

IAG Submission on the consultation document 'Building Seismic Performance: Proposals to improve the New Zealand earthquake-prone building system'

8 March 2013

Introduction

This submission presents the IAG New Zealand Group's ('IAG') response to the consultation document 'Building Seismic Performance: Proposals to improve the New Zealand earthquake-prone building system'.

This submission is in two parts. The first provides some general comments on IAG's response to earthquake-prone buildings.

The second provides specific answers to the questions posed in the consultation document. We have purposely limited our comments to those pertinent to the insurance industry. Where there are limited consequences for the industry we provide no comment.

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About the IAG New Zealand Group Limited

IAG New Zealand Limited trades under the NZI and State brands and AMI Insurance limited. IAG New Zealand Limited also underwrites general insurance for some of the country's leading financial institutions (including ASB, BNZ and The Cooperative Bank). IAG New Zealand Limited and AMI Insurance limited have a combined 42% share of the general insurance market, managing 3.8 million policies of 1.5 million New Zealanders. IAG New Zealand Limited and AMI Insurance limited are wholly owned subsidiaries of Insurance Australia Group (IAG), Australasia's largest general insurer.

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Summary

Ensuring our buildings are able withstand the impacts of earthquakes is vital given the extent of earthquake risk in New Zealand. Yet we know that many buildings fall unacceptably short of doing so and require remediation or removal.

The fact that a building is earthquake-prone is of immense interest to IAG, as are the actions planned in response and their timing. This is because the value of a building and therefore the indemnity we provide reduce once the building is known to be earthquake-prone. It is the reason and implications of this underwriting response that are the focus of our submission.

On the proposals, IAG supports the need to assess, repair or remove buildings that are earthquake-prone. We believe that this will benefit from central coordination and the application of a consistent New Building Standard (NBS) threshold. We agree that building which pose the greatest risk or have strategic importance during and after an emergency should be prioritised. We are concerned about the timeframes proposed and the funding of this significant undertaking.

Insurance and earthquake-prone buildings

We are contractual indemnifiers. We recompense building owners for the financial loss caused when their building is damaged or destroyed. An important element in this is the value of the building and therefore the level of cover provided. This sets the cap for the amount available to fund the repair or rebuild of the building.

The majority of policies will fund the repair or rebuild up to the agreed a value of the building ('replacement value'). Often this will see the building owner come out with an improved building, as old is replaced with new. However if the building has a known fault - for example being earthquake-prone, we will not rectify that fault. To do so would put the building owner in a better position than they were and go beyond indemnification.

In this circumstance we will typically fund the repair or rebuild up to a value sufficient to put the building owner back in the financial position they were immediately prior to the building being damaged or destroyed ('indemnity value'). The two most common ways of determining that value are: the replacement value of the building less depreciation ('depreciated replacement value'); and the value the building would obtain on the open, informed and willing market ('market value').

Therefore when we become aware that a building is earthquake-prone we adjust the policy to reflect the indemnity value of the building. In addition we specifically exclude meeting the cost associated with upgrading the building to exceed the 33% of NBS threshold. This underwriting response protects our commercial interests while still ensuring a level of protection for building owners.

Economic exposure

We are mindful however that insurance also has a bigger economic role which emerges from the transfer of risk. Insurance gives business, investors and banks the confidence to invest in assets such as building; safe in the knowledge that the investment is protected against unexpected loss or damage. If the worst does occur they can recover more quickly from the financial impact. By doing this insurance helps make economic growth more stable and reduces the call on the public purse.

When a building is assessed as earthquake-prone, its value falls relative to the investment in it. That fall will crystallise in either the cost of remediation and or a reduced payout in the event that the building is damaged or destroyed before being strengthened.

When insurers adjust an insurance policy to reflect the indemnity value of a building, they remove an amount of protection from the underlying investment. That reduced protection could well limit the willingness and or ability for further investment in the building to get it over the 33% NBS threshold. IAG believe this could well be the case for many building owners.

The commercial property market will naturally reach equilibrium in response to this funding pressure through changes in rentals, building stock and market participation. Until such time as that equilibrium is achieved capital is exposed. Therefore it is critical that the funding and speed of remediation is considered.

Other submitters will provide specific advice and recommendation on how the necessary funding can be realised. Our intent here is to highlight that this regime will not just impose cost, but creates a very real exposure for the nation's investment in its existing building stock. We do this to add emphasis to the need for a funding solution that balances risk and timeframes.

Answers to Specific Questions

Compulsory seismic capacity assessment of buildings

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| P1 | Local authorities would be required to make a seismic capacity assessment of all non-residential and multi-unit, multi-storey residential buildings in their districts within five years of the legislation taking effect, using a standard methodology developed by central government, and to provide the resulting seismic capacity rating to building owners. An owner could have their building's seismic capacity rating changed by commissioning their own engineering assessment. |
| P2 | Assessments would be prioritised faster for certain buildings (e.g. buildings on transport routes identified as critical in an emergency). |

Q1. *Should local authorities be required to assess the seismic capacity of all buildings covered by the earthquake-prone building system in their areas, and to issue seismic capacity ratings to owners? If not, why not?*

Yes.

Q2. *Do you think five years is a reasonable and practical time to require local authorities to carry out assessments in their districts? If not, what time do you suggest, and why?*

IAG agrees that a time frame should be set for the completion of assessments. However it should take account of the assessment methodology and the availability of structural engineers to complete the work. Additionally this should ensure that the quality of the assessment is not compromised by the need for haste.

Q3. *Should unreinforced masonry buildings be assessed faster than other buildings? If yes, within what period?*

Yes. Again, the timeframe should take account of the assessment methodology and the availability of structural engineers to complete the work, and should ensure that the quality of the assessment is not compromised by the need for haste.

Q4. *What costs and other implications do you see with these proposals to assess the seismic capacity of buildings?*

We are concerned about how post-1976 buildings with potential build quality issues that render them earthquake-prone will be identified. For example there was a new multi-unit residential development that suffered considerable damage in the 2007 Gisborne earthquake due to poor workmanship. This links to Q20 and the need for more information on the design of the seismic capacity assessment methodology.

Public register

P3 Building information would be entered into a publicly accessible register maintained by MBIE.

Q5. *Do you agree that local authorities should be required to enter information on the seismic capacity of buildings into a publicly accessible, central register to be managed by MBIE? If not, why not?*

Yes. Also refer to comments in Q7.

Q6. *Should information other than a building's seismic capacity rating be entered into the register – for example, agreed strengthening actions or information from an agreed building ratings system? If yes, what additional details? If not, why not?*

Yes. Any information pertinent for the public to understand the scale, nature and duration of the risk should be captured in the register.

Q7. *Rather than a central register, should local authorities be responsible for both collecting and publishing this information? If yes, why?*

No. IAG does not favour each authority developing a separate register, as this creates the risk of introducing inconsistencies in the information collected and will make obtaining a consolidation of national view less efficient.

Q8. *Should there be any other information disclosure requirements – for example, should building owners be legally required to display information on the building itself about the building’s seismic capacity? If yes, what information, and why?*

Yes. IAG recommends that information on the seismic performance of the building be displayed publically so that anybody entering the building is aware of the risk. This information should include: the rating; information to assess the risk associated with that rating; remedial work (if any) that has occurred to minimise the immediate risk; and information on when the required strengthening work or demolition will take place.

Q9. *What costs and other implications do you see resulting from the proposal to put seismic capacity information in a register?*

Visibility of a building’s EPB status will:

- Allow insurers to gain more understanding of individual properties and influence achieving faster compliance through underwriting terms (as discussed above).
- Alter occupancy costs as tenants either seek a reduction in rentals (to reflect changed the changes status of the building) or increase rentals as they seek space in buildings that are not earthquake-prone. Both impact the value of a building and potentially its insurance cover.

A mandatory national requirement

P4 The current national earthquake-prone building threshold (one-third of the requirement for new buildings, often referred to as 33 per cent NBS) would not be changed. However, it is proposed to establish a mandatory national requirement for all buildings to be strengthened to above the current threshold, or demolished, within a defined time period.

Q10. *Does the current earthquake-prone building threshold (33 per cent of the requirement for new buildings) strike a reasonable balance between protecting people from harm and the costs of upgrading or removing the estimated 15,000-25,000 buildings likely to be below this line? If not, what level do you suggest, and why?*

IAG believes that 33% of NBS is an appropriate level to meet the ‘life risk’ outcomes sought. Higher levels may well be needed to achieve other social and economic outcomes. For example higher %NBS may be needed to preserve New Zealand’s most special buildings. These higher levels will exacerbate the timeframe, cost and value issues already present.

It is worth noting that the 33% level does not eliminate the risk of damage to the building and represents a sizeable shortfall from the standard for a new building.

Q11. *Should the requirement for earthquake-prone buildings to be strengthened or demolished take precedence over all other legal, regulatory and planning requirements, such as those designed to protect buildings of heritage or local character? If not, why not?*

Some legal, regulatory and planning requirements placed on a building should supersede others. However, it may not be possible to establish a uniform hierarchy of requirements for all buildings. It may be that for certain classes of buildings this could be standardised but also be building-specific in some situations, such as protected buildings. It will be important that where the hierarchy differs and trade-off have been made, that this information is recorded in the register and publicly displayed.

Q12. *Should local authorities have the power to require higher levels of strengthening than the earthquake-prone building threshold, or strengthening within shorter timeframes than the legally defined period? If yes, what powers?*

First we note that the recent High Court judgement¹ by Justice Panckhurst is that local authorities do not have the power to require strengthening beyond the earthquake-prone threshold set out in the Building Regulations².

Second, that regions and certain build already meet different seismic capacity standards through the building code and the decision of building owners respectively. Indeed some buildings already exceed 100% of NBS, as they are required to outperform other buildings. Hospitals are a good example of this.

IAG is wary of deviating from a national minimum standard, i.e. a threshold for a building to be judged earthquake-prone. This threshold has been set to strike a consistent balance between the risk to life and the cost to remediate.

It is not clear what needs this additional power would serve. IAG understands that most strategically important buildings (refer Q16) are Government owned and can be strengthen to any level at the behest of the relevant Ministry. For those that are privately held it is not clear that the 33% NBS threshold or existing powers (refer Q13) are insufficient. Buildings that present greater risk should be prioritised, not held to a higher standard.

IAG is wary of deviating from a national maximum timeframe. Again it has been set to strike a consistent balance. That said it makes sense that the building that present the greatest risk should be fixed first. This would need clear guidelines to govern prioritisation and the inevitable exceptions and breaches. It should be noted that an accelerated timeline may be impractical for funding and other reasons.

¹ The Insurance Council of NZ Incorporated v Christchurch City Council CIV 2012-409-2444 [2013] NZHC 51

² Section 7, Building (Specified Systems, Change the Use, and Earthquake-prone Buildings) Regulations 2005

Q13. *Should certain features of unreinforced masonry buildings, such as chimneys and parapets, be required to be strengthened to a higher level? If yes, which features, to what level, and why?*

No. The recent judgement of the High Court is that Councils already have the ability under s.124 to require a building owner to take action to remove the danger posed to people and other property by special features such as parapets. This would be done in response to an assessment of danger and not earthquake-proneness, and therefore a reference to level of NBS is not relevant.

If a building feature were relevant to the strength of the building and therefore earthquake-proneness, then our comments in Q12 apply.

Enforcing the mandatory national requirement

P5	All buildings would be strengthened to be no longer earthquake-prone, or be demolished, within 15 years of the legislation taking effect (up to five years for local authorities to complete seismic capacity ratings, followed by 10 years for owners to strengthen or demolish buildings).
P6	Strengthening would be carried out faster for certain buildings (eg, buildings on transport routes identified as critical in an emergency).
P7	Owners of buildings assessed as earthquake-prone would have to submit a plan for strengthening or demolition within 12 months.

Q14. *Is it reasonable and practical for owners of earthquake-prone buildings to meet the following timeframes:*

- *12 months to submit plans for either strengthening or demolishing the building?*
- *10 years from the date of the seismic capacity rating to strengthen or demolish?*

If not, what alternatives do you suggest, and why?

In setting timeframes it will always be the case that the circumstances of some properties will mean the timeframe cannot be met. For example, large Body Corporates may struggle given multiple owners to meet the timeframe for submitting plans; rural-urban areas may well struggle to obtain the funding necessary to meet the strengthen or demolish timeframe.

The answer lies in part with how the inevitable breaches will be managed - recognising that the timeframes and volume of breaches are linked.

Q15. *What additional powers would local authorities require to enforce the proposed requirements?*

Care must be taken to ensure that additional powers given to Councils do not further inhibit the ability of building owners to complete the required rebuild / strengthening work, for example fines or red stickers. That said Councils must have the power to act against building owners who flagrantly disregard the EPB policy. IAG understand that these powers already exist in the Building Act.

The un-quantified factor here is the impact the market will have in either encouraging or inhibiting building owners from taking actions. Any additional powers given to councils should take this into account.

Q16. *Should local authorities be able to require faster action on buildings of strategic importance, such as those:*

- *located on transport routes identified as critical in an emergency*
- *with important public, social and economic functions, such as schools and police stations*
- *with post-earthquake recovery functions, such as civil defence centres and hospitals.*

If yes, which buildings, and how much sooner should action be required? If no, why not?

Yes. Care is need in determining what are the truly important properties; and whether the focus is on response (where civil defence, hospitals are important) and recovery (where economic functions are important).

When again is about striking the right balance between importance, speed and achievability. This would need to be assessed on a council by council basis.

Q17. *Should all unreinforced masonry buildings require strengthening more quickly than other earthquake-prone buildings? If yes, within what timeframe?*

No. It is not the construction that is important, but the potential risk posed that should drive timing. A hospital should be strengthened ahead of a multi-unit and multi-storey residential building, ahead of a small shop.

Exemptions and time extensions

P8 Certain buildings could be exempted or be given longer time to strengthen, eg, low-use rural churches or farm buildings with little passing traffic.
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Q18. *Should the owners of certain specified types of earthquake-prone buildings be able to apply to local authorities for exemptions or time extensions to the requirement to strengthen or demolish?*

Yes. It will always be the case that the circumstances of some building will require longer timeframes to prepare plans and complete the necessary work. These should very much be exceptions.

Q19. *If yes, what are your views on the following possible criteria:*

- *the building is used only by the owner, or by persons directly employed by the owner, on an occasional or infrequent basis*
- *the building is used only occasionally (less than eight hours per week), and by less than 50 people at any one time*

AND in each circumstance above:

- *all users are notified that the building is likely to collapse in a moderate earthquake*
- *the building is not a dwelling*
- *the building is not a school or hospital and does not have a post-disaster recovery function*
- *there is no risk of the building partially or fully collapsing onto a public walkway, transport route or a neighbouring building or public amenity*
- *effective mitigation measures have been put in place to protect building users from the risk of collapse in a moderate earthquake?*

If not, what alternative criteria do you suggest?

IAG believes the criteria should also include:

- The level of earthquake-proneness
- The seismic risk in the territory

Roles, advice, information and education

P9 Central government would have a much greater role in guiding and supporting local authorities and building owners, as well as in public education and information.

Q20. Are the advice, information and education activities proposed for central and local government agencies sufficient to help ensure effective implementation of the new earthquake-prone building system? If no, please elaborate?

Insurers have a keen interest in the development and application of the seismic capacity assessment methodology. We would like to see some quality assurance built into the Crown's monitoring of local authorities to ensure the quality and consistency of capacity assessments.

V1 Views are sought on whether the current Building Act fire and disability upgrade requirements are, in practice, a barrier to building owners deciding to carry out earthquake strengthening work.

Q21-Q24.

IAG has no specific comments on these questions.

V2 Views are sought on how important heritage buildings can be preserved while also being made safer.

Q25-Q29.

IAG has no specific comments on these questions. Any relaxation of the standard will exacerbate the difficulty historic buildings already experience securing and affording insurance.

V3 Views are sought on the Royal Commission’s recommendation to allow local authorities the power, following consultation with their communities, to adopt and enforce policies to require specific hazardous elements on residential buildings to be dealt with within a specified timeframe.

Q30. *Should local authorities have the power, following consultation with their communities, to adopt and enforce policies to require specific hazardous elements on residential buildings to be dealt with within a specified timeframe? Please explain answer.*

Yes. Insurers would be interested in policies that reduced the extent of building damage, for example URM chimneys.

Other questions

Q31. *What would the proposed changes mean for you?*

The proposals will provide better access to information on earthquake-prone buildings and improve our ability to assess the earthquake risk and apply appropriate underwriting and pricing decisions.

Q32. *Are you aware of any problems with current policy and practice around earthquake-prone buildings, other than those identified in this document?*

Three additional questions arise in relation to the earthquake-prone policy:

- What process (if any) will be established for building owners to dispute their seismic capacity assessment?
- What evidence will be needed that the planned and completed work raises the building beyond the 33% of the NBS?
- Will buildings require a post-remediation seismic capacity assessment to maintain an up-to-date database for reference when changes in the building code raise the seismic capacity of new buildings and therefore the 33% threshold?

Q33. *Do you agree with the following objectives for changes to the existing earthquake-prone buildings system? If no, what objectives would you propose?:*

- *reduce the risk – to an acceptable level - of people dying and being injured in or by buildings that are likely to collapse in moderate to large earthquakes.*
- *ensure that building owners and users have access to good information on the strength of buildings they own and use, to help them make good decisions about building resilience and their use of the building.*

Yes. That said it is the damage done to the building that is of principle concern to the general insurance industry. To achieve meaningful reduction in building damage would require significantly higher percentage of the NBS to be achieved, with all the related costs and implications.