

To: Minister for Canterbury Earthquake Recovery



IN CONFIDENCE

RED ZONE RESIDENTIAL PROPERTIES UNDER CONSTRUCTION AND NON-RESIDENTIAL PROPERTIES OWNED BY NOT-FOR-PROFIT ORGANISATIONS

Date	23 May 2012	Priority	Urgent
Report No	M/12/0387	File Reference	

Action Sought

		Deadline
Hon Gerry Brownlee <i>Minister for Canterbury Earthquake Recovery</i>	Sign the attached paper and lodge it with the Cabinet Office	

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Diane Turner	General Manager, Strategy, Policy and Planning		<input checked="" type="checkbox"/>
	Advisor, Strategy, Policy and Planning		

withheld under section 9(2)(a)

withheld under section 9(2)(a)

Minister's office comments

- Noted
- Seen
- Approved
- Needs change
- Withdrawn
- Not seen by Minister
- Overtaken by events
- Referred to

Comments

Red zone residential properties under construction and non-residential properties owned by not-for-profit organisations

Purpose

1. This paper attaches for your consideration a Cabinet Paper proposing the extension of a Crown offer to purchase to Canterbury red zone property owners with residential properties under construction, and non-residential properties owned by not-for-profit organisations. If you agree with its content and recommendations it is recommended that you sign it and submit it to Cabinet.

Comment

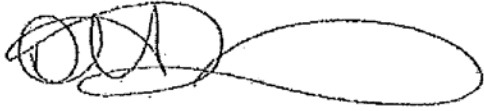
2. The attached paper proposes the extension of a Crown offer to purchase to two categories of Canterbury red zone property owners who fall outside the existing Crown offer to Insured residential property owners – namely those property owners with residential properties under construction and non-residential properties owned by not-for-profit organisations.
3. Because of the nature of the Insurance market, while these property owners could get insurance to cover their building/construction works (in the first instance) or their buildings (in the second instance), there was no ability for them to gain any kind of insurance that would also trigger land cover.
4. It is suggested that on the basis of the situation described above, consistency for red zone property owners and in consideration of the Government's recovery principals, that the Crown extends its purchase offer to red zone residential properties with dwellings under construction which held building/contract works insurance policies, and insured non-residential properties owned by not-for-profit organisations.
5. We do not consider this will create a precedent to extend a Crown offer to any other remaining property categories in the red zones.
6. The cost of purchase associated with the residential red zone property under construction proposal is estimated to be \$6.600 million at a worst-case cost scenario, with additional property transaction and management costs of \$4.950 million.
7. The cost of purchase associated with the non-residential properties owned by not-for-profit organisations proposal is estimated to be \$7.760 million at a worst-case cost scenario, with additional property transaction and management costs of \$0.412 million.

Next steps

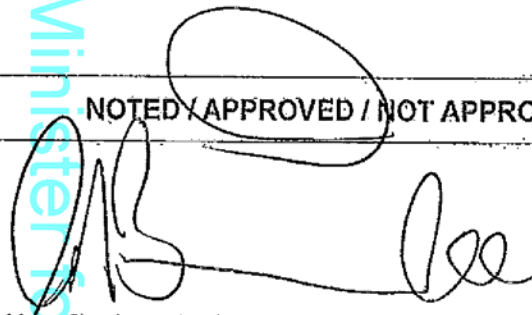
8. We recommend that you sign and submit the attached Cabinet paper (Appendix A) to the Cabinet Office.

Recommendations

- 1. It is recommended that you sign the attached paper and lodge it with the Cabinet Office.



Diane Turner
 General Manager, Strategy, Planning
 and Policy

NOTED / APPROVED / NOT APPROVED

Hon Gerry Brownlee. Minister for Canterbury Earthquake Recovery
Date: 25/05 / 2012

Released by the Minister for Canterbury Earthquake Recovery

Office of the Minister for Canterbury Earthquake Recovery

Chair
Cabinet Economic Growth and Infrastructure Committee

Red zone residential properties under construction and non-residential properties owned by not-for-profit organisations

Purpose

- 1 This paper seeks decisions regarding the treatment of two categories of property in the Canterbury red zones that are not covered by the current Crown offer to purchase insured residential properties. It recommends that the Crown extends offers to two categories of red zone properties, namely: residential properties under construction and non-residential properties owned by not-for-profit organisations.

Executive summary

- 2 Cabinet announced a package to support insured, residential property owners whose houses are located in the Canterbury red zones [CAB Min (11) 24/15 refers]. Under this package, the Crown has offered to purchase the properties at the most recent ratings valuation.
- 3 Additional property categories in the red zones are: residential properties under construction, non-residential properties owned by not-for-profit organisations, vacant land and commercial properties.
- 4 This paper discusses two categories of property in the red zones that are not eligible for the Crown offer to insured residential property owners as they do not hold residential property insurance. These are property owners with:
 - residential properties under construction
 - non-residential properties owned by not-for-profit organisations.
- 5 This paper recommends a Crown offer is extended to these two categories of red zone property owners for which, while potentially insured as fully as possible, a residential home insurance cover could not be obtained, which also triggers land cover provided by the Earthquake Commission (EQC). Aside from the EQC component of home insurance there is no mechanism in the New Zealand insurance market for insuring land.
- 6 Table 1 below summarises the relevant argument for extending the Crown offer to owners in these two property categories.

Table 1: Red zone property owners not eligible for the Crown offer to insured residential property owners

Property Type	Estimated gross cost to Crown	Situation	Possible treatment and rationale
Residential properties under construction # = 11	\$6.60M	<ul style="list-style-type: none"> Land insurance not available (not eligible for residential insurance during construction) Building works or construction works insurance available Majority are finished/nearly finished, some occupied but could not get residential insurance due to timing of earthquakes 	<ul style="list-style-type: none"> Extend a Crown offer to properties with building or contract works insurance at the most recent rating valuation The building/construction works could be insured but could not insure the land; Consistent with Crown's Recovery Principles; Supports property owners to move on with their lives with certainty and confidence.
Non-residential properties owned by not-for-profit organisations # = 7	\$7.76M	<ul style="list-style-type: none"> Land insurance not available (not eligible for residential insurance) Building insurance for buildings available All properties occupied/used by the not-for-profit organisation that owns them Most provide community support/development functions 	<ul style="list-style-type: none"> Extend a Crown offer to insured property owners to purchase property at the most recent rating valuation Property owners could not insure the land, could insure the building; Consistent with Crown's Recovery Principles; Supports not-for-profit organisation to re-establish elsewhere in Canterbury with certainty and confidence and continue to support the community

Released by the Ministry of Natural Resources and Environment for the Canterbury Earthquake Recovery Authority

Background

- 7 As a result of the Canterbury earthquakes, some six square kilometres of land across the Christchurch and Waimakariri District Council areas has been assigned red zone status. Red zones have been declared in areas where there is area-wide damage (implying an area-wide solution) and an engineering solution to remediate the land damage would be uncertain, disruptive, not timely, nor cost effective and the health and wellbeing of residents is at risk.
- 8 Zones were agreed by Cabinet on 23 June 2011, with the announcement of a package to support insured, residential property owners whose houses are located in the Canterbury red zones [CAB Min (11) 24/15 refers]. Under this package, the Crown has offered to purchase insured residential properties at the most recent ratings valuation¹ (the Crown offer). Property owners can choose either:
- Option 1 - the purchase price paid for the property is the most recent rating valuation for the land, buildings and fixtures and the Crown takes over all insurance claims for damage to the property, or
 - Option 2 - the purchase price paid for the property is the most recent rating valuation for the land and the Crown takes over the EQC claim for land damage only. The property owner retains the benefit of all insurance claims for damage to buildings and fixtures and continues to deal with EQC and their insurer to settle those claims.

Remaining Decisions

- 9 This paper recommends a Crown offer for two categories of properties in the red zones not covered under the existing Crown offer, specifically:
- residential properties with dwellings under construction
 - non-residential properties owned by not-for-profit (community) organisations.
- 10 I will give further consideration to whether any Crown purchase offers should be extended to owners of vacant land and commercial properties in the red zones and make further recommendations to Cabinet as necessary.

Crown's recovery objectives

- 11 In considering a recovery package for the owners of red zone properties, I have had regard to the Government's recovery objective – a timely, focused and expedited recovery in greater Christchurch.
- 12 To this end, the Government has focused on: certainty of outcome for home-owners as soon as practicable; creating confidence for people to be able to move forward with their lives; creating confidence in decision making processes; using the best available information to inform decisions and having a simple process in order to provide clarity and support for land-owners, residents, and businesses in those areas [CAB Min (11) 24/15 refers].
- 13 The recovery objectives have guided decisions Cabinet has already taken in regard to land zoning and the Crown offer to insured residential property owners in the red zones. A key element in this is that the Crown's offer is only extended to those with residential property insurance.

¹ i.e., the most recent valuation prior to the September 4 2010 earthquake. For Christchurch City Council this is the 2007 rating valuation, for Waimakariri District Council, the 2008 rating valuation.

- 14 This paper addresses two categories of property owners that could not obtain residential property insurance providing land cover due to the operation of the insurance market and/or the nature of their property.

Residential insurance and land cover

- 15 Residential property insurance (or 'home insurance') is available only to owners of residential properties that contain a completed dwelling. The purchase of home insurance, specifically the contract of fire insurance over a residential building, triggers EQC cover. This insurance provides additional cover to residential property owners, including cover for land immediately around the dwelling, main accessways and retaining walls, within certain limits.
- 16 Aside from the EQC component of home insurance, there is no mechanism in the New Zealand insurance market for insuring land.
- 17 Officials have identified options for the Crown's treatment of the property categories considered in this paper. Details regarding the situation for those properties not currently covered by the Crown's offer to purchase residential insured properties are outlined below by category, and are summarised at Table 1 above.

Red zone residential properties with dwellings under construction

- 18 During the construction phase of a building project, buildings can be covered for damage with building works or contract works insurance. Such insurance provides for repair only to the stage at which the construction was at the time damage was sustained. This insurance does not have a land-cover component.
- 19 Officials have identified 11 residential properties with dwellings under construction in the red zones (9 of which are in the suburb of Brooklands) and 16 in the white zones. Table 2 below summarises these property values:

Table 2:
Residential property under construction in the Canterbury red and white zones

Zone	Construction/built property value (Capital Value upper estimate based on completion status of properties)	Land Value (most recent rating valuation)	Number of properties
Red	\$6.60M	\$1.79M	11
White	\$9.60M	\$5.60M	16

Options available to the Crown for residential properties with dwellings under construction in the red zone

- 20 In considering the treatment of residential properties with dwellings under construction I have identified three possible approaches.
- 21 The first two options, which I do not support, are:
- *No Government offer to purchase residential properties with dwellings under construction that held building/contract works insurance policies, or*
 - *A package to purchase residential properties with dwellings under construction that held building/contract works insurance policies, with the offer being for the land value only*

- 22 I do not assess these options as consistent with the principles on which the Crown offer has been extended to insured residential property owners or with the Government's recovery objectives.
- 23 The third option, which I support, is a *package for the purchase of residential properties with dwellings under construction that held building/contract works insurance policies with the option of payment of land value only or a capital value based on the stage of completion.*
- 24 Under this option the Crown would extend an offer to purchase residential properties with dwellings under construction, which held building/contract works insurance policies at their most recent rating valuation equivalent value.
- 25 Properties under construction, irrespective of stage of construction, can be assessed for a rating valuation equivalent value in a process provided for under the Rating Valuation Rules (mandated by the Rating Valuations Act 1998). This process allows for benchmarking against the most recent Land Value rating valuation, providing values consistent with those being used for the current Crown offer.
- 26 Table 2 above outlines the total potential value of residential properties with dwellings under construction in all zones. Under this option, the Crown's maximum gross exposure is estimated at \$6.600 million in the current red zones.
- 27 Considering previous Crown offers, I anticipate that the net cost to the Crown will be \$4.950 million, after insurance recoveries with an additional transaction cost of an estimated \$0.420 million.
- 28 I have established that a Crown offer to properties in this category can be modelled on the offer to insured residential property owners, although modified to take account of the absence of land insurance policies and the fact that building/contract works insurance policies are often held in the name of the building contractor:
- Option 1 - the purchase price paid for the property is the most recent rating valuation for the land, buildings and fixtures and the Crown receives the benefit of all insurance claims for damage to the buildings.
 - Option 2 - the purchase price paid for the property is the most recent rating valuation for the land and the property owner retains the benefit of all insurance claims for damage to buildings and fixtures and continues to deal with their insurer and/or building contractor to settle those claims.
- 29 Any building/contract works insurance monies (already) received by an owner and/or a building contractor for damage to the property will be deducted from the purchase price established for the property under option 1².
- 30 I assess this option is consistent with the principles on which the Crown offer has been extended to insured residential property owners and would support Government's recovery principles.
- 31 In addition to those properties in the red zones, there is a potential risk to the Crown should all white zone properties be re-zoned red. Should this occur, the Crown has an additional potential gross exposure of \$9.60 million, however this figure is an upper estimate that is very unlikely to occur.

Non-residential properties owned by not-for-profit (community) organisations

- 32 Not-for-profit organisations play an important role in the health of a community. They are particularly valuable in times of community distress and challenge. The seven non-residential properties owned by not-for-profit organisations in the red zones include two churches, a

² As part of the offer process, CERA will have access to Insurance records.

community hall, an RSA hall, and two clubs. These organisations have no, or a very low turnover, are small scale and community centred.

- 33 Zoning decisions have serious implications for not-for-profit organisations whose non-residential properties are located in the red zones in terms of disruption to their activities and services, and the future realisation of capital investment of the organisation.
- 34 Taking into account the important role of not-for-profit organisations in the recovery of greater Christchurch communities, and seeking consistency in approach with other red zone property owners, I propose that insured red zone non-residential properties owned by not-for-profit organisations are extended a Crown offer. Table 3 below summarises these property values:

**Table 3:
Non-residential properties owned by not-for-profit organisations
In the Canterbury red and white zones**

Zone	Capital Value (most recent rating valuation)	Land Value (most recent rating valuation)	Number of properties
Red	\$7.76M	\$2.65M	7
White	\$5.80M	\$4.32M	7

Options available to the Crown for non-residential properties owned by not-for-profit organisations in the red zones

- 35 In considering the treatment of insured non-residential properties owned by not-for-profit organisations I have identified three possible approaches.
- 36 The first two options, which I do not support, are:
- *The Crown does not extend a purchase offer to insured non-residential properties owned by not-for-profit organisations in the red zones, or*
 - *A Crown purchase offer for insured non-residential properties owned by not-for-profit organisations in the red zones, with the offer being for the land value only*
- 37 I do not assess these options as consistent with the principles on which the Crown offer has been extended to insured residential property owners or with the Government's recovery objectives.
- 38 The third option, which I support, is a *Crown purchase offer for insured non-residential properties owned by not-for-profit organisations in the red zones.*
- 39 Under this option the Crown would extend an offer to purchase insured non-residential properties owned by not-for-profit organisations, at their most recent rating valuation equivalent value.
- 40 Non-residential not-for-profit organisations in the red zones are able to get building insurance, but as this insurance is non-residential it does not extend to land cover. By being insured, not-for-profit property owners did all that they could to protect their properties in the event of a disaster.
- 41 Table 3 above outlines the total potential value of not-for-profit properties in the red and white zones. Under this option, the Crown's maximum gross exposure is estimated at \$7.760 million in the current red zones.
- 42 Considering previous Crown offers, I anticipate that the net cost to the Crown will be \$5.775 million, after insurance recoveries with an additional transaction cost of an estimated \$0.267 million, depending on the nature of the Crown offer and uptake of that offer.

- 43 I have established that a Crown offer to properties in this category can be modelled on the offer to insured residential property owners, although modified to take account of the absence of land insurance policies:
- Option 1 - the purchase price paid for the property is the most recent rating valuation for the land, buildings and fixtures and the Crown takes over all insurance claims for damage to the buildings.
 - Option 2 - the purchase price paid for the property is the most recent rating valuation for the land and the property owner retains the benefit of all insurance claims for damage to buildings and fixtures and continues to deal with their insurer to settle those claims.
- 44 As for the current Crown offer to insured residential property owners, offers should be based on the 2007 ratings valuations for Christchurch City and the 2008 ratings valuations for Waimakariri District.
- 45 I assess this option is consistent with the principles on which the Crown offer has been extended to insured residential property owners and would support Government's recovery principles.
- 46 In addition to those properties in the red zones, there is a potential risk to the Crown should all white zone properties be re-zoned red. Should this occur, the Crown has a potential additional exposure of \$5.800 million, however this figure is an upper estimate that is very unlikely to occur.

Implications for future responses and precedent setting

- 47 This paper recommends extension of the Crown offer to residential properties with dwellings under construction, which held building/contract works insurance policies, and insured non-residential properties owned by not-for-profit organisations. I do not consider making these offers will bind the Government to making any similar offers for the remaining categories in the red zones, namely: commercial properties and vacant land.

Financial Implications

- 48 Table 4, below outlines the total financial implications for the Crown of purchases suggested in this paper:

Table 4:
Total financial implications for Crown purchases suggested in this paper

Property category	# of properties	Acquisition of Properties (\$000)		Transaction Costs (\$000)	Total Cost (\$000)	
		Gross	Net		Gross	Net
Residential properties with dwellings under construction	11	6.600	4.950	0.420	7.020	5.370
Non-residential properties owned by not-for-profit organisations	7	7.760	5.775	0.267	8.027	6.042
Total	18	14.360	10.725	0.689	15.047	11.412

Next steps

- 49 If you agree to the recommendations in this paper, I propose to make an announcement about the offers as soon as practicable.

Consultation

- 50 Treasury, EQC and the Department of Building and Housing were consulted on this paper. The Department of the Prime Minister and Cabinet was informed of this paper.

Financial implications

Red zone property under construction

- 51 CERA estimates the gross cost of purchase associated with the residential red zone property under construction proposal to be \$6.60 million at a worst-case cost scenario. However, the Crown can also recognise insurance receivables relating to the purchase properties. The exact quantum of these receivables is yet to be confirmed, but the net cost of purchasing these properties is estimated to be less than \$4.950 million. It is important to recognise that these costs could change depending on the interpretation of insurance policies and coverage.
- 52 Providing a contribution towards the legal fees of property owners of residential property under construction in the red zones is estimated to cost up to \$0.008 million, and property transaction and management costs³ of \$0.412 million.
- 53 The costs of purchasing these properties (including associated costs) will be a charge against the Canterbury Earthquake Recovery Fund (CERF). The recommendations in this paper are included in the land allocation in the CERF and have no impact on the general contingency within the CERF. The CERF was established in Budget 2011 - therefore the decisions in this paper have no further impact on the fiscal aggregates.

Red zone non-residential properties owned by not-for-profit organisations

- 54 CERA estimates the gross cost of purchase associated with the red zone non-residential properties owned by not-for-profit organisations proposal to be \$7.760 million at a worst-case cost scenario. However, the Crown can also recognise insurance receivables relating to the purchase properties. The exact quantum of these receivables is yet to be confirmed, but the net cost of purchasing these properties is estimated to be less than \$5.775 million. It is important to recognise that these costs could change depending on the interpretation of insurance policies and coverage.
- 55 Providing a contribution towards the legal fees of property owners of non-residential properties owned by not-for-profit organisations in the red zones is estimated to cost up to \$0.005 million, and property transaction and management costs⁴ of \$0.262 million.
- 56 As with the recommendation on the residential red zone property under construction decision, this decision has no further impact on the fiscal aggregates.

Human rights implications

- 57 The proposals in this paper are not inconsistent with the New Zealand Bill of Rights Act 1990, or the Human Rights Act 1993.

³ Includes demolition costs

⁴ Includes demolition costs

Legislative implications

58 There are no legislative implications arising from this paper.

Regulatory impact and compliance cost statement

59 A regulatory impact statement is not required at this time as there are no regulatory changes.

Gender implications

60 There are no gender implications associated with the proposals in this paper.

Disability perspective

61 There are no disability implications associated with the proposals in this paper.

Publicity

62 This is outlined in Paragraph 49.

Recommendations

It is recommended that Cabinet:

Background

1 **note** that on 23 June 2011, Cabinet agreed a package to support insured, residential property owners whose houses are located in the Canterbury red zones [CAB Min (11) 24/15 refers];

Residential properties under construction

- 2 **note** that property owners who are constructing a new dwelling cannot obtain residential property insurance (home insurance) and as such have no access to insurance cover for land damage;
- 3 **note** that there is no mechanism in the New Zealand market for owners of property under construction to insure their land; and that property owners were aware of this risk when building;
- 4 **agree** to the Crown making an offer to purchase residential properties with dwellings under construction, that held building/contract works insurance policies, as outlined in the current Crown offer to insured residential property owners in the Canterbury red zones;
- 5 **note** that insurance receivables that arise as a result of this offer will be deducted from the purchase price consistent with the existing Crown offers to insured residential property owners in the red zone;
- 6 **note** that the gross cost of this offer is estimated to be \$6.600 million;
- 7 **agree** that this offer will be made at the 2007 Land Value rating valuation for Christchurch City and the 2008 Land Value for Waimakariri District; double check this
- 8 **note** that the potential additional fiscal costs for the Crown should the white zones turn red is \$9.600 million;

Non-residential properties owned by not-for-profit organisations

9 **note** that there are seven non-residential properties in the red zones which are owned by small scale not-for-profit organisations which have no, or a very low, turnover and are community centred;

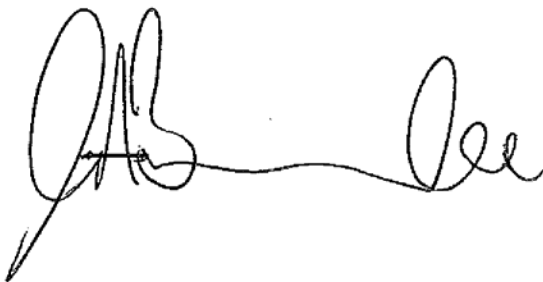
- 10 **note** that these organisations cannot obtain insurance cover for land damage, though property insurance is available to them;
- 11 **agree** to the Crown making an offer to purchase insured non-residential properties owned by not-for-profit organisations under a modified Option 1 or Option 2 as outlined in the current Crown offer to insured residential property owners in the Canterbury red zones,
- 12 **note** that the gross cost of this offer is estimated to be \$7.760 million;
- 13 **agree** that this offer will be made at the 2007 Land Value rating valuation for Christchurch City and the 2008 Land Value for Waimakariri District;
- 14 **note** that the potential additional fiscal costs for the Crown should the white zones turn red is \$5.800 million;

Financial decisions

- 15 **note** that the gross cost of purchasing residential properties under construction in the red zones is estimated to be \$6.600 million and that the gross cost of purchasing non-residential properties owned by not-for-profit organisations in the red zone is estimated to be \$7.760 million;
- 16 **note** that any insurance receivables that arise as a result of these offers will be deducted from the purchase price consistent with the existing Crown offer;
- 17 **note** that the estimated cost of contributions towards legal fees, demolition and property management as a result of these offers is a maximum of \$0.687 million;
- 18 **agree** to establish a new Departmental Output Expense appropriation "Red Zone Property Acquisition Costs" with this appropriation to be the responsibility of the Minister for Canterbury Earthquake Recovery;
- 19 **agree** that the scope of this appropriation be "This appropriation is limited to the costs associated with the management of Canterbury Red Zone properties before settlement.";
- 20 **agree** to establish a new Non-Departmental Other Expense appropriation "Red Zone Property Management Costs" with this appropriation to be the responsibility of the Minister for Canterbury Earthquake Recovery;
- 21 **agree** that the scope of this appropriation be "This appropriation is limited to the costs associated with the management of Canterbury Red Zone properties after settlement.";
- 22 **agree** to the following changes to appropriations to provide for the decisions in recommendations 4 and 11, with a corresponding impact on the operating balance:

Vote Canterbury Earthquake Recovery Minister for Canterbury Earthquake Recovery	\$m – increase/(decrease)				
	2011/12	2012/13	2013/14	2014/15	2015/16 & outyears
Non-Departmental Other Expense					
Acquisition of Canterbury Red Zone Properties	14.360	-	-	-	-
Contributions towards legal fees	-	0.013	-	-	-
Canterbury Earthquake Property Demolitions and Related Costs and Compensation	-	0.378	-	-	-
Red Zone Property Management Costs	-	0.275	-	-	-
Departmental Output Expense					
Red Zone Property Acquisition Costs	-	0.021	-	-	-
Total	14.360	0.687	-	-	-

- 23 **agree** that the proposed changes to appropriations for 2011/12 in recommendation 22 be included in the 2011/12 Additional Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;
- 24 **agree** that the proposed changes to appropriations for 2012/13 in recommendation 22 be included in the 2012/13 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;
- 25 **agree** that all the expenses (net of insurance recoveries where applicable) incurred under appropriations agreed in this paper be a charge against the Canterbury Earthquake Recovery Fund, established as part of Budget 2011;



Hon Gerry Brownlee
Minister for Canterbury Earthquake Recovery

25, 05 2012