Sneaky, Creaky and Leaky

FRANA DIVICH & DOUG COWAN

'Sneaky'

In New Zealand, climate change factors such as increased temperature and rainfall are already occurring. These changes will occur to differing extents in different parts of New Zealand throughout this century and beyond. Property lawyers need to know how these changes will impact of the land they are transacting. That is because lawyers need to advise on risk, in the interests of protecting their clients.

In April 2016 the Royal Society of New Zealand released a report entitled *Climate Change Implications for New Zealand*.[1] As the name suggests, the report outlines the various impacts of climate change on the New Zealand environment.

Coastal erosion

In regards to coastlines, "rising sea levels will lead to inundation of low-lying coastal areas, erosion and destabilisation of different coastal landforms, rising water tables and salination of freshwater."[2] The Report says that with a 30cm rise in sea level, the current '1 in 100 year' extreme sea level event would be expected to occur once every year or so in many coastal regions.[3]

Despite the risks posed by coastal erosion the New Zealand public is not deterred from continuing to live, build, develop and retire on our coastlines. We are a seafaring, sea-loving and sea-gazing island nation after all. Coastal communities need to plan and adapt to the inevitable risks and consider accommodating the changes with changing land use, 'holding the line' or even relocating.[4] The Report makes clear that "without clear legislative guidance, litigation is likely to increase as rising sea levels affect coastal properties and adaptation responses constrain development on coastal lands."[5]

"Potential erosion" is a matter that must be included in a LIM report under section 44A(2) of the Local Government Official Information and Meetings Act 1987. In light of the changing landscape and the impact of erosion on coastal properties, LIM reports are even more valuable and crucial when advising clients.

In *Weir v Kapiti Coast District Council*[6] the High Court had to assess how far and to what extent coastal hazard prediction lines should be included in a LIM report.

The prediction lines were reproduced from a report authored by Dr Robert Shand which outlined erosion that may occur to the Kapiti Coast in the next 50 and 100 years.[7] During the interim judgment the Court accepted that it had no place to assess the merits of the science in the report. Analysis of the report was left to an expert panel under the District Plan Review process, which found that the prediction lines were not sufficiently robust to be included in the District Plan.[8]

> "A LIM report should always be sought and studied as it will contain information about whether the property might be susceptible to rising sea levels, water inundation or erosion. Remember to also check the District Plan as LIM reports are not obliged to contain information contained in the District Plan.

The Council was held to have no discretion concerning whether or not to include information about potential erosion in relation to coastal properties around the Kapiti District.[9] This information must be included in the LIM. However, the Council retained a discretion on how the information was portrayed in the LIM report.[10]

There was "potential erosion" for the purposes of section 44A(2). The report and its findings were within the Council's knowledge and therefore were required to be included in the LIM. This is regardless of the fact that the report by Dr Shand was found to be of an extreme nature by an expert panel and was excluded from the District Plan. There was still a reasonable possibility of erosion and the information was within the council's knowledge.

Developing land in erosion-prone areas

A further issue that lawyers need to be aware of is that tools can be put in place to protect future owners of coastal property when a client wishes to develop land in or around areas that might be susceptible to coastal erosion. In *Mahanga E Tu Inc v Hawkes Bay Regional Council*[11] the Environment Court was asked to approve a coastal subdivision. The proposed subdivision was at Mahanga beach, located just north of the Mahia Peninsula.

The Court had to determine whether it was reasonable to grant consent for the subdivision on erosion prone coastal land and allow the owner to take the associated risks.[12] It was held that a least 20 years was a reasonable time period for which the development could be enjoyed.

The applicants accepted the risk and certainty of coastal erosion and proposed to mitigate the impact in two ways:

1. The two houses most at risk were to be designed in such a way as to allow them to be disassembled and relocated when the foredune reached a point seven metres from the houses.[13]
2. A cash bond from the developers was to be paid into a general fund in respect of each lot. This was to prevent the public purse and the unsuspecting rate payer having to pay for the relocation or removal of the homes in the future.[14] The bond was weighted to take into account inflation.

All risk was on the developers. They chose to "accept what they [saw] as a shorter term benefit against the virtual certainty of a longer term loss and its associated expense."[15]

Photo by flickr user baldeagleblufff

Recommendations

A LIM report should always be sought and studied as it will contain information about whether the property might be susceptible to rising sea levels, water inundation or erosion. Remember to also check the District Plan as LIM reports are not obliged to contain information contained in the District Plan. If in doubt your clients should be advised to obtain their own reports. A LIM report is only as good as the information the council has within its knowledge.

In order for the local council to potentially be liable it must be aware of the risk and not disclose it in the LIM or in the District Plan.

If a client wishes to develop property in a coastal area that might suffer erosion, it is advisable to present a proposed plan to mitigate the consequences in accordance with the precautionary approach outlined in Policy 3 of the New Zealand Coastal Policy Statement 2010.[16]

Policy 3 promotes managing activities in the coastal environment when the effects of those activities are uncertain but potentially significantly adverse. The policy particularly directs a precautionary approach of the use and management of coastal resources that are potentially vulnerable to effects from climate change.

The following questions should be asked if a client wishes to purchase or develop property in a coastal area:

(1) What does the LIM report say?
(2) What does the District Plan say?
(3) How long can the property be reasonably enjoyed?
(4) How are the effects of coastal erosion going to be mitigated?
(5) Is the developer or owner willing to pay a bond (which is weighted to take into account inflation) that assists in mitigating the risks involved in setting up home in a high risk area?
(6) How much are they willing to spend on the property to ensure that all associated costs with coastal erosion are complied with?
(7) Is it worth sub-dividing land if mitigation steps are required?

Property lawyers are tasked with advising their clients so they can make an informed decision, and hopefully strike the balance between cost benefit and risk management. If it is noted in the LIM report (or District Plan) that land is prone to erosion, this could affect your client's insurance rates and the overall value of the property (given that the adverse effects might exist in the future).

The questions asked in relation to coastal properties need to be asked in any areas of land known for instability. The case of *Monticello Holdings Ltd v Selwyn District Council* further highlights the need for a LIM report, not just for coastal properties but for all properties that may be susceptible to destabilisation.[17] The importance of a LIM report in light of the *Monticello* decision was stressed in an article by Debra Dorrington in the June 2016 issue of *The Property Lawyer*[18] and the authors endorse Debra's analysis.

We wish to reiterate the importance of obtaining a LIM in order to establish sufficient proximity to the purchaser. In *Monticello* the Council could not be liable in relation to issuing a LIM, or failing to record relevant information on the LIM, as no LIM was sought or obtained by the plaintiff. Councils do not owe a duty of care to the world at large to keep comprehensive records.

'Creaky'

Lawyers who deal with Canterbury properties post-earthquake routinely advise their clients to obtain engineering and geotechnical reports in addition to building reports. There are a number of unknowns in respect of foundations, structure, retaining walls and general ground conditions to be aware of.

Some of the risks to be aware of when advising clients include:

1. Some repairs have been shown to be substandard.
2. Repairs might have been undertaken without a building consent.[19]
3. There may be hidden structural and geotechnical issues.
4. Purchasers may be led to believe that repairs have been carried out when in

fact they have not.

5. A number of properties are sold 'as is where is', which may not allow a future owner to claim against an insurer or the vendor.
6. There may be issues concerning the health and safety of tenants in rental properties.

Notable court decisions

In *East v Medical Assurance Society of New Zealand Ltd* [20] the central dispute was about the timing of insurance monies and what repairs were required to restore a house to a "substantially the same as new" condition.

In the High Court, Whata J identified a potential lingering issue in that the Christchurch City Council, as the building consent authority, remained free to grant whatever consent it thought appropriate.[21] The Court's resolution of the repair issue was not going to be the final word as the Council has the last say when granting or withholding consent.

The parties in this case wished to proceed with the hearing until a conclusion was reached, which left the outcome of the consent process unanswered. Clients need to be reminded that repair work is always subject to a Council consent.

Earthquake Commission v Insurance Council of New Zealand[22] came before the Court because, as a result of the two major earthquakes, the land in question had become more prone to flooding and liquefaction. In this case the Commission sought a declaration that increased liquefaction and flooding vulnerability were not natural disaster damage in respect of residential buildings for the purposes of section 18 of the Earthquake Commission Act 1993.

The Court declared that both increased vulnerability to liquefaction and flooding were considered to be damage to the residential land only, but not to the residential building.[23] Increased vulnerability is not natural disaster damage in respect of insured buildings on that land. There was no change to the physical state or integrity of the structure or materials that make up the body of the house or its foundations.[24]

'Leaky'

Leaky building issues are a minefield for an owner in a Unit Title development. You may act for an unsuspecting purchaser who has brought into a Unit Title property where the building's defect issues have only started to surface before the potential buyer commits to the sale.

The Unit Titles Act 2010 established four disclosure provisions which place an emphasis on purchaser protection in light of the leaky building crisis. It is not possible to contract out of these disclosure provisions and they apply regardless of whether the agreement for sale and purchase is conditional or unconditional.[25]

Although there is a focus on protecting the purchaser, there is still the potential that leaky building issues can be disguised or withheld from a purchaser.

Pre-contract disclosure

Before entering an agreement for sale and purchase, the vendor must provide a pre-contract disclosure statement to the purchaser.[26] The statement must be in the prescribed form and involves making some very specific declarations.

One of the declarations that must be made is whether:[27]

> the unit or the common property is, or has been, the subject of a claim under the Weathertight Homes Resolution Services Act 2006 or any other civil proceedings relating to water penetration of the buildings in the unit title development.

However, this statement regarding weathertightness is only whether a claim is currently on foot, not whether one is anticipated or pending. If a claim does eventuate before settlement, there is a duty on the vendor to disclose the change to the purchaser.

Although this disclosure is mandatory, there is no provision in the Act for the consequences of failing to comply. There is not a lot of case law as potential purchasers are not likely to proceed to settlement without reviewing, or at least seeking the basic information in the pre-contract disclosure.

It is at least arguable that a vendor may be held liable for damages if the purchaser was induced to enter the agreement by a pre-contract disclosure statement which was either incorrect or not provided at all. Misrepresentation could also be argued.

Additionally, purchasers are entitled to rely on the information contained in a disclosure statement as conclusive evidence of the accuracy of the matters described in that statement.

Often lawyers only become involved once an agreement for sale and purchase has already been executed. If you are acting for the purchaser and do happen to receive an agreement before it has been executed, then your client should be advised to not sign until the pre-contract disclosure statement has been received and reviewed.

Pre-settlement disclosure

A pre-settlement disclosure statement must be provided by the vendor no later than the fifth working day before the settlement date. This statement largely confirms some of the previous information in the pre-contract disclosure statement, but goes on to outline further specifics about the unit and the body corporate.

> "[I]ncreased vulnerability to liquefaction and flooding were considered to be damage to the residential land only, but not to the residential building. Increased vulnerability is not natural disaster damage in respect of insured buildings on that land.

The statement must contain the prescribed information and must be accompanied by a certificate given by the body corporate, certifying that the information in the statement is correct.

Once again it is unclear whether proceedings that have been threatened but not yet brought have to be disclosed to the purchaser.

Additional disclosure

An additional disclosure statement is mandatory, but only if requested by the purchaser.

Although optional, practically the additional disclosure statement will be the most important to a purchaser wanting a comprehensive snapshot of the body corporate's financial status and obligations. The statement could provide important information on the solvency of the body corporate, its contractual arrangements, obligations and the long term maintenance plan.

This is also the only disclosure statement which must be at the cost of the purchaser. Additional disclosure can be costly and the purchaser must be made aware that they must pay for this information.

Additional disclosure is crucial when advising clients purchasing a unit title. The information itself could reveal vital material about the contracts to which the body corporate is currently a party. Contracts with a leaky building remediation specialist or a façade engineer to assess the condition of the unit redevelopment would trigger alarm bells.

> "Although optional, practically the additional disclosure statement will be the most important to a purchaser wanting a comprehensive snapshot of the body corporate's financial status and obligations.

Unfortunately, there are also ways for the body corporate to alter the meaning of the disclosure statement. The use of particular words over others can cause the statement to be interpreted in a certain way.

Therefore, you should always seek the minutes of all body corporate meetings as well as financial statements and budgets for the complex as early as possible in the purchasing process. This enables you to properly advise your client about the purchase, to prevent the sale falling through at a later stage.

As an additional cautionary measure, there should be a condition in the agreement for sale and purchase that the agreement is subject to the purchaser obtaining, inspecting and approving the body corporate minutes.

If advising a vendor, it is vital to adhere to the disclosure provisions and timeframes as non-compliance gives the purchaser the ability to postpone settlement or to cancel the agreement.

Turnover disclosure

The final disclosure provision in the Act is a turnover disclosure statement. This is a statement from the original owner or developer to the body corporate which covers a wide range of information developers would have received from contractors, sub-contractors and designers.

The developer also needs to deliver a statement setting out any interest that the original owner or any associates has in any contract or arrangement the body corporate has entered into at any time, up to and including the date of the turnover disclosure statement.

The leading leaky building case in 2015/2016 in New Zealand is the well documented '*Nautilus*' decision.

Two particular owners in the complex, the Campbells, purchased a unit in 2009 before the Act came into force. They had been given a preliminary report that outlined numerous issues with the building. A further report was imminent but the owners did not wait for the second report nor did they make the agreement conditional upon its findings. They proceeded with the purchase as the vendor was a family friend.

The Campbells were found to have directly contributed to their losses and the reduction for their contributory negligence was held to be a significant 75 percent. They failed to take basic steps to protect their position. Losing out on 75 percent of an otherwise valid legal claim can be a bitter pill to swallow when over 200 unit owners in your complex have $25 million to spend on repairs.

The Campbell's misfortune still serves as a warning. Always review the pre-contract and pre-settlement disclosure statements. If need be, seek an additional disclosure statement and pore over it. Unfortunately, the Campbells trusted a family friend instead of making their own additional enquiries. Purchasers must take all reasonable steps to protect their position.

Frana Divich

Doug Cowan

Frana Divich is a Partner at Heaney & Partners and Doug Cowan is a Barrister and Solicitor in Auckland. **The authors would like to acknowledge Lucy Gould's assistance with preparing this article and congratulate her on taking out her practising certificate.**

1. *Climate change implications for New Zealand* (The Royal Society of New Zealand, April 2016).
2. At 29.
3. At 28.
4. At 29.
5. At 29.
6. *Weir v Kapiti Coast District Council* [2015] NZHC 43.
7. Dr Robert Shand *Kapiti Coast Erosion Hazard Assessment* (Coastal Systems Ltd, Wanganui, August 2012).
8. At [7].
9. At [11].
10. At [13].
11. *Mahanga E Tu Inc v Hawkes Bay Regional Council* [2014] NZEnvC 83.
12. At [38].
13. At [39].
14. At [44].
15. At [49].
16. *New Zealand Coastal Policy Statement 2010* (Department of Conservation, 2010).
17. *Monticello Holdings Ltd v Selwyn District Council* [2015] NZHC 1674, [2016] 2 NZLR 148.
18. Debra Dorrington "Advising clients regarding LIM reports in the light of *Monticello*" *The Property Lawyer* (online ed, Wellington, June 2016) at 15.
19. This work has been undertaken relying on Schedule 1 of the Building Act 2004 or by ignoring the need for a consent entirely.
20. *East v Medical Assurance Society of New Zealand Ltd* [2014] NZHC 339.
21. At [117].
22. *Earthquake Commission v Insurance Council of New Zealand Inc* [2014] NZHC 3138.
23. At [88] and [93].
24. At [87].
25. Sections 144 and 145.
26. Section 146.
27. Unit Titles Regulations 2011, reg 33(e).
28. Unit Titles Act 2010, s 150.
29. Section 153.
30. Section 147(2).
31. Section 147(3).
32. Section 148.
33. Section 148(5).
34. Section 151.
35. Section 156.
36. Unit Titles Regulations 2011, reg 36.
37. Unit Titles Act 2010, s 156(1)(b).
38. *Body Corporate 326421 v Auckland Council* [2015] NZHC 862.
39. At [310].