

The Treasury

Treasury Advice Related to Modernising the EQC Act Information Release

December 2021

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Treasury Report: Modernising the Earthquake Commission Act: Land and Building Cover Technical Issues

Date:	19 October 2021	Report No:	T2021/2301
		File Number:	TY-2-1-17-2

Action sought

	Action sought	Deadline
Hon Grant Robertson Minister of Finance	Note this report.	None.
Hon Dr David Clark Minister Responsible for the Earthquake Commission	<p>Agree to extend to EQC land cover, rules recently agreed for determining EQC building cover of mixed-use buildings.</p> <p>Agree to improve and harmonise EQC land and building cover for items associated with the residence that are located beyond the property or landholding boundary.</p>	11 November 2021.

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Steve Cantwell	Acting Manager, Earthquake Commission Policy Team [39]	[35]	✓
Danijela Tavich	Analyst, Earthquake Commission Policy Team		

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Modernising the Earthquake Commission Act: Land and Building Cover Technical issues

Executive Summary

This report seeks decisions on proposals to address two sets of technical issues regarding Earthquake Commission (EQC) cover, namely:

- determining EQC land cover when EQC insures some, but not all, of the associated building, and
- improving and harmonising EQC land and building cover for items associated with the residence that are located wholly or partly outside the EQC-insured landholding.

EQC land cover when EQC does not insure all of the associated building

In March 2020 Cabinet made decisions to clarify and improve EQC building cover of mixed-use buildings. You recently made decisions further refining the application of EQC building cover to mixed-use buildings with multiple owners of common areas. Both those sets of decisions will be reflected in the upcoming EQC Bill. We recommend that the principles reflected in those decisions be extended to also apply to EQC land cover.

Currently EQC land cover for mixed-use, or partially insured, buildings, applies to land directly connected to the EQC-insured parts of the building. This can result in significant inequities. Most notably, if no EQC-insured dwellings are in direct contact with the land, such as a mixed-use building with shops on the ground floor, the dwellings will have no EQC land cover.

Therefore we recommend that the EQC Bill provide that in situations where EQC building cover does not apply to all of the building in question, EQC land cover settlements be based on the same principles and approach already agreed for EQC building cover in that situation. That is, EQC land cover be based on the relative residential and non-residential shares of the building, as determined by either floor area, or ownership shares. That would result in the following outcomes:

- ***For residential buildings*** (that is, buildings that are 50 percent or more residential by floor area), full EQC land cover would continue to apply,
- ***For mixed-use buildings***, (that is, buildings that are less than 50 percent residential by floor area) ***with inseparable ownership interests*** (for instance, the building is on one title) the footprint of EQC land cover would be the same as if it were a residential building. Any EQC land cover settlement would be pro-rated to match the fraction of the floor area of the building that EQC provides EQC building cover for.
- ***For mixed-use with multiple ownership interests*** (for instance, a unit-titled or company-share mixed-use apartment building), the footprint of EQC land cover would be the same as if it were a residential building. Any EQC land cover settlement would be pro-rated to match the ownership shares in the building in question of any EQC-insured dwellings and appurtenant structures and common areas.

Improving and harmonising EQC land and building cover for damaged items located beyond the boundary of the EQC-insured property or landholding

The current EQC scheme does not cover important items associated with the proper functioning of the residence, because they are beyond the boundary of the property or landholding. Some residential property owners are responsible for the repair and

maintenance of related items beyond their landholding, such as drainage pipes, garages, retaining walls, and access culverts and bridges, on council road reserve.

We recommend that EQC building and land cover apply to these items located outside the insured property boundary or landholding where the items would have qualified for EQC cover if they were located within the property or landholding, the items serve the EQC-insured residential property (that is, broadly, the insured homeowner either owns, or has the right to use the item, uses the item for a household purpose, and is responsible for the repair and maintenance of, the damaged item).

Impact on claims costs

The proposals increase EQC cover, so will increase scheme costs. EQC is unable to estimate with any precision the impact of the proposed changes on EQC's future costs.

Next Steps

We will issue drafting instructions to Parliamentary Counsel Office (PCO) so that the EQC Bill reflects your decisions on this report's recommendations. You have power to act to make decisions on the EQC Bill consistent with the guidance provided by previous Cabinet decisions (CAB-21-MIN-0177 refers).

We are working with EQC on several other technical issues and intend to provide advice on those by mid-November.

Recommended Action

We recommend that you:

EQC land cover when EQC insures some but not all of the associated building

- a **note** that for mixed-use buildings where less than 50 percent of the building's area comprises dwellings (or, after previously agreed changes are introduced, residential areas, DEV-20-MIN0039 refers), EQC building cover applies to only the residential parts of the building, and EQC land cover is currently determined based on the residential parts of the building that are in direct contact with the ground;
- b **note** that this approach can result in inequities; in situations where the entire ground floor has a non-residential use (such as shops or offices), EQC claimants cannot access EQC land cover,
- c **note** that extending EQC land cover through the approach previously agreed by Ministers for determining EQC building cover would address these issues,
- d **agree** that ***for mixed-use buildings (per recommendation (a)) with inseparable ownership interests***, EQC land cover be determined by reference to the entire mixed-use building (and associated residential appurtenant structures and accessway), and pro-rated to match the fraction of the floor area of the building that EQC provides EQC building cover for,

Agree/disagree.

- e **agree** that, ***for mixed-use buildings (per recommendation (a)) with multiple ownership interests***, for instance, a unit-titled building, EQC land cover be determined by reference to the entire mixed-use building (and associated residential appurtenant structures and accessway), and EQC land cover settlements be pro-rated to reflect the

share of the building's ownership (insurable) interests that are associated with the EQC-insured residential parts of the building,

Agree/disagree.

- f **note** that current practice is retained for residential buildings (i.e. buildings that are 50 percent or more residential by floor area),

EQC building cover for items located wholly or partly outside the EQC-insured landholding

- g **note** that EQC building cover currently only extends beyond the property boundary when the damaged item is owned by the claimant, most commonly, garages located on council road reserve,
- h **note** that sometimes claimants have the right to use and may be responsible for the cost of repairs to items located beyond the property boundary that they do not own, and so are not covered by EQC, most commonly wastewater pipes and sewerage,
- i **note** that, to address this, the then-Minister Responsible for the Earthquake Commission issued a Ministerial direction to EQC on 9 August 2016, directing EQC to take on the additional function of repairing storm water and sewerage services that were on land not owned by the claimant, and were servicing EQC-insured buildings damaged in the Canterbury earthquake sequence,
- j **agree** that the policy intent of the 2016 Ministerial direction, extended nation-wide, be reflected in the new Act. This would extend EQC building cover of services associated with insured buildings, to services beyond the property boundary where all the other conditions normally attaching to EQC cover are met,

Agree/disagree.

EQC land cover for items located wholly or partly outside the EQC-insured landholding

- k **note** that EQC land cover currently takes a range of approaches to cover for items located beyond the landholding, resulting in outcomes that appear inequitable, or inconsistent with the policy goals of the EQC scheme; for instance, driveway bridges and culverts located on council road reserve are not covered by EQC,
- l **agree** that EQC land cover apply to retaining walls, bridges and culverts beyond the landholding where:
- (i) the structure would have qualified for EQC cover if the requirement to be located on landholding was not applied, and
 - (ii) the claimant uses, and either owns, or is responsible for the repair and maintenance of, the structure,

Agree/disagree.

- m **note** that this proposal is limited only to land structures beyond the landholding; not the land itself. EQC would continue to insure only land that is within the landholding,
- n **note** that damage to land beyond the landholding (i.e. land that EQC does not insure) would not trigger EQC cover for retaining walls supporting or protecting that land. EQC would only cover retaining walls located beyond the landholding when they support or protect EQC-insured structures, such as garages located on road reserve,

- o **note** that the extension of EQC cover to retaining walls, bridges and culverts located beyond the insured landholding, will not extend cover to those items if they are located on a neighbouring residential landholding (that is, owned by a residential neighbour),

Next steps

- p **note** you have Cabinet authority to make further decisions on the EQC Bill (CAB-21-MIN-0177 refers),
- q **note** that we will issue drafting instructions to Parliamentary Counsel Office reflecting your decisions on this report,
- r **note** that we are working with EQC on several other technical issues and intend to provide advice to you on those by mid-November,
- s **note** that the above-mentioned Ministerial direction to EQC of 9 August 2016, regarding repairing storm water and sewerage services situated outside the property boundary and services that solely service an appurtenant structure, recently expired. We are will provide separate advice on its renewal shortly.

Steve Cantwell
Acting Manager, Earthquake Commission Policy Team

Hon Dr David Clark
Minister Responsible for the Earthquake Commission

Treasury Report: Modernising the Earthquake Commission Act: Land Cover Technical issues

Purpose of Report

1. This report seeks decisions on proposals to address two sets of technical issues regarding EQC cover, namely:
 - EQC land cover when EQC does not insure all of the associated EQC-insured building, and
 - EQC land and building cover for items located wholly or partly outside the EQC-insured landholding.

Analysis

2. The current EQC Act can result in EQC cover applying to natural disaster damage in ways that are inequitable, and inconsistent with the policy goal of reducing “...*the impact of natural disaster damage by encouraging resilience and by contributing to the timely replacement or reinstatement of residential land and buildings*” (DEV-21-MIN-0062 refers).
3. This report proposes the EQC Bill address two sets of issues. The issues are:
 - EQC land cover when EQC insures some but not all of the associated building, and
 - EQC land cover for items located wholly or partly outside the EQC-insured landholding (e.g. retaining walls, bridges and culverts), and EQC building cover for items located beyond the boundary of the land on which the EQC-insured residence is situated (e.g. appurtenant structures and drainage pipes).

EQC land cover when EQC does not insure all of the associated building

Recent decisions on EQC building cover when EQC does not insure all of the associated building

4. Usually if EQC insures a dwelling, EQC cover applies to all of the building containing the dwelling. However, sometimes EQC building cover only applies to part of a building. The two most common reasons are:
 - *The building is a mixed-use building.* That is, dwellings, (plus, when the proposed EQC Bill takes effect, associated appurtenant areas and the residential share of common areas) account for less than 50 percent of the total floor area. In those cases, EQC only insures the residential share of the building.
 - *The building contains multiple dwellings and individual dwelling owners are responsible for their own insurance.* In these cases, any dwelling owners who do not hold insurance are not covered by EQC, so EQC cover does not apply to whole building. This most commonly occurs with small townhouse developments.
5. In March 2020 Cabinet agreed to amend the residential building test to account for the floor area of the dwellings, appurtenant structures, and the homeowners' proportionate

interest in common areas, and, for buildings whose floor area is less than 50 percent residential (i.e. mixed-use buildings), agreed that EQC cover will extend to common areas on a proportionate basis, determined using the residential floor area in the building (DEV-20-MIN0039 refers).

6. While this approach is still retained for buildings with a single owner, you recently agreed that, for buildings with common areas shared by multiple owners, such as unit titled developments, the residential share insured by EQC be determined on the basis of the interests of EQC-insured owners interest in the shared common property (T2021/1597 refers).

Proposals for EQC land cover when EQC does not insure all of the associated building

7. The March 2020 Cabinet decisions and your recent decisions on these issues related to only EQC building cover. We recommend that these principles also be extended to apply to EQC land cover.
8. Current EQC policy regarding the application of land cover to mixed-use, or partially insured, buildings, is that EQC land cover applies to land directly connected to the EQC-insured parts of the building.
9. This can result in inequities, most notably if no EQC-insured dwellings are in contact with the land, as is common in mixed-use apartment blocks with shops or offices on the ground floor. In those situations, the dwellings have no EQC land cover. The dwelling's owners typically own the land in common with other owners of the building, and are exposed through unit title levies or similar mechanisms to the costs of remediating land damage that affects the building. Also, the current EQC cover does not always map cleanly to more complex building or land arrangements, so can be a source of dispute between EQC and claimants.
10. Therefore we recommend that the EQC Bill provide that in situations where EQC building cover does not apply to all of the building in question, EQC land cover settlements be based on the same principles and approach agreed for EQC building cover in that situation, namely be based on the relative residential and non-residential shares of the building, as determined by floor area, or ownership shares. That would result in the following outcomes:
 - ***For residential buildings with single or multiple owners*** (that is buildings that are 50 percent or more residential by floor area), no change to the current practice of providing full EQC land cover without any pro-rating to reflect the non-residential fraction of the building.
 - ***For mixed-use buildings***, that is buildings with at least one residence, and the residential areas are less than 50 percent of the building's floor area, the footprint of EQC land cover (including any associated retaining walls, bridges and culverts) would be the same as for residential buildings.¹ EQC land cover settlement would then be pro-rated to align with share of the building that EQC provides EQC building cover for. Previous decisions have determined those EQC-insured building shares will be calculated as follows:
 - ***For mixed-use buildings (i.e. less than 50 percent residential) with inseparable ownership interests***, any EQC settlement would be pro-rated to match the fraction of the floor area of the building that EQC provides EQC building cover for. For instance, if EQC-insured residential areas accounted for 25 percent of the building's floor area, EQC would calculate the land claim

¹ That is, the land on which the building is situated, associated residential appurtenant structures (if any), the 8 metres of land surrounding the main building and any associated residential appurtenant structures, and the first 60 metres of the main accessway.

entitlement for the entire building, and pay the claimants 25 percent of what EQC would pay if the building was entirely residential and insured by EQC.

- ***For mixed-use buildings (i.e. less than 50 percent residential) with multiple ownership interests***, any EQC settlement would reflect the ownership interests of any EQC-insured owners in the building in question. For instance, if EQC-insured residential areas accounted for 25 percent of the ownership interest of the building, EQC would calculate the land claim entitlement for the entire building, and pay the EQC-insured owners 25 percent of what EQC would pay if the building was entirely residential and insured by EQC.
11. This approach appropriately recognises claimant's ownership share in the damaged land, and would be sufficiently flexible to deal with situations such as townhouse developments where some dwellings have access to a private area of land for their own use, and also where areas of common land are damaged. In each case the interest would reflect the differing ownership rights and obligations.
 12. Officials also see merit in using, to the greatest extent possible, a common framework for addressing EQC building and land cover entitlements when either (i) not all owners, or (ii) not all parts of a damaged building, are covered by EQC. Extending to EQC-insured land, the principles and approach previously agreed for the application of EQC building cover to mixed-use buildings, will achieve this.
 13. Officials assess the recommended approach as likely to advantage claimants in aggregate (and so cost more overall), although claimants in some particular situations may be disadvantaged compared to the status quo. We see the improved equity outcomes and introducing clearer and consistent principles as outweighing the likely increased costs. Due to data limitations EQC is unable to quantify the estimated costs of the change.

Improving EQC land and building cover for items that are located beyond the EQC-insured property or landholding boundary

14. Some residential property owners have the use of and/or are responsible for the repair and maintenance of residential property-related items beyond their property landholding boundaries.² Examples include drainage and sewerage pipes across other private or publicly-owned land, and built structures such as garages or culverts and bridges providing access across streams or drains located on council road reserve.
15. From a policy perspective the current EQC scheme's coverage of these items is deficient, as items that EQC would otherwise cover as providing a benefit to the homeowner and that the homeowner owns or is responsible for maintaining, are sometimes not covered because they are beyond the insured landholding.

Current EQC building and land cover for items located outside the insured property or landholding boundary

Building cover

- For appurtenant structures, EQC covers structures that the residential owner owns, including if they are outside of the property boundary and no easement is in place, for instance a garage on council road reserve.

² For EQC land cover purposes, a landholding includes interests in land other than ownership, such as easements or rights-of-way.

- For services, for instance drains, EQC covers services located inside the property boundary, but not any part of services located outside the property boundary, even if there is an easement in place.

Land cover

- EQC covers retaining walls within the landholding (and within the 8 and 60 metre rules, which we do not propose changing). For retaining walls that extend beyond the landholding, EQC covers the part that is within the landholding if that part can be considered a retaining wall in its own right. EQC does not cover the retaining wall beyond the landholding (including easements, which form part of the landholding). Therefore, EQC does not cover retaining walls located beyond the landholding, but which are associated with the residential property. A common example is retaining walls built on council road reserve to support or protect a garage built on the road reserve (EQC already covers the garage itself, as an appurtenant structure).
 - EQC covers bridges and culverts if they are wholly within the landholding (including easements, and within the 8 and 60 metre rules, which we do not propose changing). EQC does not cover bridges or culverts if any part of the item is outside the landholding. Therefore, EQC typically does not cover a bridge or culvert that is partially or fully located on council road reserve land, as council practice is to not grant easements on such land.
16. We recommend addressing these issues by improving and harmonising the operation of EQC building and land cover beyond the insured landholding. We recommend that EQC building and land cover apply to items located outside the insured property boundary or landholding where:
- the items would have qualified for EQC cover if they were located within the property or landholding, and
 - the items serve the EQC-insured residential property (that is, the insured either owns, or has the right to use the item, uses the item for a household purpose, and is responsible for the repair and maintenance of, the damaged item).

Improving and harmonising EQC land and building cover for items located beyond the EQC-insured landholding

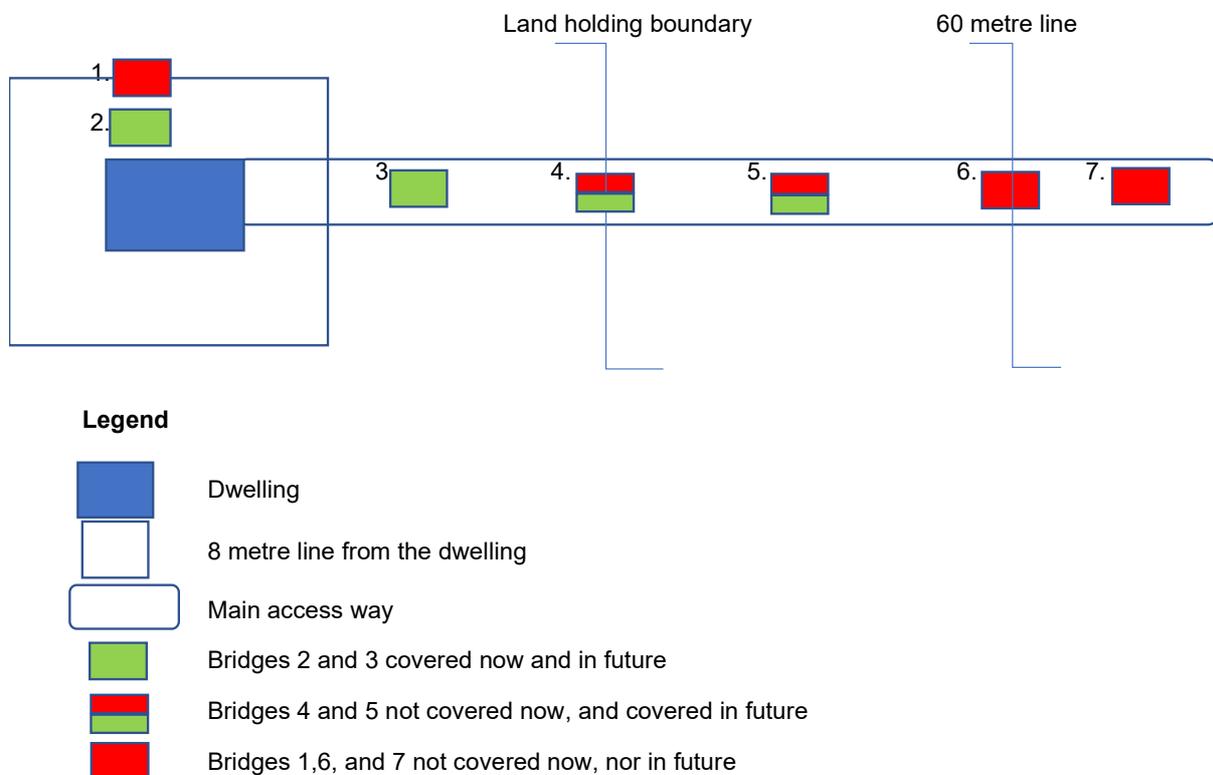
17. We recommend addressing these policy issues by improving and harmonising the operation of EQC building and land cover beyond the insured landholding. We recommend that EQC building and land cover apply to items located outside the insured landholding where the same items would have qualified for EQC cover if they were located within the landholding, are used for the benefit of the insured and the insured either owns, or benefits from and is responsible for the repair and maintenance of, the damaged item.

Photo 1: Damage to bridge providing main accessway to residence not covered by EQC as the bridge is partially on road reserve, and no easement is in place.



18. Also, this proposal focuses on clarifying the treatment of items not located beyond the boundaries of land owned by the claimant. We propose retaining unmodified the current treatment of land structures that cross the 8 and 60 metre limits of EQC land cover. That is, EQC covers the parts of retaining walls that fall within the area determined by the 8 and 60 metre rules and covers bridges and culverts if they *entirely* fall within the land area described by the 8 and 60 metre rules.

Figure 1: Examples of current and proposed future cover of bridges and culverts



19. For land cover, this proposal is limited only to land structures not on the landholding; not the land itself. EQC would continue to only insure land that is within the landholding. A consequence of this is that for retaining walls beyond the landholding, the claimant interest would be determined by any associated EQC-insured structures, such as garages. Damage to land that EQC does not insure would not trigger EQC cover of any associated damaged retaining walls.
20. For similar reasons, the extension of EQC cover to retaining walls, bridges and culverts located beyond the insured landholding will not extend cover to those items if they are located on a neighbouring residential property. This would avoid disputes and neighbours cross-claims on items located on residential property.

Renewing the 2016 Ministerial direction on storm water and sewerage services

21. The Canterbury seismic sequence generated EQC claims that revealed the above-mentioned gap in the current coverage of EQC building cover, relating to services (drains) that were not owned by the claimant i.e. the owner of the dwelling or land the dwelling is situated on but used by that dwelling.
22. To help address this, the then-Minister Responsible for the Earthquake Commission issued a Ministerial direction to EQC on 9 August 2016, directing EQC to take on the additional function of repairing storm water and sewerage services not located on the landholding and were servicing EQC-insured buildings damaged in the Canterbury earthquake sequence.³ That Ministerial direction expired recently. We will shortly provide separate advice on its renewal.

Impact on claims costs

23. The proposals increase EQC cover, so will increase scheme costs. EQC is unable to estimate with any precision the impact of the proposed changes on EQC's future costs, as EQC does not collect cost data on items that it does not currently cover. Over time, any increase in expected costs would be reflected in future EQC levy rates.

Consultation

24. EQC was consulted on this report and agree with the recommendations.

Next Steps

25. You have power to act to make decisions on the EQC Bill consistent with the guidance provided by previous Cabinet decisions (CAB-21-MIN-0177 refers). We will issue drafting instructions to Parliamentary Counsel Office (PCO) so that the EQC Bill reflects your decisions on the recommendations in this report.
26. We are working with EQC on several other technical issues and intend to provide advice on those by mid-November.
27. Separately, we will shortly provide advice on renewing the 2016 Ministerial direction regarding EQC coverage of drains not located within the insured's landholding.

³ Gazette notice number 2016-go4912, available from gazette.govt.nz
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