

The Treasury

Proactive release of Treasury advice related to the increase to the EQC Residential Building Cap

October 2021

This document has been proactively released by the Treasury on the Treasury website at

<https://www.treasury.govt.nz/publications/information-release/proactive-release-treasury-advice-related-increase-eqc-residential-building-cap>

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

- [25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information
- [26] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied
- [27] 9(2)(ba)(ii) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely otherwise to damage the public interest
- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [25] appearing where information has been withheld in a release document refers to section 9(2)(b)(ii).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Reference: T2021/342 SH-11-4-3-4-7

Date: 2 March 2021

To: Minister Responsible for the Earthquake Commission (Hon Dr David Clark)

Deadline: None

Aide Memoire: House price increases and the Earthquake Commission cap

At our last meeting, you requested information about how house prices have risen since the Earthquake Commission (EQC) cap was set at \$100,000 plus GST in 1994.

This aide memoire provides:

- an estimate of what a house purchased for \$100,000 in 1994 would cost today using different inflation indexes (Chart 1)
- median house price data since the EQC Cap was set at \$100,000 in 1994 (Chart 2).

Katie Davis, Graduate Analyst, Financial Markets, ^[39]
Dasha Leonova, Manager, Financial Markets, ^[39]

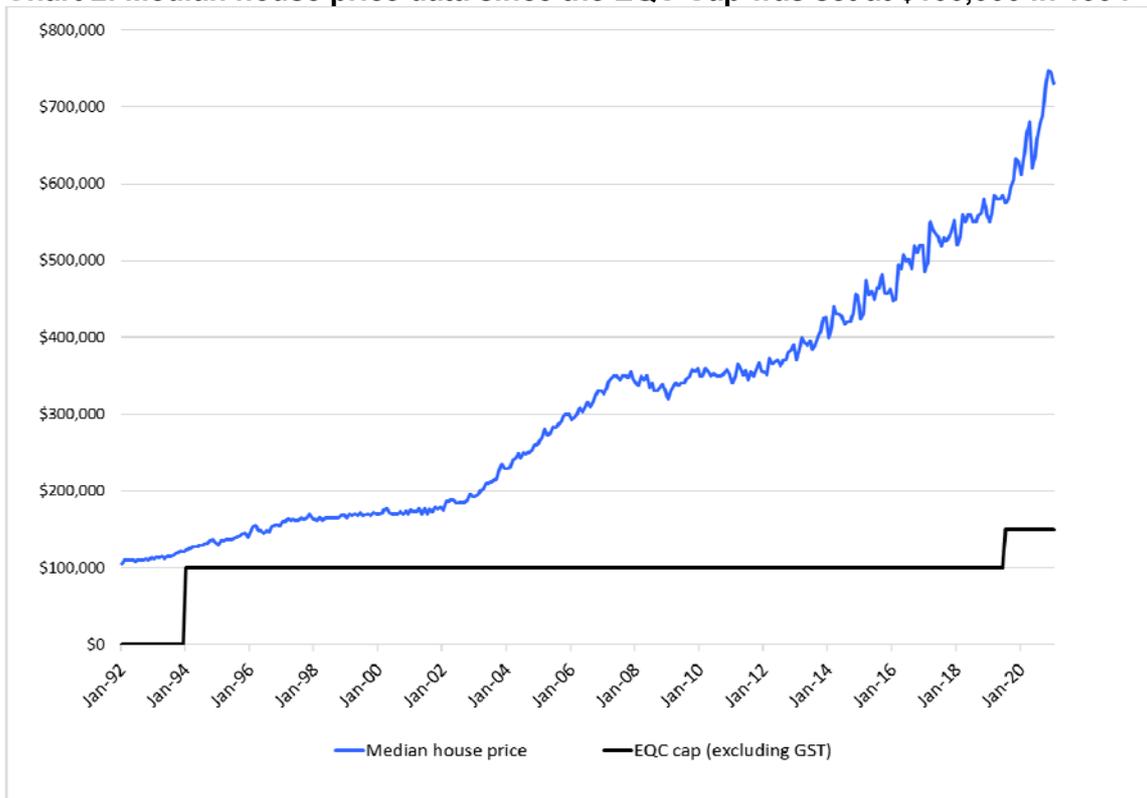
Chart 1: An estimate of what a house purchased for \$100,000 in 1994 would cost in September 2020 (“today”) (using different inflation indexes)



Source: RBNZ, StatsNZ

- **Consumers price index (CPI):** measures the price of a fixed basket of goods and services worth \$100,000 in 1994 in today’s dollar terms.
- **CPI – Purchase of new housing (excluding land):** this indicator is our best estimate of the cost to (re)build a new house in today’s dollar terms, that would have been worth \$100,000 in 1994. It measures the prices of newly built houses, excluding the land they are built on, and does not include the prices paid for existing housing stock being sold.
- The difference between the two CPI indicators reflects the greater increase in inflation of house prices excluding land (approximate construction costs) over time, relative to the inflation of general prices.
- **PropertyIQ House price index (HPI):** measures the movement in house prices for local council areas throughout New Zealand, providing an indicator of capital growth and how prices are trending in an area. This is inclusive of land value. The graph above therefore shows the price of a house (and land) that was worth \$100,000 in 1994 in today’s dollar terms.
- Note: these inflation-indexes do not control for GST and the impact this may have on pricing.

Chart 2: Median house price data since the EQC Cap was set at \$100,000 in 1994



Source: REINZ, StatsNZ

- **Median house price:** measures the “mid-point” of house prices that reflects what most people are going to be buying and selling houses for in New Zealand.
- **EQC cap (excluding GST):** shows the maximum value that EQC would pay for any given claim, excluding the value of GST.

Analysis

House price growth since 1994

Charts 1 and 2 show median house prices and the inflation-adjusted cost of a new \$100,000 house purchased in 1994 in today's¹ dollar terms over time. The cost to build a new house in 1994 in today's dollars terms is about \$300,000 (see Chart 1 – *CPI – Purchase of new housing excluding land*). However, this is for a set of goods fixed at the level required to build a house in 1994. This figure also excludes the cost of land, as the EQC cap relates to building cover under the EQC Act rather than land which is additional to EQC building cover. The value of land cover is calculated on a different basis to buildings.

The current median house price of around \$730,000 (Chart 2) is significantly different to the inflation-adjusted price (see Chart 1 – *CPI – Purchase of new housing excluding land*). This is a result of several factors for example:

- the median price includes land whereas the inflation adjusted cost to build a house does not;
- the price of land has increased significantly compared to building materials;
- the houses being built today are generally larger and more complex, and therefore require more resources;
- demand side factors such as interest rates and migration driving the price up; and,
- supply side constraints such as land availability and barriers to development.

The purpose of the EQC Cap

The EQC residential building cap was originally set at \$100,000 plus GST effective at the beginning of 1994. This was roughly the cost of building a basic house at that time. The intent was that the EQC's monopoly on disaster insurance cover should be discontinued, and the scope of the EQC's cover would become progressively limited as market conditions allowed and private insurance became available.

Since the cap was introduced, both the insurance market in New Zealand and the global reinsurance market have developed, removing EQC's monopoly on disaster insurance as intended. While some properties have experienced increased insurance prices in recent years, we have not seen widespread evidence of insurance uptake falling or residential properties having no access to insurance. There is the exception of a very small number of MUBs which do not have access to full cover, which have been warned that if they do not undertake seismic strengthening, their insurer may decline cover in the future.

Internationally, private markets for catastrophe insurance tend to be marked by low rates of insurance uptake and fluctuations in supply of this type of cover. This results in significant levels of under-insurance or non-insurance among property owners. However New Zealand has very high rates of disaster insurance, compared to other countries affected by destructive earthquakes since 1980.

¹ Where today's dollar terms is as at September 2020.