

## **Regulatory Impact Statement: Agency Disclosure Statement**

### **Proposal: Changes required to implement the financial assistance package for leaky homes**

- 1 This Regulatory Impact Statement has been prepared by the Department of Building and Housing. The paper seeks agreement to proposed amendments to the WHRS Act to allow the effective implementation of the financial assistance package for leaky homes.
- 2 In response to the leaky homes problem, on 19 April and 10 May 2010, Cabinet made decisions on the high level parameters for a repair scheme for leaky homes (which involves a financial assistance package) [CAB Min (10) 13/11 and CAB Min (10) 16/9 refer]. The proposal's discussed in this paper aim to facilitate the implementation of the financial assistance package.
- 3 The overarching objective of reform is to improve outcomes for affected owners and get more leaky homes repaired faster. This is consistent with the Governments overall policy position on leaky homes, and therefore be seen as a package to ensure those objectives are better met.
- 4 Due to the sensitivity of the weathertightness issue and the negative impact speculation can have on leaky home owners to make informed decisions, and the impact in can have on ongoing discussion with territorial authorities and banks consultation has been targeted. Limited consultation means that the present analysis has to rely on limited evidence. Therefore there is uncertainty about the costs and benefits of the option(s).
- 5 PriceWaterhouseCoopers were commissioned to undertake a study of the size and nature of the problem. Their findings are based on detailed analysis an assessment of consent numbers of building that fit the leaky home risk profile and the reconciling of evidenced failure rates as reported through the Weathertight Homes Resolution Service and the Courts with expert opinion from building specialists.
- 6 The type of evidence and information drawn on includes: the PWC report on the size and nature of the leaky home problem, Statistics New Zealand data (i.e. age profiles and income levels), banks and current WHRS data, discussions with banks, territorial authority and sector representatives.
- 7 The proposals are consistent with the Government statement on regulation.



Suzanne Townsend

**Deputy Chief Executive**

**Sector Policy**

## Executive summary

- 8 While mechanisms exist for resolving disputes leaky homes, are not being repaired at the rate expected. Industry groups, territorial authorities and owners' groups consider that a minority of leaky homes have been repaired to date (perhaps around 5,000 of the estimated 42,000 homes likely to be leaky). Access to and affordability of bank finance and the high cost of repair, including the cost of litigation, are key barriers for many leaky home owners to repairing their homes.
- 9 In response, on 19 April and 10 May 2010, Cabinet made decisions on the high level parameters for a repair scheme for leaky homes (which involves a financial assistance package) [CAB Min (10) 13/11 and CAB Min (10) 16/9 refer]. Territorial authorities were asked to support the repair scheme. The eight councils most affected by the leaky homes problem agreed to support the scheme, enabling further work to be done on the scheme details (of active claims with the WHRS, around 90 percent are in these territorial authority areas).
- 10 The initial parameters of the scheme design for the financial assistance package decided by Cabinet are:
  - Government and territorial authorities each provide a 25% direct payment to agreed repair costs, territorial authorities only make a direct payment where they had signed off the work.
  - If a homeowner opts into the scheme they must agree not to sue contributing territorial authorities and the Government (owners will still be able to pursue legal action against other parties).
  - Government provides assistance to owners to access bank finance for remaining agreed repair costs by way of loan guarantees to banks for loans made to owners eligible for the assistance and who can meet the bank's lending criteria.
- 11 The overarching objective of reform is to improve outcomes for affected owners and get more leaky homes repaired faster. This is consistent with the Governments overall policy position on leaky homes, and therefore be seen as a package to ensure those objectives are better met and is an extension of the Weathertight Homes Resolution Services objective which is focused on effective dispute resolution (to repair homes).
- 12 Councils have identified the risk of being joined into litigation between the homeowner and other parties (e.g: developer, builder, architect) as a significant barrier to them agreeing to sign up to the scheme.
- 13 An objective of the financial assistance package is the diversion of litigation cost to repair. If Councils are joined to litigation where they have paid a contribution through the financial assistance package, this objective will not be met and Councils will face both the cost of the package and on-going litigation costs. This paper considers options to reduce the risk of litigation for councils.
- 14 The financial assistance package has been designed in a way that it can be implemented without changing legislation. However, consultation with territorial authorities has identified an issue that will require legislative change to resolve.
- 15 The Department of Building and Housing's role to ensure repairs address the issues identified in assessments of damage, and ensure the public money is spent appropriately creates new potential liability risks for the Crown. This risk can either be

managed down through putting in place checks and balances to manage risk, or legislation could be passed to remove Crown liability.

- 16 The financial assistance package the Crown is offering bank guarantees/indemnities in relation to borrowing by leaky home owners that are eligible for the financial assistance package and who can meet the banks (or other approved lenders) lending criteria. A decision is required on how to best provide the responsible Minister with the authority to approve a guarantee/indemnity.

### **Status Quo and Problem Definition**

- 17 There is a large group of dwellings in New Zealand which are leaking and are deteriorating over time. A review of the size and cost of the leaky homes problem estimated 42,000 homes are likely to be leaky and the total economic cost (including repair and transaction costs) to remediate them could be \$11.3 billion. This includes stand-alone dwellings and multi-unit complexes.
- 18 Approximately 23,500 leaky homes may be less than 10 years old (i.e., within the 10 year liability limitation period as set in legislation).
- 19 The leaky home issue is creating a range of impacts that are being felt by various parties and the ongoing disputes and litigation are undermining confidence in the sector and damaging relationships and trust between home owners, territorial authorities and the building industry.
- Owners are experiencing a reduction in property values (loss of equity) and a range of parties are incurring legal and other costs to participate in dispute resolution and litigation processes (legal costs are typically between \$20,000 and \$40,000 for each party involved in a weathertightness dispute). For homes that eventually are repaired, the costs will be higher than if they had been repaired sooner.
  - People living in leaky homes can experience negative health effects.
  - The Crown is incurring costs of approximately \$19 million per year to run dispute resolution and related services. While disputes are being settled, the Crown is not getting best value because not all homes are being repaired.
  - Even after a dispute has been settled, many owners are left to pay a substantial sum towards their repairs. Many owners do not have the capital to cover this sum, and some have difficulty borrowing (some have insufficient equity, and some cannot afford to service a loan at market interest rates)
- 20 The objective of the existing Weathertight Homes Resolution Services is focused on effective dispute resolution (to help repair homes) rather than the repair of homes per se. While disputes are being settled under current mechanisms (WHRS mediation services and the Weathertight Homes Tribunal), the Crown is not getting best value because not all homes are being repaired. Industry groups, territorial authorities and owners' groups consider that a minority of leaky homes have been repaired to date (possibly around 5,000).

21 The low volume of repairs to date can be attributed to several key barriers:

*High cost of repairs and access and affordability of finance*

22 The average costs of repair, including all transaction and incidental costs, (amount dependent on type of repair, minor to full re clad) are: \$27,500 - \$410,000 for stand alone houses and \$16,250 - \$156,250 per unit for multi unit dwellings.

23 Access to and affordability of bank finance is a key barrier for many owners to the repair of their homes. Among owners who pursue liable parties, most do not obtain the full amount needed to repair their home following the outcome of dispute resolution. Many owners do not have the capital to cover the "gap" between actual repair costs and the amount received. Some are unable to access finance or service a loan for repairs.

*Dispute resolution/litigation*

24 The high transaction costs (time and money) of pursuing a claim is a deterrent for those wanting to use the existing process to access finance to get their home fixed (legal costs are typically between \$20,000 and \$40,000 for each party involved in a weathertightness dispute). The stress for home owners associated with pursuing a dispute or litigation and the uncertain outcome of the current process are also likely barriers to enter the resolution process.

*Lack of awareness*

25 Anecdotal evidence suggests that many people don't discover that their homes are leaking until they try to sell and a potential buyer has a building inspection done. Lack of awareness about the 10 year limitation period also has implications for owners not coming forward in time to make a claim.

26 In the absence of government intervention, home owners will continue to underinvest in repairing leaky homes. The immediate impact of this could be adverse health effects and inefficient energy use.

27 To address these issues, on 19 April and 10 May 2010, Cabinet made decisions on the high level parameters for a repair scheme for leaky homes (which involves a financial assistance package) [CAB Min (10) 13/11 and CAB Min (10) 16/9 refer]. Territorial authorities were asked to support the repair scheme. The eight councils most affected by the leaky homes problem agreed to support the scheme, enabling further work to be done on the scheme details.

28 The initial parameters of the scheme design for the financial assistance package decided by Cabinet are:

- Government and territorial authorities each provide a 25% direct payment to agreed repair costs, territorial authorities only make a direct payment where they had signed off the work.
- If a homeowner opts into the scheme they must agree not to sue contributing territorial authorities and the Government (owners will still be able to pursue legal action against other parties).
- Government provides assistance to owners to access bank finance for remaining agreed repair costs by way of loan guarantees to banks for loans made to owners eligible for the assistance and who can meet the bank's lending criteria.

*Scheme design and implementation issues*

29 The process for developing the design of the scheme identified a range of issues that need to be addressed before the financial assistance package can be implemented. These issues are outlined below.

*Problem definition: Territorial Authority liability*

- 30 The financial assistance package is an optional path for homeowners to choose to get their leaky homes repaired. Under the package, homeowners can, if they wish, also sue other parties (other than the Crown or relevant territorial authority) through the Weathertight Homes Tribunal or District/High Court.
- 31 If a homeowner chooses to litigate against other parties, at the same time as opting in to the financial assistance package, councils could be joined into this litigation between the homeowner and other parties (e.g: developer, builder, architect). This happens now, and will continue to happen after the financial assistance package is implemented, by the other parties arguing they are entitled to a contribution from the council towards any compensation they pay to the homeowner.
- 32 An objective of the financial assistance package is the diversion of litigation costs to repair costs. If councils are joined to litigation where they have paid a contribution through the financial assistance package, this objective will not be met and councils will face both the cost of the package and on-going litigation costs.
- 33 Senior officials representing territorial authorities have indicated their Councils will not sign up to the financial assistance package if this issue is not resolved. If councils do not agree to participate to the scheme the homeowners will not receive the full benefits of the financial assistance package.

*Problem Definition: Crown liability*

- 34 The Government must ensure repairs funded under the financial assistance package address the issues identified in the assessment of damage and the public money it contributes to the repairs is spent appropriately. The financial assistance package scheme design therefore provides for the Department of Building and Housing to have a role in the repair process. This new role creates new potential liability risks for the Crown.
- 35 The Department's role in the repair process is to provide the following checks and balances:
- An independent assessment (done by assessors contracted by the Department as is the case now under WHRS Act) of the nature and extent of the existing damage to the home and where damage may occur in the future (if it is not fixed) – the scheme design requires the territorial authority and homeowner to accept this assessment as the definitive assessment of the scope of repairs required for the home. Independent assessments avoid costly disputes over the extent of damage. They are a key feature of scheme design and are necessary for Council agreement to sign up to the scheme.
  - Approval of a “repair and payment plan”, prepared by a qualified designer contracted by the homeowner that shows how the home will be repaired and

estimates the cost of the repairs. This approval will ensure repair work is restricted to building elements related to the weathertightness defects only ("betterment" will not be funded by Government and council contributions) and prevent "gold plated" repairs being done.

- 36 Requiring parties to accept a Weathertight Homes Resolutions Service assessors report as the definitive assessment of the scope of repairs required for the home is different from the current process where assessments can be challenged by the parties trying to settle a leaky home claim. The repair and payment plans will be based on the assessor's report and the nature and scope of the repairs detailed in the repair and payment plan will have a direct impact on the repair process and the remediation options available to the designer, territorial authority and builder. This means the Crown has a more direct involvement in the repair process than currently.
- 37 The Courts are likely to hold that the Department owes a "duty of care" to the homeowner to carry out its role (outlined above) with appropriate skill and care. If the Department breaches that duty of care and the homeowner suffers loss as a result, the Courts are also likely to find the Department liable to compensate the homeowner for their loss. Any losses are likely to relate to either the defective repairs, or the repair work detailed in the repair and payment plan only fixing some but not all leaks. Given the Department's role in approving the repair and payment plan is one step removed from the building consent process, any liability it may incur in respect of defective repairs should be modest and would be shared with the territorial authority, the designer and builder who actually designed, built and inspected the repair work.
- 38 If the repair work detailed in the repair and payment plan only fixed some but not all leaks the extent of the liability will depend on how foreseeable the damage was at the time of the repair and payment plan, and the assessor's report on which it was based, was prepared. If reasonable care is taken in the preparation of the assessor's report and again when the Department approves a "repair and payment plan" the risk of liability attaching to the Crown is significantly reduced.
- 39 The Crown would not be liable for costs if the repair fails for reasons outside of its role, or control (i.e. unforeseeable circumstances), and, under current principles adopted by the Courts would not be liable for the original damage.
- 40 The extent of liability to which the Crown will be exposed will likely be limited because:
  - Checks and balances will be in place to ensure the technical quality of the assessors' reports
  - Crown will be limited to its role in relation to the approval of repair plans
  - The Crown will not be solely liable in relation to the repair plan – the territorial authority and designer are likely to share liability with the Crown if repair plans are not done correctly, and in fact may carry a more significant burden of liability because of their more detailed technical role i.e. the designer will prepare plans and specifications for the repair work which are checked and signed off by the building consent authority as being Code Compliant thus the

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design and building consent authority will bear most of the liability for the cost of the repair work

- 41 The potential liability risks can be managed by having robust processes in place in relation to the preparation of assessments and the approval of repair and payment plans to help ensure repairs fix the homes.
- 42 The scheme design includes checks and balances which will reduce the risk of failure and some ensure that reasonable care is taken. These include:
  - allowing the designer, building consent authority or builder to ask for a re-assessment if they believe the original assessment was not correct or complete
  - designers and builders will be able to change the scope of the repair work if new damage is found after repairs have started
  - appropriately skilled staff will be employed to approve the repair and payment plans, with peer review and systems in place to support good decision-making
  - the Department of Building and Housing will monitor the performance of the assessors and assessments will be peer reviewed. Where necessary, homes are re-assessed and the Department will not use assessors who do not perform competently.
- 43 The Department of Building and Housing considers that it is appropriate for the Department/Crown to be held accountable for the work that it is responsible for.

### *Problem Definition: Bank Guarantee*

- 44 The Crown is offering bank guarantees in relation to borrowing by leaky home owners that are eligible for the financial assistance package and who can meet the banks (or other approved lenders) lending criteria.
- 45 The authority to grant a guarantee or indemnity could be provided under the Public Finance Act 1989 or through new legislation.
- 46 Passing legislation to implement other elements of the financial assistance package provides an opportunity to amend the Weathertight Homes Resolution Services Act to more effectively and efficiently provide the responsible Minister with the authority to approve a guarantee/indemnity.
- 47 No additional regulatory costs arise from this option.

## **Objectives**

- 48 The objectives are to:
  - improve outcomes for affected owners; get more leaky homes repaired and faster. This is consistent with the Governments overall policy position on leaky homes, and therefore be seen as a package to ensure those objectives are better met; and
  - reduce the amount of leaky home litigation
  - design a financial assistance package which councils agree to and can be delivered by territorial authorities, the Crown and banks.

## Options

### *Territorial Authority liability*

- 49 The options to resolve this issue were constrained by what would likely be acceptable to Councils, and therefore facilitate their participation in the financial assistance package. The options are also constrained by previous Cabinet decision on the parameters of the financial assistance package.
- 50 The following options were discussed with territorial authorities as ways to reduce the risk of litigation for Councils that participate in the leaky home repair scheme:
- a) Status quo
  - b) Encourage other sector parties to voluntarily make a direct contribution as part of the financial assistance package
  - c) Homeowner indemnity of territorial authority
  - d) Crown indemnity of territorial authority
  - e) Legislation
- 51 The Department of Building and Housing initial starting position was to retain the status quo and encourage other sector parties to voluntarily make a direct contribution. This position was based on the assumption that the risk of further claims or litigation by homeowners who use the financial assistance package is likely to be low, and that homeowners who wanted to litigate or pursue dispute resolution through the Weathertight Homes Resolution Service would have done so by now.
- 52 However, the Department considered it too difficult to accurately predict the level of future litigation or the likely level of participation by the sector (required to reduce the risk). Accordingly, options a and b were not considered viable options in terms of gaining council support for the scheme and achieving the wider objective of reducing litigation.
- 53 Option c was rejected because the only certain way for the homeowner to honour the indemnity would be for them to not litigate against other potentially responsible parties (ministers had previously agreed that this option should be available to homeowners who opt into the package). Under this option the territorial authorities will incur costs to defend further claims made against them, which is inconsistent with objective of reducing the costs of litigation.
- 54 Option d proposes the government indemnifies territorial authorities for the types of costs they may incur if they were joined into further claims/litigation after providing their 25% direct contribution. This cost would include court imposed liability and legal costs.
- 55 The benefit of option d is it would cap council liability at 25% and thereby facilitate Council sign up to the leaky home financial assistance package.
- 56 The costs and risks of option d are:
- there is a risk for the Crown because the Crown could pick up the cost of territorial authority liability beyond the 25% they already provided
  - it is not possible to quantify the cost of the indemnity to the Crown, and therefore contingent Crown liability. The Department considers this would not be fiscally responsible



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- if the cost of providing the indemnity came from the \$1 billion allocated for the financial assistance package it could reduce the number of homes that could be repaired
- the territorial authorities will still need to defend claims if joined by third parties. To manage the cost of the indemnity to the indemnifying party, i.e. the Crown, the indemnifier would normally require the indemnified party, i.e. the territorial authority to vigorously defend any claims made against it. Therefore this option fails to address the objective to reduce the amount of litigation.

57 Given the unknown fiscal risk, and the unlikelihood that this option would adequately achieve the objective of reducing litigation, this option was not preferred.

*Preferred Option: Territorial authority liability*

58 The preferred option is to amend the Weathertight Homes Resolution Services Act 2006 to ensure any person who is a party to litigation in relation to a dwelling the subject of a claim under the financial assistance package, cannot join, seek to join or seek a contribution from the Crown or territorial authority.

59 The benefits and costs of this option include:

Benefits	Costs/Risks
It resolves the problem because it caps territorial authorities' liability at 25% of the repair costs – therefore councils are likely to participate in the scheme.	The rights of other possible defendants (i.e. builders, architects) are prejudiced by not being able to claim against the territorial authority if they consider that the territorial authority has contributed to the loss suffered by the homeowner.
There is no contingent liability for the Crown (compared to option d).	Taking away a legal right currently enjoyed by defendants without offering them something in return is uncommon.  Crown law advice is that the proposed changes are not inconsistent with the Bill of Rights Act.  This cost may also be partially offset by the likelihood that that amount of litigation is likely to reduce if Councils agree to the scheme. This will benefit some possible defendants who otherwise, if not for the scheme, have been including in litigation against the Council.
The legislative process is open and transparent, meaning opponents of the proposal, i.e. other possible defendants, have the opportunity to voice their opposition during the Select Committee process.	
Reduces the likelihood of litigation.	

### *Managing Crown Liability*

- 60 The DBH considers the liability risk can be managed through putting in place robust checks and balances (as described above in the problem identification section).
- 61 Given that the Department of Building and Housing has to be involved in the repair process the only option to remove crown liability completely is legislative change.
- 62 Protecting the Crown from liability for involvement in the repair process, while leaving councils and the sector fully exposed, will result in strong criticism of the financial assistance package. It would also be contrary to recent decisions made by Cabinet to amend the Building Act 2004 to make it clear that people who do building work (or are involved in the building work processes) are to be held to account for the work they do.
- 63 From a legal standpoint it could be considered inappropriate for the Crown to legislatively shield itself from liability and is contrary to the principles of good law.
- 64 For these reasons the Department of Building and Housing does not consider legislative change is necessary or appropriate.

### **Impact on the stock of regulation**

- 65 The proposals will require changes to the Weathertight Homes Resolution Services Act 2006.

### **Implementation and review**

- 66 Further work will be undertaken on implementation and review.

### **Consultation**

- 67 Due to the sensitivity of the weathertightness issue and the negative impact speculation can have on leaky home owners to make informed decisions and ongoing discussions with territorial authority's and banks consultation has been limited.
- 68 Scheme design details were developed through targeted discussions with territorial authorities, banks, homeowner and sector representatives. Feedback received on the final scheme design has been positive and all parties agree it is practical and workable at an operational level.
- 69 Only territorial authorities have been consulted on the proposal to cap territorial liability and they support this option.
- 70 Stakeholders have not been consulted on the option to legislate away the Crown's liability for repairs that fall under the financial assistance package.
- 71 Banks have been consulted on the policy proposals relating to the loan guarantee/indemnity [Westpac, ANZ/National, ASB, BNZ, ASB, TSB, HSBC, Kiwibank and the New Zealand Banking Association].
- 72 The Treasury, the Department of Internal Affairs and the Ministry of Justice have been consulted on the proposals.
- 73 This regulatory impact statement has been reviewed by the Treasury Regulatory Impact Assessment Team. They consider the proposals in the Cabinet paper do not satisfy the RIA regime's significance criteria.