
REPORT 3
(1215/11/IM)

GOVERNMENT PROPOSAL ON WEATHERTIGHT HOMES

1. Purpose of Report

The purpose of this report is for the Council to consider the Government's proposal on the provision of a financial support package announced on 17 May 2010 for owners of leaky homes.

The Government has invited local authorities to participate in this proposal, with a request to councils to provide a response by Monday 31 May 2010 on whether they will support the financial support package.

2 Executive Summary

This proposal is about getting leaky homes fixed and removing the expense of litigation. The Government wants to work closely with councils to determine the details of the Government's proposed scheme.

The social, economic and health costs of leaky homes are affecting a very significant number of home owners and their families across the country. It is estimated that 9% of the affected homes are in Wellington. The Council must prudently manage its liability, yet also wishes to see houses getting fixed. The current process of litigation is not resolving the issue — it is expensive, time consuming, stressful and very litigious, and often results in homes not being fixed.

The Government has tabled a proposal where it will contribute 25% towards the repair of leaky homes, plus the costs to administer the proposed solution. The Government has requested local authorities contribute the same level (25%) with the balance coming from the homeowner. The Government has moved a long way from its original position and is unlikely to move further.

The Government has invited local authorities to participate in this proposal, with a request to councils to provide a response to the current offer by Monday 31 May 2010. The objective of this paper is to enable the Council to respond to the Government within the timeframe requested.

There are two options for Council in dealing with the leaky building issue: to support the proposed financial assistance package and work with the Government to finalise the details of the package; or continue with the status quo (ie case by case litigation and settlement).

The Government proposal endeavours to strike a balance between financial exposure, financial certainty, and social outcomes. Given the same assumptions used in the Government proposal, it is likely the Council will be better served by accepting the proposal than continuing under the status quo. It is recommended that the Council supports the financial assistance package in principle and that officers work closely with the Government on the package details.

3. Recommendations

Officers recommend that the Council:

- 1. Receive the information;*
- 2. Agree to advise the Government that Wellington City Council supports the proposed financial assistance package announced on 17 May 2010 and welcomes the opportunity to work with the Government to finalise the details of that package.*
- 3. Agree to delegate the Chief Executive to work with government officials and the local government sector to agree the details of the financial assistance package for reporting to Council for final approval.*
- 4. Note that the financial impacts of the financial assistance package can not be fully determined until the details of it are settled, at which time the Council will then make decisions on providing for the quantum in the Annual Plan and Long Term Council Community Plan, and determine the appropriate funding under s101 (3) of the Local Government Act 2002.*

4. Background

In 1989/90, a review of the building sector identified the need to “deregulate” the regulatory environment of the sector because the existing environment was seen as being too prescriptive and overly bureaucratic. In 1991, the Building Act (the Act) was passed by Parliament.

The Act allowed for less prescriptive building consent regulations with the introduction of a performance based building code. With a focus on improving the performance of local authorities, private sector building certifiers were introduced. These certifiers were expected to compete with the local council building inspectors for issuing building consents and undertaking inspection work.

The Act, supporting regulations, and the performance of certifiers and local authorities, was expected to be monitored by a new government agency known as the Building Industry Authority (BIA).

In the mid to late nineties individuals and organisations began to notice a growing trend in building failures through water ingress. As a result, in 2002 the BIA appointed a Weathertightness Overview Group to investigate these problems.

In its final report to the BIA, the group identified the causes of the leaky homes, and made a series of recommendations in a report now known as the Hunn report. Since the release of the report, changes have been made with the aim of ensuring this problem does not reoccur and future homes will be weathertight.

While these changes were directed towards preventing a reoccurrence of the problem, in order to support the owners of existing homes and apartments that had “leaky” building problems the Weathertight Homes Resolution Service Act (WHRS Act) was introduced in 2002. The aim of the WHRS Act was to provide a speedy, flexible and cost effective process for homeowners (with leaky homes) as an alternative to the courts. The first claims were heard by the WHRS in 2003.

In response to criticism the existing WHRS process was not working it was reviewed in 2006 and the WHRS Act 2006 came into force in 2007. The WHRS process has now been in place for 6 years. In that time it is estimated that nationally:

- 5983 claims have been lodged with WHRS since 2003;
- 1412 claims have been resolved (mediation or adjudication);
- 2764 claims were closed (ie either withdrawn by the owners, or the claim was deemed as being ineligible).

At a local level, Wellington currently has 171 claims affecting 356 properties (in a multi unit development all the units can be included in one claim).

5. Discussion

5.1 *The current situation*

The Council is actively involved in defending its position in respect of the current claims process. However, the cost to the Council to settle the claims has been steadily increasing over the last few years and is predicted to continue to increase for a number of reasons.

There has been a “rule of thumb” that local authorities are proportionately liable for 20% of a settlement. However, with joint and several liability this position is often eroded so that councils are having to meet up to 100% of an award because no other party is in the financial position to contribute their share. It is becoming more common for the other parties involved in a claim to be either in

liquidation or bankrupt, or have limited funds and be unable to contribute to settlement (eg individuals or entities with no assets and/or no insurance). The Council is being seen more often as the “last man standing”.

Between 2006-2008, Council’s contribution compared to the amount *claimed* has been approximately 13% while Council’s contribution towards the amount *settled* has been around 30%. The level of Council’s contribution has been steadily increasing over the past few years so that in 2009/10 to date, the level of contribution has been 18% of the amount claimed and 60% of the final amount settled.

Since 2006 all but two of the settled claims (above excess) by Council were covered by insurance. This favourable insurance position will not continue. There are a number of outstanding claims that are not covered by insurance due to exclusions introduced regarding certain weathertight clauses. Furthermore, since late 2009 the Council, like all territorial authorities, has been unable to obtain insurance to cover its future liability in respect of new weathertight claims.

The current process is very expensive and time consuming. There is extensive use of lawyers and experts and there is evidence that claimants are encouraged to over remediate because the experts and contractors are concerned with future litigation relating to failure of their remedial work.

There is also evidence that homeowners are also encouraged to inflate the costs of their claim so that when settlement is reached, it is at the level needed to fix their home and pay the experts rather than at a level that is necessarily fair to all parties. Despite owners being awarded significant sums, unfortunately many owners are finding themselves in the situation where their legal and expert costs have consumed a significant portion of the award, reducing the value of the settlement as a remedy to the leaky building issue. There is also no requirement that the sums awarded are spent on fixing the homes.

To date, the Crown has not been successfully joined to a claim and held to have any liability.

The nature of the Wellington construction market has meant that most of the building work has been undertaken by small scale operators rather than large construction firms. Many of the entities involved in the building of the leaky buildings have since ceased to exist (having been wound-up) and individuals involved have moved away. In one instance a building company named as being a party to claims totalling more than \$30 million has ceased to operate. This has meant that the other parties such as the Council have been left to make up the settlement.

The existing process has also caused local authorities and the building sector to be risk averse in respect of remediation to leaky buildings. In some cases, despite there being evidence of leaking only to limited areas of a building, the claims involve total re-clad of the dwelling at huge cost to the owner(s) and respondent parties (including councils) as well as causing major disruption and stress to the occupiers.

The social impacts are significant under the current approach – claims take a significant time to settle, costs are inflated and houses continue to deteriorate over this time. The litigation process is very costly for affected homeowners and often settlement monies are spent on legal and expert costs rather than being spent on fixing the home.

5.2 *Discussions with Government*

As a result of concerns with the lack of progress and rising costs of resolving leaky building issues, local government approached the Government with the aim of developing a lasting solution to this problem. As a consequence the Government commissioned a report from PriceWaterhouseCoopers (PWC) in 2009 on the projected size and cost of this problem. The assessment by PWC to identify at risk homes is based on the design of the building, as well as the type of cladding systems that were installed.

The PWC report identified that nationally up to a maximum 89,000 homes (worst case) could be at risk, with an accepted middle-case scenario figure of approximately 42,000.

As a result of this assessment, discussions were held between the Government and the six most affected councils and Local Government New Zealand. In December 2009 the Government tabled an offer whereby they would contribute 10% (being administration costs and interest subsidies), with a 30% contribution from the councils for repairs. This was rejected by the councils as being too small a contribution from the Government and being unaffordable for both the homeowners and the councils. As a result, discussion between Government and councils stalled in January 2010.

5.3 *The Government's proposal*

The Government's financial assistance package will see the Government meet 25% of homeowners' agreed repair costs, local authorities contributing 25% and homeowners funding the remaining 50%, with a loan guarantee underwritten by the Government, provided claimants meet bank lending criteria.

In summary, the Government proposal is:

Direct payments from Government and Territorial Authorities

- Government contributes 25% to agreed repair costs
- Territorial authorities contribute 25% to agreed repair costs (excluding dwellings signed off by private certifiers)
- Homeowners meet the remaining 50% (and can pursue other parties such as builders and architects)
- Homeowners choose to opt-in to the scheme and agree not to pursue legal action against Councils or the Crown

Universal loan guarantee provided by Government

- Eligible owners who opt in will have access to a loan guarantee to support borrowing from participating banks (lending criteria will apply)

Eligibility

- Owners with homes less than 10 years old that meet the WHRS Act criteria for a leaky home will be eligible for the scheme.
- (The 10 year period is consistent with eligibility for the Weathertight Homes Resolution Service and court action).

Administration costs

- The Government will also pay for assessments of the nature and scope of damage, and other measures to facilitate the process for homeowners.

Under the proposal, the contributions from the Crown and councils will have to be spent on repairs. The package will be voluntary and as an alternative to the current disputes and litigation process for owners of leaky homes.

Acceptance of the financial assistance package will require homeowners to forego the right to sue the relevant local authority and the Crown in relation to the claim. Homeowners would still have the option to pursue other liable parties such as builders, developers and manufacturers of defective building products. Owners that choose to pursue a dispute against territorial authorities or the Government can do so through the Weathertight Homes Tribunal or court process but will not receive the proposed financial assistance package.

The Government will also pay for assessments of the nature and scope of damage, and other measures to facilitate the process for homeowners. This assessment of damage is critical to the direct payment approach as it will ensure the costs of claims is kept realistic and affordable, as well as making the process as easy as possible for homeowners. It is estimated the costs (to the Crown) associated with this part of the scheme will equate to an additional (approximately) 4% of the repair costs (on top of its 25% contribution).

The Government hopes to have the package available for owners of leaky homes in early 2011.

The financial assistance package is dependent on local authorities agreeing to be involved. Local authorities have until 31 May 2010 to decide if they wish to participate. The Government would then work through the details of the final package with local government.

Factors that may encourage owners to opt into financial assistance package (rather than pursuing litigation) include:

- certainty about total amount owners expect to receive;
- opportunity to obtain a significant portion of the repair cost fairly quickly, and get on with repairing their home;
- access to finance that may not otherwise be available;
- opportunity to avoid the legal and expert evidence costs, time delay and stress of dispute resolution or litigation;
- opportunity to avoid the risks of dispute resolution or litigation (eg, risk of affirmative defences and contributory negligence);
- publicity which explains that damaged buildings tend to deteriorate, with wider damage and higher repair costs.

Factors that may encourage owners to pursue a dispute or litigation (versus opting in) include:

- a view by owners that a substantially higher settlement can be obtained (while the costs likely to be incurred may not be well understood at the outset);
- desire for fairness and a “day in court”;
- opportunity to claim for other damage (this may be material in many multi-unit cases);
- ability for multi-unit owners to split costs and share risks of litigation among a large number.

5.4 Benefits/risks of the proposal

Failure to address the issue will have a significant impact on homeowners lives, as well as on the city. To date the number of claims (resolved and open) involving the Council equates to approximately 6% of the potential number of buildings within Council boundaries that could develop leaky building problems. This leaves a significant balance of homes that will most likely fail within their lifetime if no action is taken. The proposal offers an opportunity for a larger number of these homes to be repaired.

With current publicity around this issue, it is expected the number of homeowners who decide to act will increase. If the Council chose not to participate in the Government proposal, but homeowner awareness increased, even a small percentage increase in the number of claims could see a significant increase in the number of claims involving the Council.

The benefits to Wellington City Council (and its ratepayers) are:

- Commitment to a contribution of 25% from the Crown which has not to date been obtainable through the litigation process and in the absence of the Crown proposal could at law fall completely on the Council;
- An assessment process that will ensure that remediation costs are not unnecessarily inflated with questionable costs and with an emphasis on getting the home fixed;
- more timely remediation works, minimising inflationary impacts from CPI increases and further physical deterioration;
- where the package is taken up, Council's contribution is capped at 25% of the actual costs of repairs, compared to the risk in litigation that the Council has to meet 100% of the cost;
- the Council and Government contribution will have to be spent on repairs. (Under the current (litigation) approach, there is no obligation to apply settlement funds to fixing the problem);
- the issue is managed more proactively and in a way that can be quantified and better budgeted for;
- repair and expert costs will be benchmarked, so that even if owner opts out and pursues litigation, the Council will be in a stronger position to argue quantum.

5.5 Financial Impact

Financial impact under current arrangements

In order to consider the financial impact of the Government's assistance package, it must be compared to the costs of resolving leaky building claims under the current approach.

As noted in section 5.1, Council's contribution has increased from 30% of the amount settled in 2006/07 to 60% in 2009/10 as a result of the reduction in the number of parties contributing to the repair costs (last man standing). Also as previously noted, since 2006 all but two of the claims were covered by insurance although Council has been liable for the first \$100,000 of each claim.

The favourable insurance position will not continue. There are currently a number of outstanding claims that are not covered by insurance due to exclusions introduced relating to certain weathertightness clauses and the Council has been unable to obtain insurance to cover its future liability in respect of new weathertight claims since late 2009.

Council has been liable for or settled claims with a total to date of just under \$9.3m including legal costs of approximately \$2.8m. The number of new claims in 2009/10 is currently at 24 consisting of 30 dwellings. Of these claims, 18 are not covered by insurance.

The Council has disclosed in its financial statements the potential for a contingent liability for settlement of claims arising from leaky buildings. Council has an increasing exposure to weathertightness claims due to insurance issues, the higher proportion of Council contribution (as noted above) and the increasing cost of repairs and level of damage to the properties, due to the time lag of water ingress. These costs will continue to rise each year with a significant number of affected dwellings still yet to make a claim.

Financial impact under the Government proposal

The following table provides the Crown's indicative estimate of the expected entrants to the new scheme per year and the cost to Wellington City Council. These costs are based on an estimate of 23,500 eligible owners still within the 10 year limit and have been agreed between the Department of Building and Housing and Treasury.

Wellington City's portion of this (based on Wellington having 9% of affected properties nationwide) is approximately 2115 homes and estimated take up percentages of 50% and 70% have been used as follows:

| Take up 50% | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | Total |
|------------------|---------|---------|---------|---------|---------|--------------|
| Financial impact | \$10m | \$13m | \$11m | \$7m | \$4m | \$45m |
| No. dwellings | 225 | 310 | 250 | 167 | 106 | 1058 |

| Take up 70% | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | Total |
|------------------|---------|---------|---------|---------|---------|--------------|
| Financial Impact | \$13m | \$18m | \$15m | \$10m | \$6m | \$61m |
| No. dwellings | 315 | 434 | 350 | 234 | 149 | 1482 |

The proposal is for the financial assistance package to be available to new claimants until 30 June 2015, at which time the 10 year limitation period would have expired for homes built prior to 2005 and that have not made a claim.

The full impact of the financial assistance package cannot be fully determined until further work is undertaken and the details of the package are settled. In particular it is noted that:

- These figures are estimates and are sensitive to changes in the key assumptions around the number of homes affected, take up rates and cost of repairs.
- These figures exclude the cost of parties going through the litigation route, which would be an additional cost to Council.
- The costs to repair do not include the cost to Council of funding.
- The process of implementation of the package could stretch beyond the estimated 5 year period.

5.6 Matters to be resolved (in consultation with Government)

In working through the proposal with Government there are a number of areas where further detail is required, including (but not limited to):

- (a) how the costs of repairs will be independently assessed to ensure quality and to limit overstatement and escalation of costs and claims for betterment;
- (b) confirmation on how the assessment and monitoring of repair work will be independently monitored to limit the risk of over remediation;
- (c) the development of mitigation strategies to limit ongoing and future damage to at risk homes;
- (d) impacts on capacity of the sector and the sector's capability and skills to effectively manage and carry out the work;
- (e) impact on insurance arrangements for claims already made in years where insurance cover is in place, but the homeowner elects to opt into the package.

5.7 Consultation and Engagement and community views

The Government requirement for a response by 31 May 2010 has not allowed time to conduct a consultation process or ascertain community views in some other way. However, from the Council's experience in managing claims to date and engaging with a number of sector working groups, which involve parties affected by weathertightness issues, the Council is aware of the significant impact that this issue is having on affected homeowners. It is understood the Government will be engaging with the Home Owners and Buyers Association of New Zealand (HOBANZ) on the details of the proposal, alongside the work it will be doing with local government.

The impact of the proposal on ratepayers generally will be considered in future Annual Plan and LTCCP processes. Further, as the solution is likely to require legislation to implement, Wellington ratepayers will be able to make submissions as part of that process, as will the Council.

5.8 Climate Change Impacts and Considerations

This proposal does not require any immediate consideration in respect of climate change.

5.9 Long-Term Council Community Plan Considerations

Once the details of the financial assistance package are settled, the Council will be better able to determine the financial impacts and then consider the decisions required to provide for the package in the LTCCP and the Annual Plan, and consider the funding options under section 101(3) Local Government Act 2002.

6. Conclusion

The level of Council's contribution has been steadily increasing over the past few years so that in 2009/10 to date, the level of contribution has been 18% of the amount claimed and 60% of the final amount settled. Since August 2009 the Council, like all territorial authorities, has been unable to obtain insurance to cover its future liability in respect of new weathertight claims. Council contributions are likely to increase further unless an alternative approach is taken.

The proposed financial assistance package will see the Government meet 25% of homeowners' agreed repair costs, local authorities contributing 25% and homeowners funding the remaining 50%, with a loan guarantee underwritten by the Government, provided claimants meet bank lending criteria. Given the same assumptions used in the Government proposal, it is likely that the Council will be better served by accepting the proposal than continuing under the status quo.

The financial assistance package is dependent on local authorities agreeing to be involved. Local authorities have until 31 May 2010 to decide if they wish to participate in the financial assistance package. Subject to this Council's decision, and the decision of the other affected councils, the Government would then work through the details of the final package.

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Supporting Information

1) Strategic Fit / Strategic Outcome

This paper relates to Building Control and Facilitation.

2) LTCCP/Annual Plan reference and long term financial impact

Once the details of the financial assistance package are settled, the Council will be better able to determine the financial impacts and then consider the decisions required to provide for the package in the LTCCP and the Annual Plan, and consider the funding options under section 101(3) Local Government Act 2002.

3) Treaty of Waitangi considerations

N/A.

4) Decision-Making

This is a significant issue. The issue is a matter of wide public interest and of considerable social and economic impact on the owners of leaky homes and the community generally. The deadline of 31 May 2010 means that, in reliance of section 79, the Council can only comply with sections 77 and 78 as best it can in the time available. The circumstances demand a decision now.

As this proposal progresses, it will be subject to further Council decisions that will be assessed at that time under part 6 of the Local Government Act 2002.

5) Consultation

a) General Consultation

See report section 5.7

b) Consultation with Maori

N/A

6) Legal Implications

Council's lawyers have been consulted during the development of this report as has the General Counsel

7) Consistency with existing policy

There is no current Council policy