

3. WEATHERTIGHT HOMES CLAIMS IN CHRISTCHURCH

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PURPOSE OF REPORT

1. The purpose of this report is to outline for the Council, the history of the “leaky building” issue, report on recent Government proposals to assist the resolution of these claims, and provide an update on the current status of weathertight homes claims in Christchurch.

EXECUTIVE SUMMARY

2. Leaky buildings are a national issue that arose principally as the result of a systemic failure in the building industry between 1992 and 2004. During this time a combination of new legislation, relaxed building controls, new and unproven building standards, materials and building designs and unskilled builders and industry players - all lead to a scale of weathertightness problems in buildings which was unprecedented in New Zealand.
3. The issue surfaced nationally in 2002, when the Building Industry Authority (BIA) appointed a Weathertightness Overview Group to enquire into the weathertightness of buildings in New Zealand - housing that was leaking and causing decay. The subsequent (Hunn) report identified a systematic failure in the building industry causing leaky buildings.
4. More recently, in April 2009, the Government engaged Pricewaterhouse Coopers (PWC) to prepare a further report on the Weathertightness Homes issue and to estimate the cost of resolving the issue. This Government initiative was designed to show the overall scale of the problem. The report was released in December 2009 and it calculated the scale of the problem at \$11.3 billion. The report estimated that of the houses built between 1992 and 2008 a range of between 22,000 and 89,000 homes are affected and settled on 42,000 as a best estimate.
5. The Government has been in consultation with the Mayors of six of the major metropolitan Councils and suggested that the issue of leaky buildings could be resolved finally for all claimants if the Government would contribute 10 per cent of the repair cost, councils 26 per cent, and homeowners the remaining 64 per cent (with homeowners having the ability to pursue other parties to contribute i.e. builders, developers, sub contractors).
6. At present the Government proposal has been rejected by a negotiating party comprising the Mayors of Wellington and Auckland City Councils. They are seeking a proposal from the Government which would see a contribution of 50 per cent of the repair cost by the homeowners, 25 per cent by the Government and 25 per cent by councils. While details of any Government proposal have not been finalised, the matter would need to be carefully considered by all councils.
7. Currently Christchurch has 111 active claims involving 232 properties (109 active claims on the Weathertight Homes Resolution Service (WHRS) website and as at 31 January 2010 two in the District Court). This represents about 5.6 per cent of the claims nationally. The Council has previously resolved 132 claims. We are currently resolving approximately 20 claims per year with the average payout for our most recent claims (including legal costs) being \$50,296.

FINANCIAL IMPLICATIONS

8. In light of the present rate of resolution of weathertight claims, the present budget of \$170,000 in the 2009/19 LTCCP is insufficient. Staff are recommending that the Annual Plan for 2010/11 propose an increased budget to \$1 million and it is anticipated that this level of budget might be necessary for the next six years.

Do the Recommendations of this Report Align with 2009-19 LTCCP budgets?

9. This report is for the information of Councillors.

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LEGAL CONSIDERATIONS

10. See below.

Have you considered the legal implications of the issue under consideration?

11. See below.

ALIGNMENT WITH LTCCP AND ACTIVITY MANAGEMENT PLANS

12. Any future Government proposals have not been anticipated in the LTCCP or activity management plans. This matter will require further consideration by Council before any changes could be made.

Do the recommendations of this report support a level of service or project in the 2009-19 LTCCP?

13. Not applicable.

ALIGNMENT WITH STRATEGIES

14. Not applicable.

Do the recommendations align with the Council's strategies?

15. The report is for information only.

CONSULTATION FULFILMENT

16. The Metropolitan Sector Mayors have agreed that the Mayors of Wellington and Auckland should continue negotiations with Hon Maurice Williamson, Minister of Building and Housing, regarding further government proposals. Any formal proposal would need to then be considered by Council and be the subject of further consultation.

STAFF RECOMMENDATION

It is recommended that the Committee:

- (a) Receive this report.
- (b) Await any formal proposal by the Government regarding a longer term resolution of this matter.

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BACKGROUND (THE ISSUES)

17. The leaky building issue came into national focus in 2002, when the Government appointed a Weathertightness Overview Group to enquire into the weathertightness of buildings in New Zealand - in particular concerns regarding buildings that were leaking and causing decay. The subsequent (Hunn) report identified a number of factors that contributed to leaky buildings. Its conclusion was that this problem was caused by a systematic industry failure. The factors included the Building Act 1991 which moved from a prescriptive building code to a more liberal building system, which allowed the use of Private Certifiers and many new products and design methods, without adequate building controls. Coupled with this there was a lack of skilled builders and apprentices. A degradation of the quality of work being produced onsite by semi-skilled or less experienced workers, was evident.
18. The combination of these changes contributed towards buildings failing to remain weathertight and becoming part of the leaky building problem.
19. As early as November 1994, newspapers started reporting that building experts were concerned with the problems being caused from stucco finishes being applied to modern houses. They reported that the plasterers applying the modern materials had insufficient skill in the application of such finishes and that they were a potential time bomb. The modern (monolithic) cladding systems used were generally textured wall surfaces made out of plaster on polystyrene or fibre cement sheets. Proper installation was important and these materials depended on the external sealing and painting to prevent moisture penetration. Design features which heightened the risk of leaky buildings included flat roofs, no eaves, (unflushed) recessed windows, solid balustrades, complex roof and deck design and penetrations through exterior claddings for handrails, downpipe fixings etc.
20. Following the media coverage, Building Research Association of New Zealand (BRANZ) ran seminars for the building industry on the dangers involved with wrongly applying modern plastered surfaces to house exteriors. In 1996 they published a work manual on "good stucco practice" to lift awareness in the industry.
21. In 1996 the New Zealand Building Code removed the regulatory requirement for all framing timber to be preservative treated. This followed a positive BRANZ recommendation that untreated framing would have a 50-year durability performance. Councils were previously concerned at the impact this untreated timber framing would have on the buildings in their areas and refused to approve this material. However, after the BRANZ confirmation that it was suitable for general use, the material was approved.
22. From 1998 on, the Building Industry Authority (BIA) was aware of serious problems with monolithic cladding systems in Canada and the United States. These overseas countries stopped the use of foam-based EIF (polystyrene systems) as a substrate for modern plaster - unless these were used with a cavity system to provide for the possibility of moisture penetration.
23. In 2002, the BIA engaged a Weathertightness Overview Group to investigate and report on what was becoming a serious national problem. The Hunn report concluded that there was a systemic failure across the industry. Two primary matters of concern were the risks and long-term dangers of the use of untreated timber (which supports fungal growth when wet) and the problem with the modern external stucco claddings (monolithic claddings) being used as well as the lack of skill in their application.
24. With the increasing number of claims for leaky buildings in the late 1990s, and as a result of concerns about the cost of homeowners of pursuing such claims through the Courts, in 2002 Parliament established the Weathertight Homes Resolution Service (WHRS) and the Weathertight Homes Tribunal. The WHRS receives claim applications and provides assessment information, guidance and mediation services.

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25. The Tribunal is a judicially independent Tribunal that provides an adjudication process as an alternative to the Courts for leaky building claims only. The Tribunal was intended to provide a low cost assessment of the weather-tightness problems with the house and to provide access to dispute resolutions service. The Tribunal has the power to award general damages, including those for mental stress and anxiety, as well as the costs for repair work to the home. A home owner can choose to use the services of the Tribunal or to use the Courts. Other types of building claims eg, subsidence, do not have access to the Tribunal and such claims need to be resolved through the Courts if they are not settled.
26. In the legislation, administered by the WHRS and the Tribunal, a weathertightness failure is defined as "a dwellinghouse into which water has penetrated as a result of any aspect of the design, construction or alteration of the dwellinghouse, or materials used in its construction or alteration".
27. This refers to water that has unintentionally penetrated the interior of the house. It is recognised that in some building designs it is expected that water will penetrate the primary cladding, but the design ensures the water will not cause damage. This is not a failure because the water has no opportunity to damage the interior structure of the dwelling. Weathertightness failure does not include water from internal sources such as bathrooms or kitchens.
28. In the December 2009 Price Waterhouse Coopers report the authors stated:
"Building professionals report that all houses will leak eventually and it is the ability to handle those leaks that determines if damage will occur. For example, a brick exterior is porous and will leak. Brick homes are, therefore, built with cavities and outlets at the bottom of walls to allow for drainage. Using this system, very few brick houses have experienced damage from water ingress".
29. When a dwelling is damaged by water ingress, there are invariably two causes to consider:
 - the failure to prevent water ingress into the interior
 - the dwelling's inability to let water out and, hence, its inability to resist damage from water penetration.

Maintenance, or the lack thereof, is also a critical factor.

Price Waterhouse Coopers Report

30. In April 2009, the Government engaged Pricewaterhouse Coopers to prepare a report on weathertight homes and to estimate the cost of resolving the issue. This followed concern nationally that the WHRS system was not being effective in helping owners of leaky buildings, despite changes in 2006 to speed up the process. Of major concern is the associated legal costs with resolving claims and the protracted nature of negotiations. Since the introduction of the legislation, the report suggests 3,500 homes nationally have been repaired and a further 10,000 have gone beyond the 10-year period of legal liability.
31. The Price Waterhouse Coopers report was released in December 2009. In summary the report's research finding on the size and cost of the national problem is:

Size of Problem

- *Most likely estimate 40,000 - 45,000 individual dwellings (single and multi-unit)*
- *Large possible range from 22,000 to 89,000 dwellings.*
- *Only a small number (few thousand) have already been repaired.*
- *Up to around 10,000 are likely to be outside the 10 year liability limitation period.*
- *This leaves approx 31,000 dwellings needing to be repaired under the current, or any new, policy.*
- *Failures since 2006 have been minimal - this is mainly an historic problem.*

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Cost of Problem

- *Total economic cost from 1992-2020, under current policy, is \$11.3 billion (in 2008 dollars)*
- *Total economic cost to repair the approx 31,000 dwellings that could be covered by any new policy is \$6.3 billion.*
- *Costs are met, under current policy:*
 - *40 - 60% Owner*
 - *30 - 40% Councils*
 - *10 - 20% third parties (eg builders)*
- *Average cost of repair, including all transaction and incidental costs, (amount dependent on type of repair, minor to full reclad): \$27,500 - \$410,00 for stand alone houses and \$16,250 - \$156,250 per unit for multi unit dwellings.*
- *Legal fees comprise on average \$20,000 - \$40,000 of the "repair costs".*

The above figures are estimates only and are uncertain. There remain a number of important unknowns. These include:

- *The nature and extent of private repairs on leaky homes.*
- *Recognised but un-repaired serious damage.*
- *As yet unrecognised cases where there is a high probability of failure and of serious damage because of leaks.*

Accordingly, there will always be a high degree of uncertainty about any estimate of the size and cost of the leaky homes problem.

32. The PWC report also stated:

"For the consensus forecast of 42,000 failures, the total economic cost (i.e. repair and transaction costs) of remediation of the affected dwellings is estimated as \$11.3 billion (in 2008 dollars). These costs are estimated to be distributed, under the current government proposed policy, as follows:

- *69 % to the owner;*
- *25 % to councils;*
- *4 % to third parties (e.g. builders); and*
- *2 % to the government (the cost of administering the WHRS etc)*

Owners carry the largest share as:

- *they carry their own transaction costs;*
- *failures occurring after the 10-year liability limit are the owner's responsibility;*
- *many failures have gone unrecognised and will, therefore, remain the owner's responsibility;*
- *some owners are responsible for the building work (they are the developer) or have failed to mitigate damage when recognized (contributory negligence).*

33. The report concluded that the "leading causes of the leaky buildings crisis included ill-judged regulations in the 1990s and the use of untested materials and building techniques". Essentially the Building Act 1991 reduced controls and standards under the assumption that building quality would be assured by market driven forces. What followed was the use of unproven materials such as untreated timber and the use of new and untested products such as monolithic claddings. An extract from the PWC report is included as **Attachment A** to this report - it lists key legislative events.

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34. Since receiving the report in mid 2009, the Government has been in consultation with the Mayors of six of the major Metro Councils and suggested the issue of leaky buildings could be resolved finally for all claimants if the Government would contribute 10 per cent of the repair cost, Councils 26 per cent and the homeowners the remaining 64 per cent (with homeowners having the ability to pursue other parties to contribute ie builders, developers and sub contractors).
35. The Government proposal has presently been rejected by a negotiating party comprising the Mayors of Wellington and Auckland City Councils. They are seeking a proposal from the Government which would see a contribution of 50 per cent of the repair cost by the home owners, 25 per cent by the Government and 25 per cent by Councils.
36. The Government proposal obviously has significant financial implications for Councils, including Christchurch City Council, who currently have no provision in their LTCCP to meet the potential cost of a 25 per cent share. A major concern for Christchurch City is the number of affected buildings and the repair costs in the PWC report are principally based on North Island figures. These figures do not reflect the larger proportion of more conservative and lower risk dwellings built in Christchurch during 1992 to 2004 or the lower repair costs associated with leaky buildings in Christchurch.

Role of the Council with weathertightness claims

37. Legally, weathertightness claims involving the Council are based on the allegation that the Council has been negligent in approving the building consent or in the building inspections it carried out once a consent has been granted.
38. This liability for councils in the building area comes from a court decision in the 1970s and the Council receives a number of claims each year in relation to its building processes. To manage this ongoing liability the Council has had Professional Indemnity Insurance. Mostly the Council has had an excess of \$10,000 per claim with the insurer meeting the balance of any damages and costs the Council may be required to pay if negligence by the Council is proven and if loss is sustained.
39. In common with other insurances policies, a condition of the Professional Indemnity's policies has been that once the Council makes a claim the insurer takes over responsibility for deciding how that claim is managed. The insurer also decides whether or not the claim is settled or the issue is resolved through the Courts. If a claim is not settled then typically they would be dealt with in either the District or High Court depending on the quantum of damages being sought.
40. With building claims, often there are a number of parties involved, which may include the architects/designer, builder, subcontractors, Council and professional advisors such as engineers. If the Court finds there is liability on those parties then the Court also apportions the liability between those parties so that each of them is responsible for paying their portion of the damages as found by the Court. The liability is joint and several which means that if one of the parties is unable to meet their share of the cost of the claim the other liable parties have to pay that share.
41. At present any building claims (including a weathertightness claim) must be lodged with the Court or Weathertightness Homes Resolutions Services (WHRS) within 10 years of the date that the house was built or altered.
42. Building or alteration work on which a claim is based must have been completed within the 10 years preceding the date the claim is received by the WHRS.
43. The completion date is the date the house was habitable or that the alterations were fit to be used. The date of a Code of Compliance certificate will not necessary be accepted as the date of completion of a house - the Certificate could have been issued long after work was finished. An owner may be required to provide evidence on when the house was habitable, eg power connected.

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44. Alterations must have changed or modified the original house design or materials. Home maintenance and minor repairs are unlikely to be considered alterations.

Christchurch City Data

45. Between 2000-2007 there were 10,725 single dwelling units built in Christchurch. Of these 1774 were monolithic which is 16.5 per cent overall. These Christchurch percentages are considerably less than those seen nationally. Nationally, these were the percentages of monolithic buildings:

- 2000 - 40%, 2001 - 37%,
- 2002 - 37%, 2003 - 23%,
- 2004 - 18%, 2005 - 16%,
- 2006 - 17%, 2007 - 14%,
- 2008 - 14%.

46. On the WHRS national database, there are 1,939 active claims involving 3,960 residential units.
47. Christchurch has 109 active claims (5.6 per cent of the national total), involving 232 residential units and a further two claims in the District Court.
48. The following table shows the number of our claims and the amount claimed (where information is available). The claim is not just against the Council - the builder, developer and roofer are all parties to the claim. The 2003/04 year was the first year the WHRS began operations.

Period	Number of Claims	Quantum /Year	Average value of claim
May 03 - June 04	30	\$1,732,114	\$78,732
July 04 - June 05	36	\$1,427,114	\$39,642
July 05 - June 06	19	\$2,410,822	\$133,934
July 06 - June 07	25 (3 claim amount unknown)	\$2,048,374	\$93,107
July 07 - June 08	56 (31 claim amount unknown)	\$4,825,569	\$193,023
July 08 - June 09	45 (41 claim amount unknown)	\$859,395	\$214,849
July 09 - Dec 09	12 (12 claim amount unknown)	\$0	\$0

49. The average payout to claimants since 2004 from the Council and its insurers is \$27,503. However, legal costs almost double this and recently an escalation in costs as other parties go out of business has left the Council with a greater proportion of the cost, being jointly and severally liable under the Act (average insurance and legal cost of the last 30 claims is \$48,000).
50. The Council has had 225 claims since the introduction of the WHRS legislation and have settled 114. The balance is made up of the 109 claims still active on the WHRS website and two claims where the owners have gone straight to the District Court, bypassing the WHRS system. The recent legislative streamlining of the WHRS process and claimants being encouraged to repair leaks prior to lodging their claim has accelerated the pace at which claims are settled. Currently the Council is resolving approximately 20 claims each year. In 2006 to 2008, the average was resolution of 14 claims per year. The claims we have been settling more recently have averaged \$50,000 (including legal fees).

Council's Weathertight Insurance

51. The Council's insurer Riskpool has been progressively changing the terms of the Council's Professional Indemnity policy and insurance excess regarding weathertight claims.
52. Prior to 2006, our excess was \$10,000, in 2006 new claims were given a \$50,000 excess and now all claims (including retrospective claims) have a \$50,000 excess. The insurance limit for multi unit claims was set at \$500,000 in 2006, and from 2007 all Council weathertight claims have a limit collectively of \$500,000 per year. From 1 July 2009, all new claims for weathertightness are not covered by Riskpool and the Council is self insured. No insurance company today provides cover for Weathertight claims.

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53. The 97 active claims listed with the WHRS and two filed in the District Court are covered by the Council's insurance, with a \$50,000 excess for each claim. The Council has been formally advised by WHRS that a further 12 claims have been filed with WHRS since 1 July 2009 (when insurance ceased) but at this time there is no information as to what damages are being sought. It is the combination of 97 insured claims and 12 uninsured claims which leads to the 109 WHRS active claims plus the two claims in the District Court.

2010/11 Annual Plan Provision

54. Staff have recommended an increase for the 2010/11 Annual Plan of \$830,000 to \$1 million for six years to meet leaky building claims. The basis for this is that there is currently \$170,000 in the LTCCP for 10 years. So an additional \$830,000 is proposed in the 2009/10 Annual Plan for a total of \$1 million.
55. There are currently 111 leaky building claims (109 on WHRS and two in the District Court).
56. The Council is now settling approximately 20 claims a year with an average payment per claim of \$50,000. This gives a total of \$1 million per annum.
57. Assuming that the average settlement rate of 20 claims continues and that there are no new claims then the Council will have settled the remaining 110 claims in approximately six years.
58. Therefore it is recommended that the Council provide the additional \$830,000 for six years until the 2016/17 financial year. The Council could then leave \$170,000 per annum for the balance of the LTCCP to meet any residual claims.
59. These figures are approximate and will need to be revisited regularly.