

Insurance Council of New Zealand

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29 April 2021

Committee Secretariat
Finance and Expenditure Committee
Parliament Buildings
Wellington

By email: fe@parliament.govt.nz

Dear Committee Members,

ICNZ submission on the Unit Titles (Strengthening Body Corporate Governance and Other Matters) Amendment Bill

Thank you for the opportunity to submit on the Unit Titles (Strengthening Body Corporate Governance and Other Matters) Amendment Bill (**the Bill**).

By way of background, ICNZ's members are general insurers and reinsurers that insure about 95 percent of the Aotearoa New Zealand general insurance market, including about a trillion dollars' worth of Aotearoa New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

We wish to appear before the Committee to speak to our submission.

Please contact Jane Brown (jane@icnz.org.nz) if you have any questions on our submission or require further information.

Submission

We support the proposed reforms under the Bill as they will ensure Aotearoa New Zealand's property law around high-density housing operates more effectively and provides more protection for people buying or living in a unit title complex. In particular, we support the proposed upgrade of disclosure requirements (including in relation to insurance), the strengthening of governance arrangements, changes to increase the professionalism and standards of body corporate managers, and measures to ensure that planning and funding of long-term maintenance projects is adequate and proportionate to the size of the complex concerned.

The Committee should be aware however, that due to the need for denser housing in urban areas and a desire to avoid the negative perceptions that can be associated with body corporates, there are a growing number of multi-unit buildings that have no body corporate structure nor governance

structure and are therefore not subject to the Unit Titles Act 2010 (**the Act**). This in turn makes these properties more vulnerable to the issues that the Bill seeks to address. These properties are being actively marketed by promoting the absence of any body corporate fees, yet they share many attributes of a body corporate including the common areas and critical structural elements that body corporates are required to manage, and raise complexities with respect to insurance protection for occupants. It was the absence of an appropriate governance structure for cross-lease properties with a shared foundation, roof and common areas in Christchurch that contributed to significant delays in settling insurance claims after the Canterbury Earthquake Sequence.

ICNZ appreciates that some of the concerns we have raised in previous correspondence will be rectified by this Bill, such as enhanced disclosure for prospective purchasers, but would also like to take the opportunity to raise a number of additional issues relating to multi-unit buildings (**MUBs**) that the Bill does not consider. We believe, that if these issues are not addressed, they may create a growing problem for MUB owners and may incentivise the avoidance of body corporate structures.

Multi-unit property issues previously raised by ICNZ

In ICNZ's 2017 submission on the Review of the Unit Titles Act 2010 Discussion Document, we highlighted some of the issues experienced by general insurers in relation to MUBs during the Canterbury Earthquake Sequence. We urged MBIE to consider possible improvements to legislation in order to ensure an effective and efficient insurance response and reinstatement of housing, especially post-natural disaster where reinstatement of housing is an area-wide, economy-wide issue. Unfortunately, the concerns have not yet been addressed and therefore need repeating here, particularly because of the increasing trend away from body corporate structures in an effort to make property more attractive to purchasers.

One difficulty insurers experienced was the complexity in trying to obtain agreement between multiple unit owners to a building reinstatement pathway, a problem which was exacerbated for cross-lease arrangements, as memoranda of lease require agreement between all unit owners. Specifically, problems can arise where:

- There are differences between unit owners' level of insurance coverage, including that some unit owners may be uninsured or underinsured.
- There are differences between unit owners' preference for how a property should be reinstated.
- Unit owners are absent, especially after a natural disaster.
- Unit owners do not understand their memorandum of lease obligations in a cross-lease situation.

In accordance with the Act, a body corporate will take out one material damage policy covering all units within the building (or buildings), where there is no body corporate structure however (for example, where property is structured as a cross-lease or fee simple), each individual unit owner is responsible for obtaining their own insurance. This can be particularly problematic where units are uninsured or underinsured, as that decision by one unit owner will impact on the insurable interests of others, because in the event of significant damage, there will be a smaller pool of funds to reinstate the MUB. Additionally, in the absence of a single policy covering a MUB, there is little to no cover for common property (property provided for the enjoyment of all unit owners within a MUB, including entrance ways, paths, driveways, parking bays, detached carports, BBQ areas, playground/gardens) available should loss or damage occur. Even if individual owner's shares in common property were covered by individual policies, each owner would be required to make a claim (even if their enjoyment of their individual unit or enjoyment of the complex is unaffected) and consequently pay the required policy excess, thereby eroding the pool of funds available to carry out repairs by the total amount of

excesses payable. Insurers will also have reservations about cash settling individual claims for common property damage in situations where it is impossible for the repairs to proceed either due to lack of funds or lack of interest from other unit owners in making claims or carrying out repairs.

ICNZ suggested a number of solutions to the issues in our 2017 submission, including:

- Education and disclosure obligations to purchasers and other unit owners.
- Enhanced governance and more accessible dispute resolution arrangements for MUBs and shared property.
- Legislation that allows a reinstatement pathway to proceed with the consent of a majority of unit owners. A forum like a body corporate committee with related governance arrangements would be appropriate. Governance arrangements need to ensure that one unit holder cannot hold up reinstatement for all other unit owners, and to set out a low cost and accessible disputes process where there is a stalemate between unit owners on a reinstatement pathway.
- Legislation that requires owners of units in MUBs to insure the units and/or the building with one insurer, under one policy. This is not a problem for properties subject to the Act which already have that requirement, but is for older unit title structures, recently built multi-unit complexes on individual titles, and cross-leased properties. ICNZ's view is that all these properties should be required to insure with one insurer under one policy, but at present, are not legally required to.

For completeness, a copy of ICNZ's 2017 submission is annexed to this submission for your information.

All multi-unit properties should have a governing body

In addition to the possible solutions raised in 2017, ICNZ strongly suggests that for the sake of consistency, ensuring protection of individual unit owner's assets in general, and for a robust and valued insurance process to respond, all high-density adjoined housing/multi-unit complexes should be required by legislation to have some form of body corporate or other governance structure. That body should at a minimum, comply with the same prudent responsibilities as are required for a body corporate under the current Act and those proposed in the Bill. Otherwise, the problem of non-body corporates will proliferate, and unit owners may be adversely affected. It is also possible that non-body corporate MUBs will find it increasingly difficult to secure insurance due to the risks they present. ICNZ has previously highlighted insurer perceptions of non-body corporate MUBs, warning that insurers may be reluctant to provide cover in future. A copy of ICNZ's media release on this issue is also annexed to the submission.

Insurance provisions in the Unit Titles Act should be updated

One other area which ought to be addressed as part of this review, relates to the insurance provisions in sections 135 and 137. Section 135(1) of the Act currently refers to 'full insurable value' and section 137(2)(b) to 'full replacement cover'. These terms are inconsistent and do not reflect the insurance industry's standard usage of defined sums insured for unit title developments, as opposed to full replacement. We believe that the terms should be amended to reflect current practice and to ensure that the provisions do not present any ambiguity. The use of 'full replacement' implies an open sum insured, which is not generally how insurance for body corporates is offered, with cover being provided subject to a sum insured and as an additive to cover provided under the EQC Act in relation to natural disasters. Other than the wording of the provision, some body corporates may not find that full replacement insurance is affordable, and others still may struggle to secure cover at all due to the level of risk a property presents. We are unclear of the implications for a body corporate if, despite

best efforts, they were unable to secure any insurance cover and who would then appear to be in breach of the Act.

If the language in sections 135 and 137 were to be changed, then that raises the question of the policy intent behind the provisions. For example, what is the policy intent in terms of the level of insurance cover – presumably it is a level that would adequately provide for reinstatement of all buildings and shared items. While we would caution against making the legislation overly prescriptive, there should be clear expectations that the insurance held by a body corporate will sufficiently protect the interest of unit title owners, if that is the intent.

Despite section 135, section 137(2) permits indemnity cover if full replacement cover is not available. The term ‘indemnity’ is a somewhat complicated term, and for certain properties can equate to a very small sum. For example, it is possible that an old multi-unit building in poor condition may have an indemnity value that is significantly less than the replacement value. It is highly unlikely that there would be insurer interest in properties where the indemnity value is only a very small proportion of the replacement value. This is because insurers will look to insure more resilient buildings which would not be the case when there is a big difference between the indemnity and replacement value. Additionally, related to comments made above, if the Government’s policy intent in the insurance provisions of the Act is that unit titles will have a certain level of insurance cover, allowing for indemnity value may not satisfy that intent.

Because full replacement may not be available for every body corporate, ICNZ believes that it would be a more accurate reflection of market offerings to replace the references in the Act to ‘full replacement cover’, ‘full insurable value’ and ‘indemnity cover’ with a provision that permits body corporates (or their broker) and insurers to negotiate an ‘agreed sum insured’ where replacement cover is not available. To reflect the presumed policy intent behind the insurance provisions of the Act, we believe that a body corporate should be required to take out full replacement cover if it is available, as deliberate underinsurance should not be encouraged. Despite this, there could be some flexibility permitted for insurance arrangements in limited circumstances. For example, to encourage the development of highly resilient MUB structures (such as those with base isolators), particularly in parts of the country which are known to have higher levels of seismicity. In these situations, the law should not act as an impediment to body corporates seeking to negotiate the most suitable insurance cover for their circumstances, such as by retaining a greater proportion of risk via a higher excess. To form the basis of negotiations of the ‘agreed sum insured’ where replacement cover is not available, the body corporate could be required to obtain an insurance valuation of the full replacement value from a suitably qualified person.

Legislative drafters should also be aware of the interaction between section 135 (a body corporate must hold insurance) and section 137(1) (an individual unit owner can insure their own unit). There is a risk that where a resolution is passed under section 137(2) and individual owners insure their own unit, with the body corporate responsible for insuring common property, that a situation will be created where there is dual insurance, which can present additional complexities.

Finally, when considering the insurance provisions of the Act, it must also be borne in mind that anything less than full insurance cover may affect a purchaser’s ability to raise a mortgage. Potential adverse consequences from changes to the legislation will therefore need to be carefully balanced against ensuring the insurance provisions accurately reflect cover offered by the market, and the possibility of differing insurer risk appetites and ability of body corporates to secure cover.

Conclusion

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact our Legal Counsel by emailing jane@icnz.org.nz.

Yours sincerely,

Handwritten signature of Tim Grafton in black ink, featuring a stylized 'T' and 'G'.

Tim Grafton
Chief Executive

Handwritten signature of Jane Brown in blue ink, appearing as a cursive 'JB'.

Jane Brown
Legal Counsel

ANNEXURE 1 – ICNZ Unit Titles Act Review 2017 submission



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3 March 2017

Unit Titles Act Review
Construction and Housing Markets, BRM
MBIE
PO Box 1473
Wellington 6140

Emailed to: UTAreview2016@mbie.govt.nz

To Whom It May Concern,

RE: ICNZ submission on Review of the Unit Titles Act 2010

1. Thank you for the opportunity to submit on this Review. We submit on behalf of the Insurance Council of New Zealand (“ICNZ”). ICNZ represents 26 members who operate as general insurers in New Zealand, and who collectively insure over half a trillion dollars in New Zealand’s assets (including property) and liabilities.
2. We support the Discussion Document’s proposed improvements to consumer disclosure, body corporate governance, professional requirements for body corporate managers, improvement to long term maintenance plans and increasing accessibility to dispute resolution.
3. The remainder of our submission focuses on a set of issues that is, strictly speaking, out of scope of the Discussion Document. However, we have been invited during consultation with MBIE officials on the Review to submit on these issues as they are critical contextual issues for the regulation of the building and housing environment more broadly. We will also copy this submission to Minister Brownlee who has expressed an interest in these issues arising from problems that were encountered after the Canterbury Earthquake series.
4. Insurers faced significant hurdles during their efforts to reinstate property they insure that were damaged in the Canterbury Earthquake Sequence. Those hurdles were caused by shortcomings in laws relating to shared interests in individual properties in multi-unit buildings (“MUBs” in this letter), and also other shared property such as multiple buildings on an individual parcel of land. Cross leased properties posed special difficulties, particularly where unit owners share common foundations, walls and roofing. These MUB issues must be borne in mind by MBIE for possible improvements to legislation governing MUBs and shared property, to ensure an effective and efficient insurance response and reinstatement

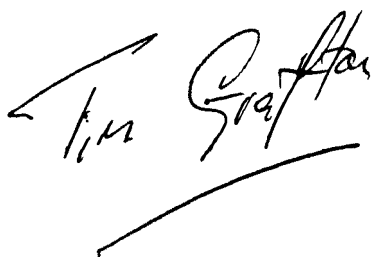
of housing, especially post-natural disaster where reinstatement of housing is an area-wide, economy-wide issue.

5. The central problem is the complexity involved in obtaining agreement between multiple unit owners to a building reinstatement pathway, after those units have suffered insured damage. Unit owners may have conflicting or competing interests, and individual and separate insurance arrangements when in a MUB or other shared property arrangement and without a body corporate committee and associated governance arrangements under the Unit Titles Act. Cross-lease arrangements pose a particular problem, as memoranda of lease require agreement between all parties (all unit owners) involved in the cross-lease. We submit enhanced governance and more accessible dispute resolution arrangement may improve the situation, though a change to legislation to help determine unit owner rights is ideally required.
6. Post-earthquake damage scenarios provide the most obvious examples, but the issues we raise apply equally to situations where MUBs and shared property are damaged by fire and other perils.
7. Specifically, problems arise where:
 - a. There are differences between unit owners' level of insurance coverage, including that some unit owners may be uninsured or underinsured.
 - b. There are differences between unit owners' preference for how a property should be reinstated.
 - c. Unit owners are absent, especially after a natural disaster.
 - d. Unit owners do not understand their memorandum of lease obligations in a cross-lease situation.
8. Unit owners in a MUB are affected by the insurance arrangements of other owners, making disclosure of others' insurance arrangements necessary, and/or requirements for the other unit owners to hold adequate insurance in shared property situations necessary. Uninsured and underinsured units pose specific problems. A body corporate under the Unit Titles Act with a single building with multiple units (or several buildings with multiple units) will take out one material damage policy covering the entire property (except for the individual unit owners' contents). But in situations where there is no body corporate to take out that insurance, individual unit owners are responsible for entering their own insurance arrangements, even where those units are in the same building.
9. When individual unit owners are responsible for their own insurance, one unit owners' insurable property interests can be significantly impacted by the other owners' actions. Uninsured and underinsured units are a specific problem. One unit owner's decision not to take out insurance after purchasing a property, or who lets that insurance lapse, reduces the pool of funds available to reinstate the MUB for the benefit of all unit owners.

10. Disputes between unit owners that hold up efficient reinstatement can range from the fundamental (such as what kind of foundation solution to reinstate a building on) to the trivial (such as what colour of paint to use on the exterior of a MUB).
11. Unit owners may make different decisions about how to use the indemnity under their insurance contract. For example, insurance contracts often include the ability for the insured unit owner or the insurer to reinstate the property, or to cash settle for the value of the loss or damage to their property. If one unit owner decides to cash settle with their insurer instead of reinstate, that decision impacts other unit owners who may want to reinstate, and who cannot progress without the agreement of all unit owners, or the financial contribution from all unit owners, to each bear their fair share of reinstating the building. Disagreement by one unit owner blocks the other unit owners from reinstating their property.
12. The Memorandum of Lease in cross-leased properties is often misunderstood by homeowners, and purchasers are often not fully or properly advised on these MOL before purchasing a property. We understand the Law Society has taken steps to ensure property lawyers are apprised of issues so as to advise clients appropriately, especially post-Canterbury Earthquakes, but this is not a complete solution.
13. Insurers have also seen issues related to the lack of understanding of memorandum of lease obligations in cross-lease situations, both from unit owners, advocates advising unit owners, and lawyers advising unit owners. Some unit owners may take insurance proceeds or Earthquake Commission Act proceeds and put those proceeds to personal use, instead of fulfil their memorandum of lease obligations (if those obligations exist in memoranda of lease, which is not always the case).
14. There are issues relating to having different insurers for one MUB. Each insurer sends out assessors to inspect a property and advise on the extent of repairs required. Insurers have seen differences in the assessment of the same property between assessors. These differences do not help a shared reinstatement pathway for the unit owners collectively and for reinstatement of the building. Insurers advise that, for example, assessors would advise on cosmetic repairs to an individual unit and subsequent settlement with the particular unit owner, but without considering structural issues relating to the building as a whole and the impact of adjacent units. Some sites need major releveling work to a MUB or to the land a MUB is on.
15. Titles may also be in defect, such as where a unit owner or neighbouring unit owners make alterations to their property but do not update the title. This causes further delays for unit owners who are collectively looking for a shared reinstatement pathway, and in our view emphasises the need for continuing disclosure obligations or some other form of governance mechanism sitting above the individual unit owners, who otherwise are not sufficiently incentivised than to act in their own individual interests.
16. Possible solutions to the issues we have raised could include:

- a. Education and disclosure obligations to purchasers and other unit owners.
 - b. Enhanced governance and more accessible dispute resolution arrangements for MUBs and shared property.
 - c. Legislation that allows a reinstatement pathway to proceed with the consent of a majority of unit owners. A forum like a body corporate committee with related governance arrangements would be appropriate. Governance arrangements need to ensure that one unit holder cannot hold up reinstatement for all other unit owners, and to set out a low cost and accessible disputes process where there is a stalemate between unit owners on a reinstatement pathway.
 - d. Legislation that requires owners of units in MUBs to insure the units and/or the building with one insurer. This is not a problem for properties subject to the Unit Titles Act 2010, but is for older unit title structures and cross-leased properties.
17. Finally, we expect the problems we have outlined above to worsen in future, for two reasons. First, the insurance market in New Zealand has moved to provide policies on a sum insured basis rather than a full reinstatement basis. This means the problem of unit owners in a MUB having different levels of insurance for their property (outlined above) will exacerbate. Second, insurers are more likely to opt to cash settle rather than repair or reinstate property in future. This will put pressure on unit owners to coordinate their own repairs with, perhaps, not enough cash to complete the work, especially if they have underinsured compared to the reinstatement value of the building, and with the governance issues outlined above added on top. In our view, the appropriate response is a legislative/regulatory one. All MUBs need to have some form of body corporate committee or other governance structure which manages repairs, insurance, and administration of the building as a whole.
18. Thank you again for considering our submission. If you have any questions, please contact our legal counsel Nick Mereu on (04) 495 8008 or nick@icnz.org.nz.

Yours sincerely,

A handwritten signature in black ink that reads "Tim Grafton". The signature is written in a cursive style and is positioned above a horizontal line.

Tim Grafton
Chief Executive

MEDIA RELEASE

27 January 2021

Insurers caution home buyers to be wary of insurance pitfalls for multi-unit buildings

Are you buying a new home attached to others? Is it being sold without a body-corporate to reduce costs and issues? The Insurance Council of New Zealand is urging all potential or existing owners of multi-unit property to check they can adequately insure their property.

“If a unit is attached to other units and doesn’t have a body corporate structure in place, many insurers may not provide insurance because of complexities that can arise at claim time if not all units are insured or if they have different levels of cover from different insurers,” says Tim Grafton, Chief Executive ICNZ.

“Owning your own home is increasingly difficult for New Zealanders and we want to ensure buyers aren’t tripped up by steps to make properties appear more affordable when they could actually cause more expense in the future.

“With high-density housing one of the solutions to address New Zealand’s housing availability and affordability it is critical that property owners are able to appropriately protect their assets. We encourage people to talk to an insurer early on so they can help them understand the insurance that is available or the questions they may need to ask before purchasing.”

While body corporates can be seen as adding extra cost and administration for owners, they also offer a single point of insurance for the entire building, including units, shared spaces and common property. Critically this ensures all owners have insurance in place, with one insurer, meaning claims can be handled simply and efficiently.

However, there can be gaps in cover for multi-units with shared spaces and common property often not covered by insurance, where more than one insurer is involved.

“Ultimately it can lead to a really nasty experience for owners – especially following a significant event that causes wide damage that isn’t insured.

“Uninsured or underinsured units can cause repair delays, impacting on everyone’s ability to pick up the pieces and get back to normal.”

ICNZ says that if you’re looking to buy within a multi-unit building, a multi-unit complex (multiple buildings), or a property that is attached to others, be sure to tell your insurer before you go unconditional. “This means you can have a robust conversation about the type of property and what level of cover the insurer may offer to best to meet your needs – enabling you to make an informed decision to proceed with the purchase or not, and avoid possible pitfalls,” says Mr Grafton.

“Don’t get caught up in sales pitch from developers or agents. Properties are sometimes marketed as being BC free to save owners time and money – but the ultimate outcome is that it won’t!”

ANNEXURE 2 – ICNZ media release

To help buyers and homeowners understand more about purchasing home insurance in a multi-unit building ICNZ has developed a helpful consumer guide which is available on its website.