

The Treasury

Treasury Advice Related to Modernising the EQC Act Information Release

December 2021

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Treasury Report: EQC Act Review: Refining the objectives of a future EQC scheme

Date:	24 September 2020	Report No:	T2020/3164
		File Number:	TY-2-1-17-2-2

Action sought

	Action sought	Deadline
Hon Grant Robertson Minister Responsible for the Earthquake Commission	Decisions on the scope of the Government's interest in restoring disaster damage to housing.	29 September 2020

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Steve Cantwell	Principal Advisor, Earthquake Commission Policy Team ^[39]	N/A (mob)	✓
Helen McDonald	Manager, Earthquake Commission Policy Team	^[35]	

Minister's Office actions (if required)

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: EQC Act Review: Refining the objectives of a future EQC scheme

Executive summary

This report seeks decisions from you on refining the objectives of the Earthquake Commission (EQC) scheme. These decisions will help focus future advice on reform and modernising opportunities for the EQC scheme.

You recently agreed on your policy objectives for the future EQC scheme and EQC Act, and that the scheme would retain its existing core features (T2020/2370 refers).

This report uses stylised future EQC schemes to illustrate four broad strategic options for the principal policy objective of reinstating or replacing residential property that suffers natural disaster damage. The key questions these options raise are:

- Do the Government's interests extend beyond repairing homes to a safe and sanitary standard?
- Do the Government's interests extend beyond reinstating the damaged residential building? If so, how much further?

The four strategic options are:

- **Restore basic necessities:** Restore only the function of core necessities for safe and sanitary housing, and no more.
- **Restore housing:** Full reinstatement or replacement of only the buildings and appurtenant structures that provide living, accommodation, cooking, ablution and laundry facilities, access to the home(s), services, and any land essential for such reinstatement or replacement. No cover for other appurtenances or land that do not serve these defined housing purposes. We see this option as focusing EQC coverage on the Government's key interests in reinstating housing in disaster-affected communities. (**Recommended option**).
- **Restore housing plus core appurtenances:** The same as the 'restore housing' option above, with additional cover for a limited range of appurtenant structures and land associated with, but not essential for, housing purposes (e.g. separate carport, garage or storage sheds). (**Recommended option if the 'restore housing' option does not meet your objectives for scheme coverage**). If you choose this option, we will provide advice to refine it further. This option can be calibrated to be close to the previous option (restore housing) or the next option (restore housing and appurtenances with few limits), depending on how limited or expansive the EQC cover of appurtenant structures is.
- **Restore housing and appurtenances with few limits or exclusions (status quo):** Full reinstatement or replacement of all residential buildings, appurtenant structures and some associated land, with exclusions continuing to include specified 'lifestyle' amenities such as swimming pools, tennis courts and jetties and non-essential 'finishes' such as paving on accessways.

Annex 1 and 2 provide tabular and diagrammatic summaries of these options.

We will incorporate your decisions on the options this paper into our upcoming advice on modernisation of the EQC scheme, including reporting on EQC building cover, EQC land cover, and the statutory purposes of the scheme.

Recommended action

We recommend that you:

- a **note** that you have four broad strategic options for the policy objective of the EQC scheme to reinstate or replace residential property that suffers natural disaster damage:
1. Restore basic necessities for a safe and sanitary home (without addressing aesthetic and cosmetic damage)
 2. Restore housing
 3. Restore housing plus targeted appurtenances, or
 4. Restore housing and appurtenances with few limits or exclusions (status quo).

EITHER

- b **agree** that the 'restore housing' option described in this report best captures the Government's objectives for the EQC scheme (**recommended option**).

Agree/disagree.

OR

- c **agree** that the 'restore housing plus targeted appurtenances' option described in this report best captures the Government's objectives for the EQC scheme (**officials' next-preferred option**).

Agree/disagree.

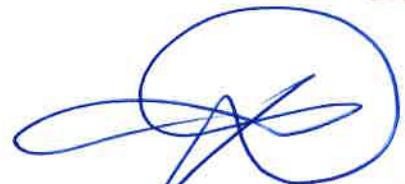
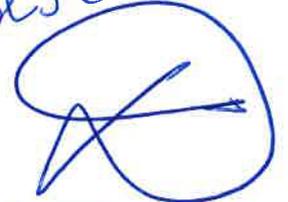
- d **note** that this decision will inform upcoming advice on more detailed design choices regarding the EQC scheme.

?

Helen McDonald
Manager, Earthquake Commission Policy Team

Hon Grant Robertson
Minister Responsible for the Earthquake Commission

Please stick with status quo as subsequently discussed.



David Clark.

26/1/21

Treasury Report: EQC Act Review: Refining the objectives of a future EQC scheme

Purpose of report

1. The purpose of this report is to seek a decision from you to refine the objectives of the EQC scheme. Your decision will help focus future advice on reform and modernising the EQC scheme.

Recent decisions on the objectives and scope of review of EQC Act

2. You recently agreed (T2020/2370 refers) that the below list accurately captures your policy objectives for the future EQC scheme and EQC Act:
 - a To help create the right conditions for high levels of homeowner disaster insurance, including through supporting availability and affordability of insurance, and facilitating better public understanding of property risks and insurance,
 - b to minimise the potential for property owners to experience socially unacceptable distress and loss in the event of a natural disaster,
 - c to support an efficient approach to the overall management of natural disaster risk and recovery, that contributes to New Zealand's long-term preparedness and resilience, both nationally and across regions,
 - d to contribute to the effective management by the Crown of fiscal risks associated with natural disasters, and
 - e to respond to the recommendations of the Public Inquiry into the EQC (the Public Inquiry) that have been identified as being addressed through the review of the EQC Act.
3. You also agreed, in the same report, that the review of the EQC Act would be 'evolutionary' and therefore retain:
 - a EQC cover being first-loss cover,
 - b access to EQC cover being determined by compulsory attachment to qualifying private insurance policies on the relevant property,
 - c EQC premiums being collected by private insurers and passed to EQC,
 - d the EQC scheme being focused on only residential property (although we will provide advice on boundary issues such as mixed-use buildings (MUBs), land cover, definitions, technical changes and so on),
 - e EQC building and land cover be retained (although we will advise on the configuration and coverage of both building and land cover), and
 - f EQC continuing to be a Crown Entity.

Further refining your previous decisions on building and land cover

4. The framing of the Government policy interests in report T2020/2370 was that, for the EQC scheme to be durable in the face of post-disaster pressures, at a minimum the scheme's configuration should not result in losses for the affected community that are above the threshold of "unacceptable distress and loss" that forces an ad-hoc post-disaster government response.
5. The above decisions provide useful high-level guidance on the Government's objectives, and hence, design, of the EQC scheme. However, we have yet to confirm with you which strategic approach to the design of the scheme best reflects and balances the Government's five objectives for the scheme.
6. Therefore, this report seeks decisions intended to further clarify and confirm the Government's policy objectives for the EQC scheme. These clarifications will build on your earlier decisions, and provide important strategic context for our subsequent advice on scheme design issues, including:
 - the extent, basis and interaction between building cover and land cover
 - the standard of repair for building cover
 - the level of the monetary cap for building cover, and
 - the statutory purposes and objectives for EQC and the EQC scheme.

Scope of the Government's interest in restoring natural disaster damage to housing

7. The coverage of the current EQC scheme has been shaped by past judgements by successive governments regarding core policy objectives, including the decisions to:
 - remove non-residential property from the scheme from 1994
 - add land cover to the scheme in the 1980's following the Abbotsford landslip
 - exclude items such as outside paving, swimming pools, tennis courts and wharfs and jetties from EQC cover from its inception, and
 - remove EQC cover for household contents as part of the 2019 amendments.
8. These previous design decisions suggest that the current core policy objectives of the scheme are to provide the resources to enable damaged residential property to be repaired, either by EQC or the associated private insurer cover. However the exclusions of some items of residential property suggests government interests are more focused than simply capturing all residential property.
9. We see four broad strategic options for the principal policy objective of reinstating or replacing residential property that suffers natural disaster damage. We have developed stylised options to represent what a future EQC scheme might look like if designed to deliver that version of government interests. The key questions these options raise are:
 - do the Government's interests extend beyond repairing homes to a safe and sanitary standard?
 - do the Government's interests extend beyond reinstating the damaged residential building? If so, how much further?

10. The EQC scheme currently focuses on residential buildings, dwellings, and associated access, services (power, gas, water, and wastewater), appurtenant structures and land, including any retaining walls, bridges and culverts necessary to protect and support the home, associated buildings, and access to it.
11. Appurtenant structures are any building other than the main residential building. Appurtenant structures are included in the current definition of 'residential building' in the EQC Act, so are covered by EQC unless specifically excluded (such as wharfs). Structures currently covered by EQC range from substantial items such as garages and sleep outs through to clothes lines, chicken coops, dog runs, play houses, and fixed outdoor entertainment areas such as barbeque pits.
12. The EQC scheme also covers residential land closely associated with the insured buildings. Land cover is described in the 'residential land' section of this report.
13. The four strategic options are:
 - **Restore basic necessities:** Restore only the function of core necessities for safe and sanitary housing and no more (i.e. the minimum required to meet relevant laws with no attention to aesthetics or wider utility of appurtenant structures or the land).
 - **Restore housing:** Full reinstatement or replacement of only the buildings and appurtenant structures that provide living, accommodation, cooking, ablution and laundry facilities, access to the home(s), services, and any land essential for such reinstatement or replacement. No cover for other appurtenances or land that do not serve these defined housing purposes.
 - **Restore housing plus core appurtenances:** The same as the 'restore housing' option, but with additional cover for a limited range of appurtenant structures and land associated with, but not essential for, housing purposes (e.g. separate carport, garage or storage sheds).
 - **Restore housing and appurtenances with few limits or exclusions (status quo):** Full reinstatement or replacement of all residential buildings, appurtenant structures and some associated land, with exclusions for specified 'lifestyle' amenities such as swimming pools, tennis courts and jetties, and non-essential 'finishes' such as paving on accessways.
14. These four strategic options are discussed further below. Although the stylised examples focus on stand-alone homes, the options are equally applicable to multi-unit and mixed-use buildings. Annex 2 shows the options in diagrammatic form.

Restore basic necessities (option one)

15. At a minimum, a government post-disaster objective is to restore the core necessities of a safe and sanitary home. An EQC scheme configured on this basis would focus on the repair or reinstatement of essential functional requirements of a safe and sanitary home (e.g. weather tightness, structural safety, functioning water, power, and waste water). It would repair damage only to the extent necessary to achieve that goal. It would not repair aesthetic damage, nor reinstate buildings and finishes to a 'when-new' condition.
16. Options akin to this were proposed by some submissions on the 2015 discussion document on reforming the EQC scheme. Such proposals are in response to concerns that much EQC effort in Canterbury was directed to cosmetic repair, distracting EQC from focusing on higher-priority work restoring safe and sanitary homes.
17. The advantage of this option is that it focuses EQC on restoring safe and sanitary housing, which is an immediate post-disaster recovery priority. However, we see this

option as incompatible with the dual insurance model of the current scheme, which you have agreed to retain as part of an evolutionary review.

18. That is because an EQC repair standard focused on restoring safe and sanitary functionality is very different from, and lower, than the repair standard applicable under private insurance policies. Therefore, any EQC claim would be accompanied by a claim with the private insurer for the same damage, with EQC repairing structure and utility and the private insurer repairing to a when-new aesthetic finish. This would create pervasive claims attribution and management disputes. We expect that such an approach would result in worse claims experiences for homeowners than at present, which is inconsistent with the objective of responding to the recommendations of the Public Inquiry.
19. Also, as part of other upcoming reporting, we intend to provide you advice recommending changes intended to minimise differences between EQC and insurer's repair standards. This option would result in a larger difference in repair standards. The increase in insurers claim costs on below-cap EQC claims would also be reflected in higher private insurer premiums. We do not recommend this option.

Restore housing (option two) (recommended option)

20. This option focuses on reinstating the home. An EQC scheme configured on this basis would cover the dwelling or residential building or other structures that collectively provide living, accommodation, cooking, ablution and laundry facilities, access to those structures, services, and any land and associated retaining walls, bridges and culverts necessary to provide those structures. This option increases the focus of the EQC scheme on housing, while retaining the 'when-new' repair standard of the current scheme.
21. The key advantages of this option are:
 - it focuses on, and addresses, what appear to be the core Government interests motivating the EQC scheme. Compared to the current scheme, this scheme would be much more focused on insuring the home. Appurtenant structures would not be covered unless they provided a core residential function, for instance an outside laundry. Land damage would be covered if its repair was necessary to protect or support buildings, access, or any other structures covered by EQC.
 - it responds to the Public Inquiry's concerns regarding housing quality by focusing on reinstating the home.
 - it provides the most policy, legislative and administrative clarity to homeowners, insurers and EQC regarding what EQC covers, and
 - as it would generally not cover appurtenant structures, its levy rate and fiscal risks would be lower than for schemes with more extensive cover.
22. Key disadvantages are:
 - It provides less EQC cover of appurtenant structures, and associated land, than the current scheme.
 - It raises equity issues. A garage incorporated into the residential building would be covered by EQC, whereas a separate garage would not (option three mitigates this issue, at the cost of expanding scheme coverage).
23. We see this option as matching the scheme's coverage to the political-economy rationale for the scheme, namely insuring homeowner assets that are likely to force

post-disaster support from government if there are significant levels of uninsured in the disaster-affected community. Therefore, we recommend this option.

24. If Ministers consider that the Government interests motivating the EQC scheme extend beyond the coverage provided by this option, we recommend expanding the coverage as much as necessary to meet those wider Government interests, while staying as close to this model as possible. The next option provides a design that can be calibrated in this way.
25. The next two options both provide the cover described in this option, plus cover to additional structures as outlined below.

**Restore housing plus core appurtenances (option three)
(officials' next-preferred option)**

26. A slightly broader view of the core government post-disaster housing objectives extends coverage to include structures and land associated with a limited number of highly-valued household activities or capabilities. The strongest candidates being separate garages and carports.
27. As the EQC scheme currently covers most appurtenant structures, this option would exclude from EQC cover any appurtenant structures unless they met certain defined purposes.
28. The key advantages of this option are:
 - compared to the 'restoring housing' option, it has the flexibility to incorporate any appurtenant structures and land that are closely associated with government or community views of core or essential characteristics of a home, such as a detached garage or substantial equipment shed,
 - it avoids the potential equity problems of the 'restoring housing' option,
 - compared to the status quo option, limiting cover to the home and defined appurtenant structures would provide policy, legislative and administrative clarity to homeowners, insurers and EQC regarding what EQC covers, and the improved focus responds to the Public Inquiry's concerns regarding housing quality.
 - the levy rate and fiscal risks would be lower than for the status quo option.
29. The key disadvantages are:
 - it loses some of the policy, legislative and administrative clarity of option two,
 - including some appurtenances and excluding others will raise boundary issues with mixed-use appurtenances used for both included and excluded purposes,
 - unless the policy basis for coverage is very clear, sustaining any chosen boundary may be difficult in the face of post-disaster pressures to extend the scheme to more appurtenant structures, and
 - the reduction in EQC's cover of appurtenant structures may be criticised by clamant groups.
30. We recommend this option if you consider that the 'restore housing' option does not best capture the Government's objectives for the EQC scheme.

31. If you choose this option, we will provide further advice to refine it. This option can be calibrated to be close to the previous option or the next option, depending on how limited or expansive the EQC cover of appurtenant structures is.

Restore housing and appurtenances with few limits or exclusions (status quo) (option four)

32. This is the status-quo option. The key advantage is that it substantially retains the existing coverage of appurtenant structures.
33. The key disadvantages are:
- it retains EQC cover for a wide range of appurtenant structures, including many that are minor or of limited Government interest,
 - coverage of these minor structures adds uncertainty and complexity to EQC building and land cover,
 - land cover associated with appurtenant structures can be unduly generous,
 - it has the highest levy rate and fiscal risks (although the differences are likely fairly minor).
34. If you chose this option, we will provide advice on refining the scheme's treatment of appurtenant structures along current lines, including whether minor structures should be retained, and the configuration of EQC land cover associated with appurtenant structures.

Will appurtenant structures not covered by EQC be insured elsewhere?

35. Three of the above-described options would result in EQC no longer insuring at least some appurtenant structures. Private insurance policies currently generally cover appurtenant structures. However, private insurers often charge higher excesses for natural disaster damage to items that are not covered by EQC. For instance, Vero's Residential Home Policy¹ provides for a \$5,000 excess on natural disaster damage to items not covered by EQC (such as tennis courts).
36. Insurers have expressed support for clarifying the definition of appurtenant structures. Insurers suggest the future EQC Act or regulations address the current ambiguity by specifying a list of structures captured within the definition. Therefore, although we have not tested these options with insurers, their position appears closest to options three and four.
37. Private insurer policies are designed around the current EQC scheme. If EQC's coverage of appurtenant structures changes significantly, private insurance policies may evolve to manage or price any risks transferred to them. We do not know how material these changes might be. We will consult insurers as part of developing our follow-on advice, once your decisions on this paper are known.

¹ Source: Policy wording on Vero website, 19 September 2020.

How will your decisions inform upcoming advice?

Monetary caps on EQC building cover

38. We intend to provide substantive advice on options for the monetary cap on EQC building cover. Some general observations regarding the above four options are:
- none of the options rule out any particular dollar value for the monetary cap on building cover,
 - in principle, for a given EQC cap, the more the EQC scheme focuses on the home and its essential housing functions, and excludes appurtenant structures, the greater the EQC resources available to be directed to reinstating the home,
 - the ‘restore basic necessities’ implies a relatively low cap, as this option makes the lowest financial demands on the scheme,
 - EQC are unable to provide data on the historical share of EQC claims expenses attributable to appurtenant structures, but EQC advise that appurtenant structures generate a relatively small fraction of EQC claims expenses, so this trade-off is likely very modest. A 2012 survey of claims from the Port Hills in Christchurch noted that about 20 percent of surveyed claims would be affected if appurtenant structures were excluded from EQC cover, and
 - we envisage that in future the scheme will be priced to reflect its expected costs. Lower-cost designs will result in lower EQC premiums. Any costs and risks transferred to private insurers can be expected to be reflected in their premiums.

Residential buildings and appurtenant structures

39. How the Act defines residential buildings and what is included in them is a key determinant in the scope of EQC cover. Your decision on what configuration of EQC cover best balances the Government’s objectives will help guide future policy recommendations regarding the scheme’s coverage.

Residential Land

40. EQC land cover currently covers:
- land under or within 8 meters of the insured building, and any appurtenant buildings and structures (known as “the 8 metre rule”),
 - the first 60 metres of the main accessway (but not its artificial surface),
 - any retaining walls, bridges and culverts in that area, and
 - all retaining walls within 60 metres of the building which are necessary for the support or protection of the building or any other property covered by EQC land cover (this and the accessway rule collectively known as “the 60 metre rule”).
41. EQC land cover operates entirely separately from EQC building cover, and is subject to different monetary caps and excesses.
42. A key question we will address in future reporting is whether land cover should be adjusted to better match the Government’s interests in providing EQC cover to residential property. That requires determining if EQC land cover only exists to provide protection, support and access to the residential building and any appurtenant structures covered by EQC, or also serves other objectives too. Your decisions on this report will help focus that advice on design questions of most relevance to you.

43. Private insurers do not insure land, so any reduction in EQC land cover transfers the associated risk to the property owner.

Statutory purpose

44. The Public Inquiry recommended that the EQC Act include a purpose statement and set of statutory principles to aid interpretation and guide future decision makers. You will receive advice on a purpose statement in October 2020.
45. Our advice on a purpose statement will take into account the intervention logic to support the current design of a capped first-loss natural disaster insurance scheme, alongside the decisions you make on the scope and targeting of land and building cover discussed in this paper.

Consultation

46. The EQC, the Ministry for the Environment, the Reserve Bank, the Department of Internal Affairs, the National Emergency Management Agency, and the Ministry of Business, Innovation and Employment were consulted on this report. The Department of Prime Minister and Cabinet were informed.
47. We have not yet sought the views of non-government stakeholders on these proposals. We anticipate insurers and claimant groups would oppose option one. As noted earlier, although we have not yet consulted insurers on the options in this report, their current position appears closest to options three and four. Insurers have also expressed support for land cover being more integrated with EQC building cover.

Next Steps

48. We will incorporate your decisions on this paper into our upcoming advice on modernisation of the EQC scheme, including reporting on EQC building cover, EQC land cover, and the statutory purposes of the scheme.

Annex 1: Scope of EQC Cover under illustrative future design options

Option/ Government Objective	Illustrative Future EQC Scheme’s Coverage of...			Recommendation
	Dwellings and residential buildings	Appurtenant structures	Residential land	
Restore basic necessities	Restore to safe and sanitary standard only. Relatively low monetary cap.	Covered to extent needed to deliver basic necessities	Covered to extent needed to restore support and protection of the home, and services and access to it.	Not recommended as it creates challenging interactions between EQC and private insurance cover.
Restore housing	Restore home and services to current scheme’s standard of repair. Focuses EQC funds on housing repair.	Covered if needed to restore services to home (so generally not covered).	Covered to extent needed to restore support and protection of the home, and services and access to it.	Officials recommended option.
Restore housing plus targeted appurtenances	Restore home and services to current scheme’s standard of repair. Focuses EQC funds up to cap on repairing the home and chosen appurtenances.	Covered if meets specified list or criteria.	Covered to extent needed to restore support and protection of the home, services and access to it, and included appurtenant structures. Or, could adopt status quo land cover.	Officials recommended option if Ministers judge “Restore housing” option does not best meet policy objectives. Depending on decisions on cover of appurtenant structures and land, has potential to be akin to status quo.
Status Quo: Restore housing and appurtenances with few limits or exclusions	Restore home and services to current scheme’s standard of repair.	Currently covered unless specifically excluded.	All land under or within 8 metres of residential building or appurtenant structure covered. First 60 metres of accessway covered. Or, could adopt “housing plus targeted appurtenances” land cover.	If Ministers prefer the status quo option, we will report on options for better calibrating cover on appurtenant structures and their associated land.

Annex 2: Alternative options for reinstating or replacing homes

KEY

Orange icons: structures covered by EQC
Grey icons: structures not covered by EQC
Green dotted lines: associated land cover by EQC

Home restored to support function of core necessities (i.e. no attention to aesthetics). Includes services. Garage and other appurtenances not covered by EQC.

Land restored to support home and access way.

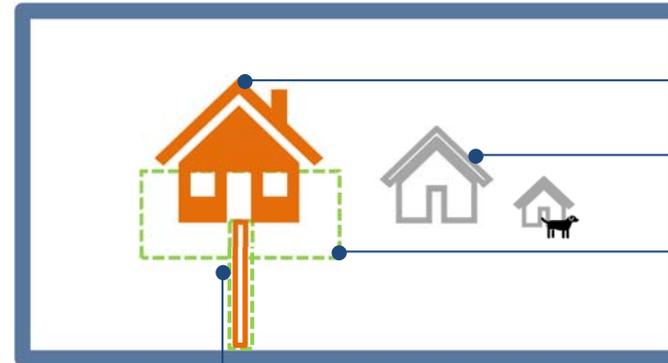
Option 1: Restore basic necessities



Access restored.

Appurtenances like garages and kennels **not** restored.

Option 2: Restore housing (recommended)



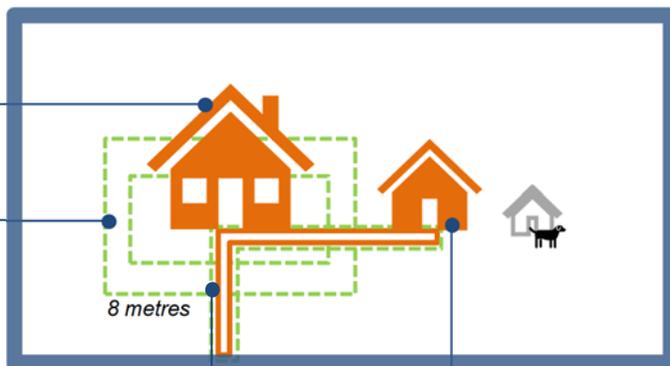
Access restored.

Home fully restored. Includes services.

Appurtenances like garages and kennels **not** restored.

Land restored to support home and access way.

Option 3: Restore housing plus targeted appurtenances



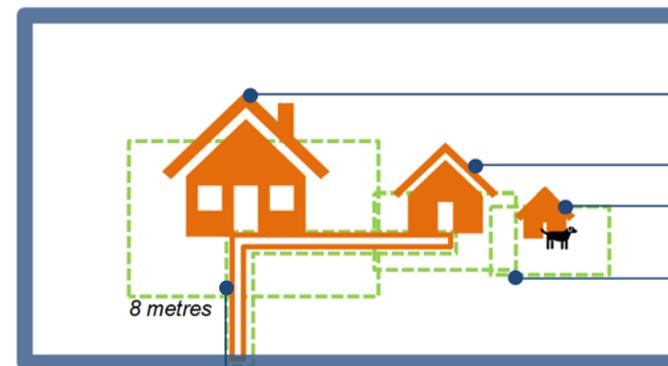
Access restored.

Targeted appurtenances like garages restored.

Home restored. Includes services.

Land restored to support home, access way, and targeted appurtenances. There is a choice under Option 3 of whether to retain land cover to 8 metres, or make it more targeted for purposes of supporting the home.

Option 4: Restore housing and appurtenances with few exclusions (status quo)



Access restored.

Home restored. Includes services.

Appurtenances like garages and kennels restored.

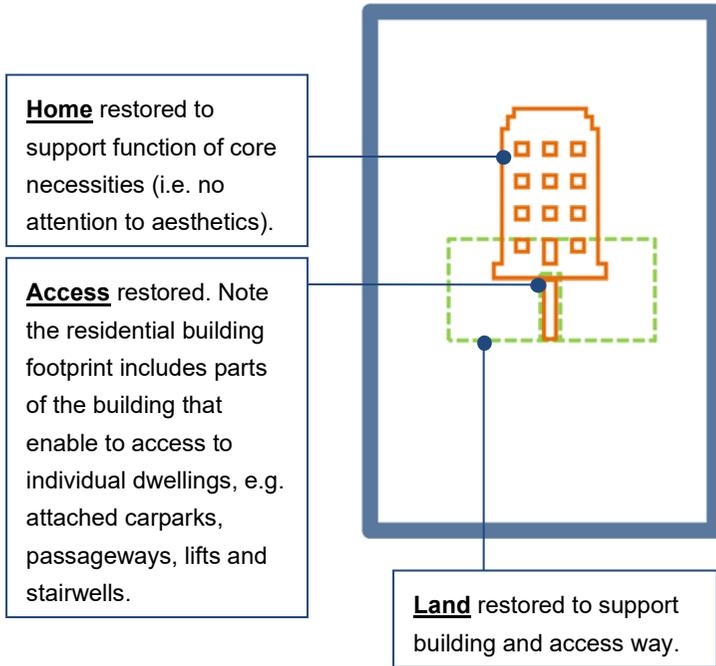
Land restored to support access way and restored to 8 metres around the home and appurtenances. Note we will provide further advice on land cover for appurtenances if you choose Option 4.

Implications for multi-unit buildings

KEY
Orange icons: structures covered by EQC
Grey icons: structures not covered by EQC
Green dotted lines: associated land cover by EQC

The four options would also apply to multi-unit buildings (MUBs). MUBs tend to not have separate appurtenant structures. For MUBs (and stand-alone houses) with no appurtenant structures the design options simplify to two options. This is depicted in the below diagram.

Option 1: Restore basic necessities



Option 2: Restore housing to “when new” standard (recommended)

