NZIER suggests that introducing an accelerated and more streamlined consenting process for simple buildings would generate large savings for consumers (approximately \$118m per annum once streamlining of consents is fully implemented).¹³ While there are benefits in terms of administrative efficiency, the bulk of the savings would come from reduced time delays and associated 'deadweight costs' incurred by households. These deadweight costs include home owners having to rearrange their affairs while building work is completed (e.g. rent alternative accommodation) as well as holding costs.

Reducing consenting and inspection workloads has knock-on effects for building consent authorities. One likely impact of the proposed streamlined consent processes is that building consent authorities will focus principally on higher risk work, where the consent and inspection system currently adds most value. By specialising in this work, the quality of regulatory decision-making would be expected to increase, and there may be further gains in administrative efficiency as a result.

Proposals to develop a streamlined consenting process for commercial buildings could further reduce consenting volumes for high value projects, although any gains in administrative efficiency are expected to be minor as this building work represents a low proportion of consents, and most building consent authorities contract out third-party review functions because of the complexities and specialised skills involved.

The proposals to require an up-front risk assessment of the development for commercial buildings, leading to a quality assurance plan agreed by the building consent authority and the owner, are designed to support and facilitate effective business practice. For many owners and developers, there will be little change from the present; the commercial risk currently lies with developers and owners so they currently have incentives to ensure that quality assurance systems for building construction are appropriate. There is no evidence of systematic poor performance in this sector. The proposals to allow building consent authority checks to use independent third parties around the implementation of agreed quality assurance plans are essentially a formalisation of existing practice.

A consequential impact of the reduction in workload and the associated building fees and charges is that some building consent authorities may need to reduce their building inspection workforce. As a result, the changes will not result in building consent authorities having surplus capacity. Further, it is possible building consent authority revenue may decline by proportionately more than the reduction in consenting and inspection volumes, since there is a fixed cost element to building consent authority cost structures.¹⁴ Consequential increases in building consent fees for the 'other' category building work, and other building controls work that remains with the building consent authorities, may therefore occur following the changes.

¹³ See www.dbh.govt.nz for details.

¹⁴ The building consent and inspection fees on low value work tend to represent a higher proportion of the value of work than the fees on higher value work.

Significant reductions in consenting volumes are likely to raise questions about the viability of the current distribution of building control functions across 75 local authority building consent authorities. Each building consent authority incurs fixed costs associated with accreditation, registration and monitoring by Department of Building and Housing and the maintenance of their own systems and processes. Further, the small scale of building consent authorities mean there may be savings associated with alternative institutional arrangements for building control administration.

Other compliance costs associated with the fragmentation of building control functions relate to inconsistent decision-making across building consent authorities. This increases transaction costs for producers operating across multiple jurisdictions (e.g. national operators) particularly where novel designs, building systems or products are involved. In particular, manufacturers and distributors of certain types of building products incur significant costs because of the need to 'educate' each building consent authority about their product's scope of use and its relationship to the requirements of the Building Code. There are potentially significant reductions in compliance costs associated with a more nationally consistent approach. The ongoing work around possible consolidation and centralisation of building regulation is important in this regard. This is discussed later in this document.

A number of the options are designed to clarify the purpose of building regulation, improve the specificity of building performance standards and their presentation (e.g. around building types), and improve accessibility to the Building Code, Compliance Documents, Standards and other supporting information. These changes will benefit both producers and building officials and are expected to reduce transaction costs associated with establishing Code compliance. These benefits have not been quantified.

The package of options to simplify, streamline and consolidate the system of building controls is expected to have economic benefits beyond the saving in compliance costs. Many of these wider benefits are dependent on the interactions between elements of the whole package, including those elements relating to the rebalancing of risk and responsibility, and the strengthening of consumer supports.

The key to ensuring that reduced inspections and consenting processes do not result in decreases in building quality in Schedule 1 and simple building projects is the effectiveness of the consumer package, and in particular, the effectiveness of the contracting and disclosure arrangements. In addition to the consumer package, and in order to minimise risk, it is proposed that building work for the vast majority of these projects can only be carried out by licensed building practitioners (LBPs).¹⁵ A key element in the reduction of associated risks is to ensure that the regulations pertaining

¹⁵ A significant process has been underway for some time to ensure that building practitioners are appropriately licensed. There is a move to making the scheme – the Licensed Building Practitioners (LBP) Scheme – qualification based (it is currently competency based). There is also an accountability element implicit via a complaints procedure. See <http://www.dbh.govt.nz/lbp> for information on Licensed Building Practitioners.

to the streamlining of consents are not promulgated until sufficient progress has been made with other elements of the package.¹⁶

Judgements and Options

The key judgements, and options considered are not around the conceptual underpinnings of these proposals, but rather around the balances implicit. One option that was considered was to increase the types of building activities added to Schedule 1, albeit that some of the buildings may have some conditions attached (i.e. that the work must be undertaken by a licensed building practitioner). Essentially, the ultimate recommendation to require at least a level of consenting (albeit with lower levels of inspections than present) on most building activities reflects a judgement around the risks implicit.

As alluded to above, the important future judgement in this area will be around the promulgation of the regulations that essentially 'turns on' the stepped consenting regime. It would not be appropriate to press on with stepped consenting until the appropriate pre-requisites have been met. While this may reduce some of the possible efficiency benefits discussed in this document (especially those quantified by NZIER), it would be the appropriate course of action so that there are not undue risks on building quantity going forward.

Benefits and Costs

In addition to the benefits discussed above, there are costs associated with further development of the package of options, consultation on those options, and their implementation. Some or all of these costs would be passed on to consumers, and may fall disproportionately on those consumers who undertake higher risk building work. However, the overall reduction in compliance costs is expected to more than offset these costs. Overall the greatest benefits are likely to be realised by those classes of consumers that are currently facing the highest risks and costs of defects and disputes.

Many of the costs and benefits have been quantified. This is set out in Table 3 below (where quantification has not been possible, some comment has been made). The quantified benefits easily outweigh the quantified costs but, as noted above, will only accrue if stepped consenting is 'turned on' – and stepped consenting should only be turned on if the risks associated with stepped consenting can be appropriately managed.

¹⁶ The recommended report to the Minister of Building and Housing that will comment on progress around developing a better understanding of the Building Code, greater practitioner competence, improved consumer support arrangement, and an effective monitoring regime to ensure building quality is maintained or improved is pivotal in this regard. Essentially, these factors are pre-requisites to promulgation of the stepped consenting regime.

Table 3: Benefits and costs of stepped consenting

	Implementation costs	Ongoing costs (\$m/yr)	Benefits (\$m/yr)	Comment
Schedule 1 consenting changes				
Time savings (owner benefits)			\$1.3 m (time savings)	Estimated by NZIER
Consent fee and inspection fee savings (owner benefits). Assumed that owners still face costs of lodging.		\$0.1 m (enforcement increase)	\$1.4 m (reduced consent fees) \$0.7 m (reduced inspection fees)	Possible costs of smaller Building Consent Authorities running unsustainable units. E.g. higher consent fees elsewhere or increase in rates.
Targeted residential consenting (simple buildings)				
Time savings			\$118 m (time savings)	Estimated by NZIER
Reduced fees	\$1.15 m (Building consent authority restructuring costs)		\$4.4 - \$7.1m ¹⁷	May take time to realise savings as restructuring and information costs will need to be recovered
Reduced inspections	\$5.4 m (Building consent authority system changes)		\$7.0 - \$11.3m	
Reallocation of responsibility	\$5 m (Sector spending time learning about code, adjusting to new responsibilities etc)	Ongoing skills maintenance – costs already part of occupational regimes.		Although it is intended that there is an increase in building quality ¹⁸ , it is possible there is some reduction in building quality in short term for non-critical work
Homeowners		\$0.1 - \$0.3 m (private building inspections) ¹⁹		
Monitoring system for	\$0.7 m	\$0.6 m	Better building quality	

¹⁷ Fees for smaller building consent authorities areas may not reduce as overheads could be spread over smaller numbers of consents. Indeed, it has been noted through analysis of submissions that territorial authorities (TAs) would have fewer building consent authority staff (with less work and little revenue stream from simple work). Some may find it hard to maintain a viable building consent authority team without increased costs to remaining consent applicants or rates/other subsidy. Territorial authorities would spend more time answering enquiries around what is exempt work, about whether work been carried out under an exemption, who is a licensed building practitioner, what to do when things are going wrong etc. Much of this additional work would be funded out of rates, not consents, unless an alternative is devised.

¹⁸ From increase in knowledge (from implementation training) and from sector wanting to minimise their own liability from risk of failure for work not checked by Building consent authority.

¹⁹ Some homeowners may choose private inspections because of reduced building consent authority role.

targeted consenting			outcomes from targeted interventions. Early warning system to detect failures ²⁰ .	
Department of Building and Housing implementation costs (guidance, roadshows, education Licensed Building Practitioners)	\$1.0 m			
Complex commercial building work				
Building owners	Cost of developing quality assurance system if not one already ²¹	Increase in peer review costs (transfer from regulator to building contractor). Risk profile development	Improvement in building quality outcomes. Better commercial outcomes. Significant reduction in level of rework. Reduced regulator costs.	

²⁰ This monitoring regime does not include systems to detect systemic failure. It solely examines whether targeted consenting is working as expected and if the policy settings (e.g. scope and nature of checks) are needed.

²¹ Research shows significant commercial benefits from a quality assurance system, such as significant reductions in rework and on time delivery. An Australian study showed the failure (rework costs) changed from 10 to 2% of project cost representing an economic savings of 7 percent.

Part 2: Setting clear rules and expectations (improving the Building Code)

Submissions to the Building Act review and other feedback show that, while the framework supporting the Building Code (the Code) is conceptually sound and in accordance with international best practice, building professionals, trades people, and building consent authorities sometimes have difficulty accessing and understanding the Code and other documents that make up the Code framework. A separate RIS would be needed if any of these options were to be pursued.

Significant work is underway (and proposed to continue) to improve the specification of parts of the Code, especially where performance requirements are unclear. This is designed to reduce the costs of design and improve efficiency of the interface between building professionals, building consent authorities and other parties (e.g., Fire Service Commission Design Review Unit).

The work will include:

- investigating the feasibility of establishing an expert advisory service to provide advice about Code compliance where it is unclear whether an innovative design meets Code performance requirements
- developing an education programme for building practitioners, working with existing education providers to address knowledge gaps and to ensure that more resources are devoted to education.
- developing protocols and guidance to improve the interface between the building regulatory system and the New Zealand Standards system
- developing a detailed business case with options for the integration of the information contained in the various documents, including New Zealand Standards, that make up the Code system so that it can be accessed, or sorted, according to building type, location and/or the different parties involved in the building process; this will include options for making better use of information technology and will be integrated with the work on consolidating the administration of building regulatory requirements.

It is anticipated that improved clarity and accessibility of the Code and related documents will improve compliance with the Code and reduce costs for building practitioners. It should also aid the development of a more consistent approach nationally.

Improved specification of, and accessibility to the Code is a fundamental prerequisite for an effective and efficient performance-based regulation. It is anticipated that the benefits, especially in problem areas such as fire, will outweigh the costs involved.²² Accessibility to the Code is an important enabler of the benefits of other aspects of the reforms, particularly the stepped consenting system.

²² This has not been quantified.

Part 3: Improvements to the effectiveness and efficiency of how the system is administered

The proposal is to seek agreement on the attributes of a nationally consistent and administratively efficient building regulatory system that would then provide the basis for further work on a preferred approach to improving the performance of the building regulatory system. As such, no regulatory policy decisions are currently sought and the following analysis of costs, benefits and risks is preliminary only.

Officials have developed and explored two options for improving building regulatory system administration, for the purposes of testing at a high level whether or not the benefits of administrative reform would justify the costs and risks of achieving it.

Two specific options²³ were considered in some depth:

- a regionalised option – that would result in the establishment of a small number of regional hubs that would provide management and back office support for the local delivery of building consent inspection and enforcement services, and
- a centralised option – that would result in delivery of building consent functions by a single national entity supported by its own regional service centres. This option would see central government assuming greater responsibility. It would require the development of a national consenting capability, which would be supported by regional processing centres, along with national specialisation for specific consenting categories or issues such as those involved with complex commercial buildings.

Both options are enabled by developments in, and reductions in the cost of information technology. Both options would retain and build on the current national regulatory functions performed by the Department of Building and Housing.

The options analysis confirms there both options have the potential to generate significant savings and productivity improvements and would:

- improve the consistency of consumer experience and the quality of decision-making
- reduce costs of consent production by an estimated 40%
- achieve estimated consumer benefits and operational savings around \$250m over five years (i.e. one years total operating costs every five years)
- decrease the costs of building consent and inspection services for consumers
- translate to time and money savings that reduce drag on sector productivity.

²³ The Building Act Review Discussion Document (February 2010) mentioned that “this work will consider a wide range of alternative arrangements, including clustering options that could, for example, see building consent authorities operating on a regional rather than district basis, providing building control functions across several territorial authority districts. It will also explore the costs and benefits of greater consolidation of building consent functions nationally and the scope for private provision of building regulatory services.”

Both options would require central government investment, as well as leadership, legislative change, and coordination of the development of a national system. Both options have associated impacts and risks. In particular, local government operations would potentially be significantly impacted, particularly under the centralised option. Both options would involve financial impacts on local government. Change may also affect how local authorities operate associated functions such as resource management consenting. There is a risk, largely controllable through the approach to implementation, that this proposal could result in a less customer-centric approach to the overall development (land and building) process.

Section 3: Risks, conclusions and related matters

Risks of the overall package

The overall dynamic effects of the package are based on assumptions that the package will result in significant changes in behaviour by consumers, building practitioners and building consent authorities. In short, residential consumers and building practitioners will take more responsibility for their roles in the building process, and less reliance will be played on the system of building controls to manage and safeguard quality in the building process. The package also introduces a greater role for insurers and surety providers in the identification and management of risk, which is expected to significantly alter the dynamics in the sector around risk management.

One risk of the package is that practitioners and their backers, faced by greater exposure to risk and liability, may adopt a very conservative approach. In effect, the highly risk averse approach taken by building consent authorities may transfer to other parties in the system. The design of warranties and any surety arrangements, and striking the right balance in the overall package, is key to ensuring the costs of the package do not outweigh the benefits.

A further risk of the package is its potential to raise barriers to entry and/or raise the costs of participating in industry. In particular, there are concerns about how new entrants to the industry, small operators, and DIYers will be affected by the changes. It is possible that certain classes of people may be 'priced out' of the industry, which can be seen as both beneficial (e.g. for practitioners whose skills are not sufficient for the work they are doing) and costly (e.g. if this impedes the ability of the industry to respond to increases in demand). The ability of the construction sector to expand in response to increases in demand is an important factor in the overall supply-side responsiveness of the housing market, with implications for the cost of building and housing affordability. Of course, even though times may be 'good' in the construction sector at any given moment, there is no reason to drop building standards.

One specific risk in this regard relates to the way in which the structure of the building sector evolves. Currently, the building sector is predominantly made up of sole traders and small and medium enterprises (SMEs). If there were to be a significant number of SMEs drop out of business – and transfer to larger firms (and if those larger firms were to be more expensive for little/no added value) – then the reforms would not be beneficial overall.

It is not clear that this will be the case however. While there will be some increased costs, to a large extent the changes proposed are an attempt to codify – and make mandatory – practices that are occurring in many cases at present. For many of the better building practitioners, the changes to operating practices to comply with the proposed reforms are likely to be relatively small. There are good reasons, around specialisation of skills, why the existing industry structure has evolved.

Many of the changes to simplify and streamline the consenting process assume that there will be a sufficient supply of competent practitioners to access the new

processes, and that these practitioners will have sufficient incentives and abilities to ensure work is performed to a high level. In other words, the changes rely on the entry requirements for the Licensed Building Practitioner Scheme being sufficient to ensure licensed building practitioners have the skills necessary to perform simple building work with a lesser degree of third party review, while not being so onerous that there is an insufficient supply of licensed building practitioners when the restricted work scheme comes into effect. If these assumptions are incorrect, then there are risks that the benefits of streamlining will be overstated. The interface between the licensed building practitioner scheme and other package elements will be a key focus in monitoring initiatives, and potentially, in future policy development work.

Consultation

A Sector Reference Group and Sector Working Groups made up of members of the building industry, local authorities and consumer advocates have provided strategic and operational input into the review, ensuring that the sector's issues and concerns are addressed by the options under consideration, and that the Department's analysis is robust when viewed from the sector's perspective. The Sector Reference Group has provided input into regulatory impacts of the options.

An Officials Reference Group has been consulted throughout the review process and have seen and commented on drafts of this assessment. Relevant departments have been consulted on the Cabinet paper developments.

Further to this, the Department of Building and Housing analysed the 381 submissions that were received on the Building Act review discussion document (February 2010), as well as the comments received through the public meetings (approximately 1000 people attended meetings around the country to discuss the proposals). Significant differences exist between the proposals set out in the discussion document and those currently proposed, particularly in the areas of moving towards more a stepped consenting approach (both Schedule 1 and simple building work).²⁴ This is as a result of submissions received, ongoing discussions with the Sector Reference Group, and further analysis that was undertaken. A submissions summary is to be published.

Key findings from the consultation exercise are as follows:

- i) there are gaps in designers and builders knowledge and understanding of the minimum requirements set out in the Building Code
- ii) designers, builders, consumers and building consent authorities are not always clear on who is accountable for meeting Building Code requirements and what they can rely on others for. For instance, many designers believe that they should be able to rely on builders to construct their designs to meet Building Code requirements without the designer needing to specify all of the necessary detail, while many builders do not believe they need to know relevant Building Code clauses. Both believe that they can rely on

²⁴ The changes have essentially added more checks and balances to, and reduced the scope of, the previous proposals in order to reduce risks implicit.

building consent authorities to identify and correct inadequacies in their work

- iii) there is a heavy reliance, especially since the weathertightness crisis, on building consent authorities by consumers, designers and builders to provide quality assurance and to ultimately underwrite the quality of residential building work when things go wrong.
- iv) designers and builders are unwilling to accept accountability for the quality of their work if it means them being exposed to all of the costs of building defects (including those attributable to any other parties that cannot be brought to account)
- v) there are gaps and weaknesses in the measures in place to support consumers in their purchase of building work, to resolve disagreements or disputes with building contractors, and to hold building contractors to account for the quality of their building work; and
- vi) skill deficits are a major concern for many people, across all areas (building consent authorities, designers and builders, and consumers), and are a constraint on reducing the role of building consent authorities.

Conclusions and recommendations

Officials are of the view that the overall direction and balance of the package is sound. The package is quite nuanced, particularly the consumer package. Significant consideration has been given to ensuring that the correct incentives are created on the various players in the sector. It will be important to ensure that industry progress is sufficiently monitored as it is not possible to be entirely confident as to the way in which a complex industry will react in the face of changes to the regulatory system.

The package will take time to bed in, and the benefits are likely to accrue gradually. It will take time to develop the strength of the sector, and a strong and vibrant building sector lies at the heart of a highly-performing industry.

In particular, the package of measures is crucially dependent on the nature of the dynamics that develop, and the extent to which the proposed package leads to positive innovation. There is a risk that some players react in a very risk-averse manner, and that opportunities for improvement are lost.

The specific dynamics in the industry that are most important relate to the response of the building industry to the changes. The package is intended to incentivise poorer performers to improve their game, or if this is not possible, to, at the extreme, exit the industry. Additional costs will be created in terms of an increased reliance on surety products etc, and the balance of these costs have to be weighed against the benefits to be gained.

There are judgements around the margin of the policy, and future decisions – and the extent to which implementation challenges are met – will influence the effectiveness of the policy. Officials are of the view that the overall benefits outweigh the costs when compared to alternatives. While there can be debate around the margins of the policy proposed – and there are important decisions to come, the policy package is superior to others available.

Implementation

A key part of the implementation of the package (in addition to proposed legislative changes) relates to the communication of the changes involved. Activities are planned to work with the construction industry, building consent authorities and consumers around both the consumer package and the streamlining of consent processes.

Many of the changes sought are behavioural and attitudinal as opposed to structural. For this reason, much of the implementation of the programme is focused on communication. Having said this, support is planned for the development of a broader market for relevant insurance products and facilitating improved dispute resolution.

The sequencing of promulgation of the various elements of the package is important. In particular, while there should be relatively quick progress made in terms of the introduction of mandatory contracts with disclosure requirements, consumer information, and dispute resolution procedures, it would be unwise to progress strongly with a move to more streamlined consenting until a number of pre-requisites are in place.

The reduction in the volumes of consent and inspection work for building consent authorities is likely to strengthen the case for moving towards a more consolidated / centralised model for managing the consent process. This is not a given however; there are significant costs involved (and a number of options exist), so evaluation of the alternatives is desirable.

A further implementation requirement relates to ensuring compliance with the new requirements related to contracting, disclosure and checklists. This has not yet been developed but will be subject to a report to Ministers.

Monitoring, evaluation and review

The changes are complex and in a number of cases implementation is dependent on certain pre-conditions being in place. There is a need for an effective monitoring and evaluation strategy, to assess impact as changes are rolled out and to help in informing decisions about when to bring certain regulatory changes into force. The Department has work underway to develop its evaluation and monitoring approach, building on existing monitoring strategy for the sector. This will include but not be limited to:

- monitoring sector capability and building practitioner competence
- monitoring building quality and defects

- monitoring development of the market for surety products
- monitoring the overall efficiency and effectiveness of the system of building control administration, including compliance with changes to the consenting and inspection system and consent processing times
- ongoing monitoring of building consent authority capability related to the accreditation programme, with particular emphasis on smaller building consent authorities because of the disproportionate impacts of the stepped consenting proposals on them.