



**MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT**
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Regulatory impact statement

Application of the Residential Tenancies Act 1986 to rental premises which are not lawful for residential purposes

Agency disclosure statement

This Regulatory Impact Statement has been prepared by the Ministry of Business Innovation and Employment (MBIE). It provides an analysis of options for addressing a tenancy sector issue which has recently emerged in respect of tenancies over rental premises which are not lawful for residential use.

The analysis has been constrained by the limited time available, specifically it has not been possible to undertake a comprehensive analysis of the possible costs, risks and unintended consequences of the proposals.

It is not possible to quantify or even estimate how many tenancies relate to premises which may be unlawful for residential purposes. This is because the lawfulness or otherwise of rental premises only arises when the relevant local council is involved and a case comes before the Tenancy Tribunal. However, the frequency with which the issue is arising in the Tribunal (almost weekly) suggests that there are likely to be a high number of rental properties across the country which could be said to be unlawful for residential purposes.

It is difficult to assess how or whether the preferred proposal will have an impact on the supply of rental housing. The proposals may result in a slight reduction in the availability of rental properties, as landlords become aware of the new provisions and penalties for entering tenancies over unlawful rental premises. Were this to occur, there could be a disproportionate impact on vulnerable tenants, who are likely to be more inclined to enter into tenancies where the premises are unlawful, due to limited choice. However, we consider the benefits of the proposal outweigh the costs, because of the importance of ensuring landlords provide rental properties which are fit for purpose. In addition, it is important that landlords do not evade their obligations under the Residential Tenancies Act and that all tenants are afforded all their rights and protections in the Residential Tenancy Act.

Under the preferred proposal, where the parties wish the tenancy to continue, the Tribunal will be able, where appropriate, to give the landlord the opportunity to comply with the relevant legislative requirements. Therefore we do not expect the proposals to result in many displaced tenants or have adverse welfare consequences.

Due to the time constraints, it was not possible to undertake consultation with representatives of the tenancy sector, which may have produced other proposals for addressing the issue. Should the proposals be implemented, future reviews of the Residential Tenancies Act will provide an opportunity to assess the effectiveness of the changes.

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Status quo and problem definition

Background

How can residential premises be “unlawful”?

1. Unlawful residential premises are those used for residential purposes but which are not lawfully permitted to be used for residential purposes because they were physically constructed for another purpose. Examples are commercial buildings being used for residential purposes, and existing dwellings or garages being used for more than one household group without the appropriate physical separation for safety purposes. Such premises may contravene the Building Act 2004 if they do not comply with the building code, if the building is deemed dangerous or unsanitary, or if there are inadequate means of escape from fire. In other cases, the use of the premises for residential purposes is inconsistent with the relevant resource consent. In cases which come before the Tenancy Tribunal, premises have been deemed unlawful for residential purposes by councils, which have responsibility for enforcing the requirements of the Building Act 2004 and Resource Management Act 1991.

Relevant provisions of the Residential Tenancies Act 1986

2. In entering into tenancy agreements over premises which are not lawful for residential purposes, landlords would be breaching their obligations under the Residential Tenancies Act 1986 (RTA) to:
 - a. “comply with all requirements in respect of buildings, health, and safety under any enactment so far as they apply to the premises” (sections 45(1)(c) and 66I(1)(c) of the RTA) - an on-going obligation; and
 - b. “take all reasonable steps to ensure that at the commencement of the tenancy, there is no legal impediment to the occupation of the premises for residential purposes” – an obligation at the start of the tenancy (sections 36 and 66H(2)(c) of the RTA).

Previous understanding of the application of the RTA to unlawful residential premises

3. Unlawful residential premises were previously found to be covered by the RTA and the Tribunal would make orders in relation to such tenancies in the same way they would a lawful residential premise, so long as the use and intention of the parties was for residential purposes (e.g. rent refunds, rent reduction, termination, compensation for failure to comply with building requirements and work orders to remedy the breach).
4. This approach appeared to be in accordance with the definition of residential premises in the RTA as “any premises used or intended for occupation by any person as a place of residence” (section 2). In many instances the Tribunal ordered remedies in favour of the landlord, such as rent arrears and other costs, despite breaches by the landlord of his or her obligations under the RTA to comply with relevant enactments and ensure there is no legal impediment to occupation of the premises for residential purposes.

Magnitude of unlawful residential premises

5. It is not possible to quantify how many tenants may be living in residential premises which could be considered unlawful but the number is likely to be high because of the number of situations to which the decision could apply, including illegally converted garages, unconsented dwellings and commercial properties. The issue could be more prevalent in

Auckland where pressure for rental housing is higher than in other areas.

Effect of High Court decision on Tribunal jurisdiction and remedies

6. A High Court case - *Anderson v FM Custodians Ltd* [2013 NZHC 2423] (*Anderson*) – has set a precedent which has called into question the previously understood application of the RTA in cases of unlawful residential premises and has created legal uncertainty. In the *Anderson* case, the High Court found that where a property is not lawfully able to be used for residential purposes (in that case the unlawfulness was the use of a building outside the scope of its resource consent), it is not a ‘residential premises’, as defined in the RTA. Essentially, the High Court inferred lawfulness into the definition of “residential premises” in section 2 of the Act.
7. The *Anderson* decision has affected the Tribunal’s jurisdiction and its ability to award remedies in cases where the premises in question are unlawful for residential use. Most adjudicators are following the *Anderson* precedent ruling that the Tribunal has no jurisdiction, because the premises cannot lawfully be used as residential premises and therefore there is no residential tenancy agreement. It follows that the Tribunal cannot invoke any remedies under the RTA, except for ordering a partial or full refund of rent and other amounts received from the tenant on the grounds that the tenancy was a “prohibited transaction” under section 137 (Prohibited transactions) of the RTA.
8. In a few cases adjudicators have decided that if the tenancy is not covered by the RTA (because the property in question is unlawful for residential purposes), then the Tribunal has no jurisdiction at all and cannot make any orders, including section 137 rent refunds. Since *Anderson*, the Tribunal has not been making orders in favour of landlords where the premises are found to be unlawful (e.g. rent arrears).

Problem definition

Tenancy Tribunal does not have discretion to award appropriate remedies

9. The *Anderson* decision has had a constraining effect on the ability of the Tribunal to exercise discretion in ordering appropriate remedies. In most cases the Tribunal has only awarded partial or full rent refunds. Unlike other disputes, the Tribunal does not have the ability to investigate and adjudicate on a case by case basis, in accordance with its duty under the RTA to “exercise its jurisdiction in a manner that is most likely to ensure the fair and expeditious resolution of disputes” (section 85).
10. There is a wide spectrum of residential premises which could fall into the category of “unlawful” (for example due to a lack of resource consent or building certification), from well-appointed but unconsented “granny flats” (which are safe and habitable in all respects) through to badly converted garages or cottages on farms with inadequate plumbing and insulation (which are genuinely unfit for rental purposes). While there may be some situations in which a full rent refund may be inappropriate, there may be others where it would not, for example a subsidiary unit on an existing property for which the landlord has not obtained the relevant resource consent for residential use or which does not comply with the relevant district plan. In such circumstances, it would be unfair for opportunistic tenants to obtain a rent refund “windfall”.

Lack of protection for tenants

11. The Tenancy Tribunal’s lack of jurisdiction over disputes in these cases means that tenants living in unlawful residential premises are not consistently afforded the protections and standards under the RTA, for example: bond lodgement requirements; smoke alarms; insulation; requirements in respect of buildings, health, and safety; cleanliness requirements; termination notice requirements; rent increase obligations; and rights to quiet enjoyment.

Role of MBIE Tenancy Compliance and Investigations Team unclear

12. It has become unclear whether the Tenancy Compliance and Investigations Team (in the Ministry of Business Innovation and Employment) is able to take action against landlords in breach of minimum obligations under the Act in respect of unlawful residential premises, because of the effect of the *Anderson* decision.

Inadequacy of legislative deterrents

13. The issue has highlighted the inadequacy of legislative deterrents available to discourage landlords from offering tenancies over unlawful premises. Councils have the ability to require compliance or failing that, issue infringement notices or take prosecutions against property owners (including landlords) under the Building Act 2004, for example for:
 - a. changing the use of a building without notifying and obtaining approval of the council (e.g. from commercial to residential);
 - b. carrying out building work which does not comply with the building code (whether or not a building consent is required);
 - c. carrying out building work without the required building consent; and
 - d. knowingly permitting a person to use a building for which the building is unsafe or unsanitary or that has inadequate means of escape from fire.
14. However, it is understood that many such offences are not prosecuted and neither are many infringement fines issued, as they are not brought to the attention of councils and because of the resources required to prove non-compliance. Infringement fines for failure to comply with these requirements under the Building Act are generally only between \$1,000 and \$5,000. In any case, the Building Act has very few requirements (and penalties) to regulate premises at the point at which they are offered for rent.
15. It is unfair that some landlords can continue to benefit while evading legal requirements, while the vast majority of landlords are rightfully complying with their obligations.

Objectives

Outcomes/objectives

16. The objective of the proposal is to provide clarity and guidance to the Tenancy Tribunal and rental sector where rental premises are found to be unlawful for residential purposes. In doing so, the solution should:
 - a. ensure tenants are afforded the full protection of the RTA in cases where the use of the residential premises is found to be unlawful;
 - b. discourage landlords from offering tenancies for premises which are not lawfully able to be used for residential purposes;
 - c. ensure the application of the RTA and the jurisdiction of the Tribunal is clear; and
 - d. enable the Tribunal to exercise its discretion in terms of ordering appropriate remedies (including the refunding of rent).

Options and impact analysis

Options considered

17. Three options were assessed against the objectives above as follows:
 1. *Status quo*
 2. *Amend RTA to cover unlawful residential premises*
 3. *Amend the RTA to include specific orders and remedies to address unlawful residential premises*

Option 1 – status quo

18. Under this option, no legislative change would be required. It would be left up to the Tribunal to make decisions taking into account the precedent set by the *Anderson* decision. Under this option, the Principal Tenancy Adjudicator could issue a Practice Note in order to ensure consistent decisions.

Analysis against criteria – option 1

19. This option does not meet the objectives as it does not address the legal uncertainty and does not:
 - a. ensure tenants are afforded the full protection of the RTA in cases where the use of the residential premises is found to be unlawful;

- b. discourage landlords from offering tenancies for premises which are not lawfully able to be used for residential purposes;
- c. ensure the application of the RTA and the jurisdiction of the Tribunal is clear; and
- d. enable the Tribunal to exercise its discretion in terms of ordering appropriate remedies (including the refunding of rent).

Option 2 – Amend RTA to cover unlawful residential premises

- 20. Under this option, the definition of “residential premises” in the RTA would be amended to expressly include premises for which residential use is unlawful (due to non-compliance with relevant legislation). This would clarify the application of the RTA and the jurisdiction of the Tribunal in a way which returned the situation to the understanding prior to the *Anderson* decision.

Analysis against criteria – option 2

- 21. This option would clarify the application of the RTA and the jurisdiction of the Tribunal in respect of unlawful residential premises and therefore satisfy the third objective. It would also ensure that tenants were afforded the full protection of the RTA (the first objective), as the whole RTA would apply to cases where the premises were found to be unlawful for residential purposes. Therefore tenants would be able to enforce their rights, for example in respect of bond lodgement, smoke alarms and insulation.
- 22. However, while option 2 would give the Tribunal discretion over remedies (objective four), it does not guarantee the Tribunal will exercise its discretion to order appropriate remedies in all cases. This is because the Tribunal would be able to apply the whole framework of rights, obligations and remedies under the RTA to both tenants *and* landlords. For example, even where a landlord was found to have breached his or her obligations in respect of section 45(1)(c) (compliance with building, health and safety requirements under any enactment), adjudicators would still be able to award costs and work orders in favour of the landlord.
- 23. This was the case prior to the application of the *Anderson* decision, when the Tribunal frequently awarded rent arrears and other costs in favour of landlords, despite rental premises being found to be in breach of legal requirements in respect of the Building code, health and safety and sanitation. This is not appropriate in terms of protecting vulnerable tenants from unscrupulous landlords and neither would it discourage landlords from offering unlawful rental premises – objective two.
- 24. Option 2 risks “legitimising” unlawful tenancies, as there would be no change to the current types of exemplary damages for which a landlord can be liable and inadequate statutory deterrents for such behaviour.

Option 3 - Amend the RTA to include specific orders and remedies to address unlawful residential premises

- 25. Under option 3, the RTA would be amended to clarify the application of the RTA and therefore the Tribunal’s jurisdiction and to include a tailored set of provisions in respect of unlawful residential premises, including specific penalties. Under this option, the RTA would be amended to:
 - a. include a provision that, for the avoidance of doubt, in cases where the residential premises are unlawful because of any legal impediment to the occupation for residential purposes or the premises cannot lawfully be used for residential purposes, the Tenancy Tribunal has jurisdiction to consider such cases; and the chief executive of the Ministry of Business, Innovation and Employment (MBIE) may continue to exercise all duties,

obligations and discretionary powers under the RTA;

b. provide that:

- where the Tribunal makes an order requiring the landlord to remedy the legal impediment within a specified time frame by complying with the relevant enactment (e.g. applying and obtaining the relevant consents or permits from the council), it will be an unlawful act if a landlord fails to comply with such an order; and
- the unlawful act above attract exemplary damages of up to \$4,000 (equivalent to exemplary damages for the unlawful act of failure by landlord to meet obligations in respect of cleanliness, maintenance, building or health and safety requirements);

c. provide that where the Tribunal finds that a landlord failed to comply with sections 45(1)(c) or 66l(1)(c) or to ensure that there is no legal impediment to the occupation of the premises for residential purposes, it may make any or all of the remedies and orders against the landlord available to it under the RTA, including:

- an order of exemplary damages for committing an unlawful act by failing to comply with the landlord's obligation in sections 45(1)(c) or 66l(1)(c) of the RTA;
- if appropriate in the circumstances, an order requiring the landlord to remedy the breach within a specified time frame, by complying with the relevant enactment;
- an order of exemplary damages for committing an unlawful act for failing to take all reasonable steps to comply with the above order;
- an order terminating the tenancy on an application by the tenant;
- an order for the repayment of the whole or part of the rent paid to the landlord, taking into account the benefit received by the tenant from the tenancy; and
- any other order in favour of the tenant that the Tribunal considers appropriate for the circumstances, taking into account the benefit received by the tenant in relation to the tenancy;

d. provide that where the Tribunal finds that a landlord has breached his or her obligation to ensure there is no legal impediment to the occupation of the premises for residential purposes, the Tribunal shall not order rent arrears in favour of the landlord (unless, taking into account the benefit of the tenant in relation to the tenancy, it would be unfair not to order rent arrears)

e. Subject to the above limitations, all other provisions of the RTA would continue to apply. Tenants would still be bound by their responsibilities under the RTA and have access to all the usual remedies against landlords, such as compensation for breach right to quiet enjoyment or exemplary damage for harassment.

Analysis against criteria – option 3

26. Option 3 best meets the objectives for the proposal. It would clarify the application of the RTA and the jurisdiction of the Tribunal and ensure tenants are afforded the full protection of the RTA in cases where the use of the residential premises are found to be unlawful – objectives three and one.
27. It would enable the Tribunal to exercise its discretion in terms of making appropriate orders, as the amendments will prescribe a “menu” of remedies for the Tribunal to invoke which are suitable for the particular circumstances of a case – including taking into account the benefits and other considerations tenants may have gained throughout the tenancy (objective four).
28. Importantly, by including a specific unlawful act and associated exemplary damages, option 3 will address the objective of discouraging landlords from offering tenancies for premises which are not lawfully able to be used for residential purposes. Preventing landlords from claiming rent arrears will also signal the seriousness of the breach and act as a deterrent (objective two).
29. There is a risk that vulnerable tenants (e.g. those of limited means) may be disproportionately affected by the proposal, as they are more likely to accept tenancies where the premises are unlawful, due to limited choice. There may be a slight reduction in rental housing on offer once the proposal is implemented and as landlords become aware of the changes. However, the overriding principle is ensuring landlords provide rental properties which are fit for purpose and therefore the changes are likely to benefit all tenants – including vulnerable tenants – in the long run. Sub-standard rental premises should not be legitimised on the basis that “at least the tenant has a roof over her head”.
30. Under option 3, the Tribunal will be able to give the landlord the opportunity to comply with the relevant legislative requirements (where appropriate and the parties wish the tenancy to continue).
31. Registered community housing providers (and their tenants) are unlikely to be affected by the proposals as they are unlikely to be operating unlawful premises. This is because, in order to become a registered community housing provider, organisations must provide evidence to the Community Housing Regulatory Authority that they have adequate policies and procedures to ensure that they comply with relevant legislation (including the Building Act 2004, Building Regulations 2004, RTA).

Consultation

Agency consultation

32. The following agencies were consulted on this Regulatory Impact Statement: the Treasury, the Ministry of Justice, Housing New Zealand Corporation, the Ministry of Social Development, the Ministry of Justice, Te Puni Kokiri, the Ministry for the Environment and the Department of Internal Affairs. The Department of the Prime Minister and Cabinet was informed.

Stakeholder consultation

33. The Principal Tenancy Adjudicator of the Tenancy Tribunal was consulted on the proposals.
34. Due to the time constraints, it was not been possible to undertake consultation with representatives of the tenancy sector.

Conclusions and recommendations

35. Option 3 is MBIE's preferred option for addressing the issue of unlawful residential tenancies. This is because it best meets all the policy objectives and provides a balanced solution. Option 3 gives the Tribunal discretion to award remedies on a case by case basis but with statutory guidance.
36. The benefits of the proposal outweigh the costs, because of the importance of ensuring landlords provide rental properties which are fit for purpose. In addition, it is important that landlords do not evade their obligations under the Residential Tenancies Act and that all tenants are afforded all their rights and protections in the Residential Tenancy Act.

Implementation plan

37. The final policy option agreed by Cabinet for implementation would require amendments to the RTA. No regulations would be required to be made in order to give effect to the policy options.
38. MBIE would publicise the proposed amendment, and further details once the RTA amendments were in force. The policy would be publicised through the Service Centre, website, ephemera and other options as decided by Government.
39. MBIE will also work with the Tenancy Tribunal to ensure staff understand the implications for their business and are ready to deal with applications under the new legislative framework.
40. The enforcement of Tenancy Tribunal Orders would not be affected by this proposal.

Monitoring, evaluation and review

41. Tenancy Tribunal decisions will be monitored as a gauge of the effectiveness of the amendments once legislation has been passed. MBIE will also liaise with Tenancy Services staff (including mediators and adjudicators) and seek feedback from tenancy stakeholder groups.
42. The impact of the amendments will also be monitored in terms of the number of contact centre calls about unlawful residential premises.
43. Finally, the effectiveness or otherwise of the changes will be able to be assessed in the context of upcoming reviews of the Residential Tenancies Act.