

To: Minister for Canterbury Earthquake Recovery



IN CONFIDENCE

INITIAL THINKING REGARDING RED ZONE PROPERTY OWNERS NOT COVERED BY THE CROWN OFFER TO PURCHASE RESIDENTIAL INSURED PROPERTIES

| | | | |
|-----------|---------------|----------------|--------|
| Date | 3 April, 2012 | Priority | URGENT |
| Report No | M/12/0314 | File Reference | |

Action Sought

| | | Deadline |
|--|------------------------|------------------|
| Hon Gerry Brownlee <i>Minister for Canterbury Earthquake Recovery</i> | Discuss with officials | Thursday 5 April |

Contact for Telephone Discussion (if required)

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

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- Withdrawn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

Noted 10/04

Initial thinking regarding red zone property owners not covered by the Crown offer to purchase residential insured properties

Executive summary

- 1 Cabinet announced a package to support insured, residential property owners whose houses are located in the 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.
- 2 This paper discusses five categories of property owners in the red zones who are not eligible for the Crown offer to insured residential property owners as they do not hold residential property insurance, which also triggers land cover provided by the Earthquake Commission (EQC). These are property owners with:
 - residential properties under construction
 - vacant land
 - commercial and industrial properties
 - properties owned by not-for-profit organisations
 - Waimakariri leasehold properties.
- 3 This paper considers whether the existing Crown offer should be extended to those red zone properties for which there are reasonable grounds for why people were uninsured altogether (first two categories) or where property owners had property insurance but land cover was unavailable (remaining three categories).
- 4 The distinction between the above property categories is relatively small. If an offer to purchase is extended to one category, there is an argument to extend this treatment to all five categories. CERA's preliminary assessment is that the property owners of the five property categories above are extended a Crown purchase offer.
- 5 CERA does not consider that the Crown would set unmanageable precedents for the treatment of any property which lies outside the red zones if it accepts the suggestions in this paper. Nor does CERA consider that the risks to insurance payouts are significant.
- 6 The argument for extending a Crown offer to purchase is the strongest for residential properties with dwellings under construction and for vacant land. Property owners would have been expected to obtain residential property insurance for improvements once the land was built on. Lack of insurance providing land cover is largely a temporal issue that would have been expected to end once construction was completed.
- 7 The argument for extension is less strong for commercial and industrial properties, and non-residential properties owned by not-for-profit organisations. In these cases there is no ability to gain any kind of insurance that would also trigger land cover. Theoretically the Crown might pay the value of the buildings only, on the grounds that compensation for the land was never an option under normal circumstances. We do not believe, however, that this approach is consistent with the Crown's recovery principles below.
- 8 The fifth category is properties where the owner of the improvements on the land leases the land from the Waimakariri District Council (WDC). Properties in this category, even with residential property insurance, are not eligible for the Crown offer because the land is owned by the WDC.
- 9 The Canterbury Earthquake Recovery Authority (CERA) believes that a Crown offer to purchase the leasehold interest in the land and any insured improvements owned by the lessee is consistent with the extension of a Crown offer to other property owners discussed in

this paper. While the Crown's offer is not extended to Councils as property owners, leasehold properties are distinguishable from other Council-owned properties in that most of the value is held by the owner of the leasehold interest and the Crown would purchase the leasehold, not the freehold, interest in the land.

- 10 Table 1 below summarises the relevant argument for extending the Crown offer to owners in the five property categories.
- 11 This paper also includes, for your information, an update on the status of those tranche 1 property owners who have received an offer but are yet to sign a sale and purchase agreement. Statistics are also provided on the number and value of uninsured residential homes in the red zones.

Consultation

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

Recommendations

- 13 It is recommended that you **discuss** this paper with officials.



Diane Turner
General Manager Strategy Planning
and Policy

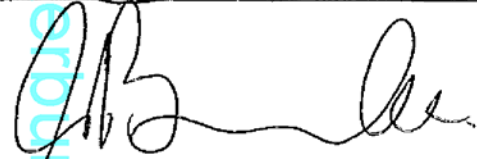
| |
|--|
| NOTED / APPROVED / NOT APPROVED |
|  |
| Hon Gerry Brownlee Minister for Canterbury Earthquake Recovery |
| Date: 10/04/2012 |

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 (14) | \$8.34M | <ul style="list-style-type: none"> Land insurance not available (not eligible for residential insurance during construction) Building/construction 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 purchase property at a rating equivalent value for buildings and most recent rating valuation for land to property owners with building or contract works insurance Property owners could insure the building/construction works 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. |
| Vacant land (86) | \$14.1M | <ul style="list-style-type: none"> Land insurance not available All except ~10 owned by individuals (rather than developers) All zoned residential | <ul style="list-style-type: none"> Extend a Crown offer to purchase land at the most recent rating valuation Property owners could not insure the land; Consistent with Crown's Recovery Principles; Supports property owners to move on with their lives with certainty and confidence |
| Commercial and industrial properties (28) | \$12.7M | <ul style="list-style-type: none"> Land insurance not available Commercial insurance for buildings available Mainly small operators, reliant on local community patronage/support (corner stores, vets) Some properties are leased rather than owner occupied | <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 owner-occupied businesses to re-establish elsewhere in Canterbury with certainty and confidence and continue to employ staff/provide service to community |
| Non-residential properties owned by not-for-profit organisations (11) | \$10.0M | <ul style="list-style-type: none"> Land insurance not available Commercial 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 |
| Waimakariri D. Council leasehold properties (6) | \$1.30M | <ul style="list-style-type: none"> Lessees own the buildings on the land but don't own land, therefore are not eligible for the Crown offer Residential or Commercial insurance for buildings available | <ul style="list-style-type: none"> Extend a Crown offer to insured property owners to purchase leasehold interest in land and any buildings Lessee could insure buildings and land but can not receive benefit of land component of insurance cover (the proceeds of this cover payable to owner of freehold interest in land); Consistent with Crown's Recovery Principles Supports lessee to move on with their lives with certainty and confidence |

Background

- 1 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.
- 2 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.
- 3 On 27 June 2011, Cabinet noted that subsequent decisions will be required in relation to the treatment of commercial properties, uninsured properties, and vacant lots in the red zones, none of which fall into the category of 'insured residential properties' [CAB Min (11) 24/15 refers].

Remaining Decisions

- 4 This paper advises you on the situation in regards to five categories of properties in the red zones not covered under the Crown offer, specifically:
 - 4.1 residential properties with dwellings under construction
 - 4.2 vacant residential land
 - 4.3 commercial and industrial properties
 - 4.4 non-residential properties owned by not-for-profit (community) organisations
 - 4.5 Waimakariri District Council leasehold properties.
- 5 Crown-owned and Council-owned land (aside from Waimakariri District Council leasehold land) is not considered in this paper. Properties that are uninsured as a result of purchase transaction design issues are addressed under the Chief Executive Power to Act (paper pending).

Crown's recovery objectives

- 6 In considering a recovery package for the owners of red zone properties, officials have had regard to the Government's recovery objective – a timely, focused and expedited recovery in greater Christchurch.
- 7 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

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.

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].

- 8 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.
- 9 This paper addresses situations where residential property insurance was impossible for the property owner to obtain due to the operation of the insurance market and/or the nature of their property.

Residential insurance and land cover

- 10 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.
- 11 Aside from the EQC component of home insurance, there is no mechanism in the New Zealand insurance market for insuring land.

Properties in the red zones not covered by the Crown's offer to residential insured properties

- 12 CERA has identified options for the Crown's treatment of the property categories considered in this paper and identifies our preliminary assessment of each.
- 13 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

- 14 During the construction phase of a building project, buildings can be covered for damage with building or contract works insurance. This provides for repair to the stage at which the construction was at the time damage was sustained. This insurance does not have a land-cover component. The Insurance Council has advised that property owners with dwellings under construction would have held building or contract works insurance, however these policies will have been paid out, where required due to damage, or cancelled based on the non-completion of the building projects.
- 15 Once a residential dwelling is completed, it is expected that the property owner would take out home insurance (providing land cover).
- 16 CERA has identified 14 residential properties with dwellings under construction in the red zones, 11 of which are in the suburb of Brooklands, three in the orange zone and 16 in the white zone. Table 2 below summarises the cost implications for the Crown should all of these properties be zoned red:

Table 2:

Residential property under construction in the Canterbury red, orange 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 | \$8.34M | \$2.34M | 14 |
| Orange | \$1.04M | \$0.75M | 3 |
| White | \$9.60M | \$5.60M | 16 |

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

- 17 There are three options for you to consider regarding the treatment of residential properties with dwellings under construction:

Option A: No Government offer to purchase residential properties with dwellings under construction

- 18 Under this option claims for damage to buildings will be processed under building works or contract works insurance policies, which may result in full or partial payouts based on the level of damage to the buildings. In the absence of home insurance and its associated EQC land cover; there would be no compensation to owners for the loss of the value of the land.
- 19 CERA considers that this option does not meet the Crown's recovery objectives. Without support from the Crown, this group of property owners will have difficulty re-establishing themselves financially and moving on with their lives with certainty and confidence
- 20 It should be noted that the absence of land (EQC) cover for these properties impacts the Crown's insurance recovery position. However, under the current Crown offer the Crown is accepting losses in situations where residential properties are only partially damaged and insurance proceeds assignable to the Crown are limited. In addition, some owners have not made EQC claims within the statutory timeframe, but are still eligible for the offer, notwithstanding the impact on the Crown's insurance recovery position.
- 21 Option A is not assessed by CERA as being consistent with the Crown's recovery objectives. Officials have also had regard to principles on which the Crown offer has been extended to residential property owners.

Option B: A package to purchase residential properties with dwellings under construction for the land value only

- 22 Under this option the Crown would extend an offer to purchase residential properties with dwellings under construction for the land value only leaving the owners to negotiate compensation for damage to buildings under building works or contract works insurance policies.
- 23 This would mean that the owners of construction projects with limited damage will receive little in the way of compensation from insurance policies. In cases where a project is near completion there will be substantial losses.

- 24 At this time, CERA believes that over half of the properties in this category are close to or at completion, with damage that is minimal or partial and will result in little or inadequate compensation from existing insurance in regards to property owners being able to move on from the properties and re-establish elsewhere.
- 25 For these reasons, and those canvassed in relation to Option A above, CERA does not assess this option as being consistent with the Crown's recovery objectives. Officials have also had regard to principles on which the Crown offer has been extended to residential property owners.

Option C: A package for the purchase of residential properties with dwellings under construction with the option of payment of land value only or a capital value based on the stage of completion

- 26 Under this option the Crown would extend an offer to purchase residential properties with dwellings under construction at their most recent rating valuation² equivalent value. 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.
- 27 CERA assesses that this option is consistent with the Crown's recovery objectives, and it does not exclude these red zone property owners from Government support based on their inability to obtain home insurance. Without support from the Crown this group of property owners may have difficulty re-establishing themselves and moving on with their lives with certainty and confidence.
- 28 Any insurance monies (already) received by an owner for damage to the property will be deducted from the purchase price established for the property³. An owner would also have the option of retaining all proceeds from their insurer if the amount the insurer had agreed to pay for the damage to the buildings under construction exceeds the rating valuation equivalent value for the buildings and receive a payment for the land value only.
- 29 Under Option C, the Crown's maximum gross exposure is estimated at \$8.34 million in the current red zones, with an additional transaction cost of an estimated \$0.355 million. Estimated average per property transaction costs have been established for the current Crown purchase offer [CAB Min (11) 32/16 refers].
- 30 In addition to those properties in the red zones, there is a potential risk to the Crown should all orange and white zone properties be re-zoned red. Should this occur, the Crown has a potential exposure of \$10.64 million, excluding potential transaction costs. However \$9.60 million of this figure lies in the white zones and is an upper estimate that is very unlikely to occur.

Red zone vacant land

- 31 There are two options available to the Crown in regard to the treatment of vacant land in the red zones – to extend an offer to purchase this land, or not to extend an offer to purchase this land.
- 32 Should the Crown not extend an offer to purchase vacant land in the red zones, it would result in an inconsistency in approach in comparison with other red zone property owners and would not support the Crown's recovery principals.

² For Christchurch City Council this is the 2007 rating valuation, for Waimakariri District Council, the 2008 rating valuation.

³ As part of the offer process, CERA will have access to insurance records and property owners must sign a statutory declaration regarding insurance status and claims received.

- 33 For the reasons identified in paragraph 27, we suggest that you consider extending the Crown's offer to vacant land in the red zones. This offer would be extended at the most recent rateable value of the land.
- 34 The Crown has already offered support to insured residential property owners with damaged properties, who, but for the Crown offer would suffer potentially unrecoverable financial losses. CERA considers that a similar approach is warranted here to allow owners of vacant land to move on with their lives with certainty and confidence. This approach is consistent with the Crown's recovery objectives.
- 35 Table 3 below summarises the cost implications for the Crown should all properties in this category be zoned red. It is unlikely that the land value figure for white zone properties will be realised:

Table 3

Value of vacant land in the Canterbury red, orange and white Zones

| Zone | Land Value (most recent rating valuation) | Number of properties |
|--------|--|----------------------|
| Red | \$14.29M | 86 |
| Orange | \$2.17M | 7 |
| White | \$79.29M | 25 |

- 36 The likely direct purchase cost to the Crown is \$14.29 million, with a transaction cost of \$2.13 million.
- 37 In addition to those properties in the red zones, there is a potential risk to the Crown should all orange and white zone properties be re-zoned red. Should all orange and white zone properties be re-zoned red, the Crown has a potential exposure of \$81.46 million, excluding potential transaction costs. However \$79.29 million of this figure lies in the white zones and is an upper estimate that is very unlikely to be actuated.

Commercial and Industrial Properties in the red zones

- 38 The owners of commercial and industrial buildings are able to insure their buildings under private insurance contracts, but are not eligible for EQC cover. Therefore the owners of commercial and industrial buildings are not able to insure the land they own.
- 39 CERA has identified 28 commercial and industrial properties in the red zones. Most are small properties from which small businesses operate, such as corner stores, takeaway shops, veterinary clinics and cafes. The businesses are predominantly owner-operated and service local communities. As such, most have lost or will soon lose their customer base, even if they are still able to operate.
- 40 Some of the 28 identified commercial and industrial properties are owned by the operators of the businesses that inhabit them. However, some businesses lease the buildings from which they operate. These business entities will not benefit from a Crown offer to purchase commercial and industrial properties.
- 41 There are additional commercial and industrial properties in the current orange and white zones. The probability that portions of land in orange and white zones will be later zoned red is uncertain.

Table 4 below summarises the cost implications for the Crown should all properties in this category be zoned red:

**Table 4:
Commercial and Industrial Properties in the Canterbury red, orange and white zones**

| Zone | Capital Value (most recent rating valuation) | Land Value (most recent rating valuation) | Number of properties |
|--------|---|--|-------------------------|
| Red | \$12.70M | \$7.86M | 28 |
| Orange | \$1.27M | \$0.03M | 1 |
| White | \$26.36M | \$13.65M | 43 |

Options available to the Crown for Commercial and Industrial Properties in the red zone

42 There are three options available to the Crown for the treatment of commercial and industrial property owners in the red zone:

- Option A: Do not provide a Crown offer for commercial and industrial property owners in the red zones.
- Option B: Provide a Crown purchase offer under which the Crown offers to purchase the property at the land value only.
- Option C: Provide a Crown purchase offer under which the Crown offers to purchase the land and buildings that comprise a commercial and industrial property along the lines of the current package for insured residential property owners.

43 CERA considers that Option C represents an approach consistent with the Crown's recovery objectives. Officials have also had regard to principles on which the Crown offer has been extended to residential property owners.

Option A: No Crown purchase offer for Commercial and Industrial Properties

- 44 Under this option claims for damage to buildings would be processed under contracts of commercial insurance with private insurance companies. Building owners will suffer losses flowing from shortfalls between the value of the properties and insurance proceeds. There would be no compensation to property owners for the loss of the value of associated land.
- 45 There is currently no evidence to suggest that the owners of commercial and industrial buildings are better able to withstand losses than residential property owners. For those property owners operating a business from the commercial properties they own, the decision to extend or not the Crown offer will impact more widely than the business owners, but also on the employees of those businesses if losses dissuade business owners from re-establishing elsewhere. Further, there would be an obvious inconsistency in the treatment of commercial property owners, versus other red zone property owners, that could be perceived to reflect a business unfriendly attitude.
- 46 CERA considers that this option does not meet the Crown's recovery objective of supporting a speedy recovery, or its focus on providing certainty and confidence so that people can move on with their lives.

Option B: A Crown purchase offer for the purchase of Commercial and Industrial Properties for their land value only

- 47 Under this option the Crown's offer would leave the owners to negotiate compensation for their buildings under their commercial insurance policies with private insurers. This would mean that the owners of buildings with limited damage will face protracted settlements delaying their ability to re-establish their business and move on with their lives and may receive little in the way of compensation from insurance policies.
- 48 For the reasons canvassed in relation to Option A above, CERA assesses that Option B is inconsistent with the approach proposed in this paper for the treatment of other red zone properties and would diverge from the Government's recovery principles.
- 49 Should you select this option, however, CERA recommends that the property be purchased at its 2007 land value rating valuation for Christchurch City and its 2008 land value for Waimakariri District.
- 50 The net cost of this option is estimated to be \$7.86 million.

Option C: A Crown purchase offer under which the Crown offers to purchase a commercial and industrial property along the lines of the current package for insured residential property owners.

- 51 Under this option the Crown would extend a Crown purchase offer to commercial and industrial property owners in the red zones along the lines of the current package for insured residential property owners. Any offer for the purchase of commercial and industrial properties should be limited to insured property owners. An offer to uninsured commercial and industrial property owners raises a significant moral hazard i.e. incentives to insure in the future would be significantly reduced. Furthermore, the extension of assistance to such property owners would be unfair to those property owners that have been paying insurance premiums.
- 52 CERA considers that this option is consistent with the approach the Crown has adopted for insured residential property owners, and is consistent with the proposed treatment of other red zone properties in this paper. It does not exclude red zone property owners from Government support based on their inability to obtain home insurance. And in each case, the Crown's assistance will facilitate a speedier recovery and afford protection from losses affecting the ability of red zone property owners to move on with their lives with certainty and confidence.
- 53 CERA recommends that an offer to commercial and industrial property owners be modelled on the current offer to insured residential property owners, 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.
- 54 Offers should similarly be based on the 2007 rating valuations for Christchurch City and the 2008 rating valuations for Waimakariri District. Any insurance monies received by an owner for damage to the buildings where an owner takes Option 1 will be deducted from the purchase price established for the property⁴.

⁴ As part of the offer process, CERA will have access to insurance records and property owners must sign a statutory declaration regarding insurance status and claims received.

- 55 Under Option C, the Crown's gross exposure is estimated at \$12.70 million in the current red zones, with an additional transaction cost of an estimated \$0.684 million.
- 56 In addition to those properties in the red zones, there is a potential risk to the Crown should all Orange and White Zone properties be re-zoned red. Should this occur, the Crown has a potential exposure of \$27.63M million, excluding potential transaction costs. However \$26.36 million of this figure lies in the White Zones and is an upper estimate that is very unlikely to occur.

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

- 57 Not-for-profits play an important role in the health of a community. They are particularly valuable in times of community distress and challenge. The 12 non-residential properties owned by not-for-profit organisations in the red zones include two churches, two community halls, two Scout dens, three Playcentres, an RSA hall, and a radio club.
- 58 The suggested treatment in this paper covers only six of these properties, as the other six are located on Council owned-land and are therefore not eligible for a Crown offer under current conditions. Further consideration will need to be made as to how (if at all) the Government may assist those not-for-profits with non-residential properties in the red zones, whose buildings are located on council owned land, to release their investments in these buildings.
- 59 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.
- 60 Taking into account the important role of not-for-profits in the recovery of greater Christchurch communities, and seeking consistency in approach with other red zone property owners, CERA proposes that non-residential properties in the red zones owned by not-for-profit organisations are extended a Crown offer.
- 61 Table 6 below summarises the cost implications for the Crown should all properties in this category be zoned red:

**Table 6:
Not-for-profit Properties in the Canterbury red, orange and white zones**

| Zone | Capital Value (most recent rating valuation) | Land Value (most recent rating valuation) | Number of properties |
|--------|---|--|-------------------------|
| Red | \$7.05M | \$2.16M | 6 |
| Orange | \$0 (no improvements) | \$0.49M | 1 |
| White | \$2.11M | \$1.29M | 3 |

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

- 62 There are three options available to the Crown in regard to non-residential properties owned by not-for-profit organisations. CERA considers that Option B best fits with the Government recovery objectives:
- Option A: To provide a Crown purchase offer to all non-residential properties owned by not-for-profit organisations (whether insured or not) in the red zones.
- Option B: To provide a Crown purchase offer to insured non-residential properties owned by not-for-profit organisations in the red zones.

Option C: Not to extend a Crown purchase offer to non-residential properties owned by not-for-profit organisations in the red zones.

Option A: A Government purchase offer for all non-residential properties owned by not-for-profit organisations (whether insured or not) in the red zones

63 Under this option the Crown would extend a purchase offer to all non-residential properties owned by not-for-profit organisations in the red zones to purchase the property at its 2007 Land Value rating valuation for Christchurch City and its 2008 Land Value for Waimakariri District. Insured landowners will be free to pursue their private insurance company for any other insurance claims they have.

64 If the Government was to provide assistance to uninsured not-for-profit property owners, it raises a significant moral hazard i.e. incentives to insure in the future would be significantly reduced. Furthermore the extension of assistance to such property owners would be unfair to those property owners that have been paying insurance premiums.

Option B: A Crown purchase offer for insured non-residential properties owned by not-for-profit organisations in the red zones

65 Non-residential not-for-profit organisations in the red zones are able to get building insurance, but not land insurance. By being insured, not-for-profit property owners did all that they could to protect their assets in the event of a disaster.

66 Table 6 above, outlines the total potential value of not-for-profit properties in all zones. The likely cost implications for the Crown in relation to non-residential properties owned by not-for-profit organisations in the red zones are between \$2.16 million and \$7.05 million, with a transaction cost of \$0.151 million, depending on the nature of the Crown offer and uptake of that offer.

67 CERA believes that a Crown offer to properties in this category and in the red zones could 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.

68 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.

69 CERA assesses that Option B is consistent with the approach proposed in this paper for the treatment of other red zone properties and would support the Government's recovery principles.

Option C: The Government does not extend a purchase offer to non-residential properties owned by not-for-profit organisations in the Residential red zones

70 Under this option claims for damage to buildings will be processed under owners' insurance policies. In the absence of any insurance providing land cover, there would be no compensation to not-for-profit organisations for the loss of the value of the associated land.

- 71 This would not meet the government objectives of certainty, confidence for landowners or a simple process, or provide consistency in treatment with other red zone property owners. CERA considers that this option does not meet the Crown's recovery objectives.

Waimakariri District Council Leasehold Properties in the red zone

- 72 CERA has identified seven residential properties in the Waimakariri District that are occupied under Glasgow leases. This means that the land is owned by the WDC, and leased to occupants who hold a perpetually renewable leasehold interest and own any buildings, fences and improvements on the land. Table 7 below summarises the potential cost implications for the Crown:

Table 7:

Waimakariri District Council leasehold properties in the red zone

| Land Value (2008 ratings valuation) | Improvements value (2008 ratings valuation) | Number of properties |
|--|--|-------------------------|
| \$0.88M | \$0.41M | 7 |

- 73 In essence, owning one of these leasehold properties is similar to having a freehold interest, in that leaseholders can secure a mortgage over their lease and, provided they have the consent of the WDC, they can assign their leasehold interest and sell their dwelling. CERA's research indicates these properties sell for close to free-hold value.
- 74 Leasehold property owners have not received the Crown offer to residential red zone residents, as they do not own their land. As such, they are unable to release their capital, that being the value of the leasehold interest and any improvements to the land. The WDC has informed us that, since the land was red zoned, it has not been charging rent to these residential leasehold owners.

Options available to the Crown for Waimakariri District Council leasehold properties in the red zone

- 75 There are four options for you to consider regarding the treatment of owners of WDC leasehold properties in the red zone. CERA assesses that Option B is consistent with the approach proposed in this paper for the treatment of other red zone properties and would support the Government's recovery principles.

- Option A: Not to extend a Crown purchase offer to WDC leasehold property owners in the red zones.
- Option B: To provide a Crown purchase offer to insured WDC leasehold property owners in the red zones.
- Option C: To provide a Crown purchase offer to all WDC leasehold property owners (whether insured or not) in the red zones.
- Option D: To provide a Crown purchase offer to insured WDC leasehold property owners in the red zones *and* to the Waimakariri District Council to purchase the freehold value of the land.

Option A: Not to extend a Crown purchase offer to Waimakariri District Council leasehold property owners in the red zones.

- 76 Under this option claims for damage to buildings will be processed under owners insurance policies. In the absence of an insurable interest in the land, there would be no compensation to owners for the loss of the value of their leasehold interest.
- 77 CERA considers this would be likely to result in significant loss of capital for leaseholders, as they would not be able to release any of the value of their lease. This would not meet the Crown's recovery objectives of certainty, confidence for landowners or a simple process, or provide consistency in treatment with other red zone property owners. CERA considers that this option does not meet the Crown's recovery objectives.
- 78 For the reasons outlined above, CERA does not prefer Option A.

Option B: A Crown purchase offer to insured leasehold property owners for the purchase of the leasehold interest and improvements

- 79 Under this option the Crown would extend an offer to insured leasehold property owners to purchase the leasehold interest at a value to be determined (see following paragraph), and the improvements at the 2008 rateable value for Waimakariri District. Any purchase of the freehold interest from the District Council could occur independently, and at a later date, when a decision is made regarding Crown purchase of Council owned properties in the red zones. The fact that the Crown already owned the leasehold interest would be reflected in the price paid for the freehold interest in the land.
- 80 Information is available regarding the land value and improvements value of the leasehold properties (see Table 7). Under this option, a process would need to be developed for determining the value of the leasehold interest. We suggest a similar process to the purchase price review process (Cab Min (11) 34/17 refers), whereby a valuer would assess the property to determine an apportionment of the land value between the leasehold and freehold interest. The Crown offer would be based on the leasehold interest and the rateable value of the improvements. The purchase price review process for Crown offers will operate, but under the condition that the leaseholder wishes to challenge the value of the *leasehold interest* determined by the Crown.
- 81 If the Crown was to purchase the leasehold interest, it would be obliged to pay rent and comply with the terms of the lease until the freehold interest was transferred to the Crown. The terms of the lease include such requirements as obtaining the written consent of the District Council before removing any buildings, fences or improvements or selling the dwelling. The WDC has indicated that it would not charge the Crown rent under the leases.
- 82 CERA believes that a Crown offer to insured WDC leasehold property owners could be modelled on that for insured residential property owners, with the difference that instead of land, the Crown is purchasing a lease:
- Option 1 - the purchase price paid would be the most recent rating valuation adjusted to provide for a payment for the leasehold interest and the buildings and fixtures and the Crown would take over all insurance claims for damage to the buildings.
 - Option 2 - the purchase price paid would be the most recent rating valuation adjusted to provide for a payment for the leasehold interest. The lessee would retain the benefit of all insurance claims for damage to buildings and fixtures and continue to deal with EQC and their insurer to settle those claims.

- 83 Under Option C, the Crown's gross exposure is estimated at \$1.29 million, with an additional transaction cost of an estimated \$0.177 million. Estimated average per property transaction costs have been established for the current Crown purchase offer [CAB Min (11) 32/16 refers].
- 84 CERA prefers this option as it provides consistency in treatment with other red zone property owners and meets the Crown's recovery objectives.

Option C: To provide a Crown purchase offer to all Waimakariri District Council leasehold property owners (whether insured or not) in the red zones

- 85 Under this option the Crown would extend a purchase offer to all Waimakariri District Council leasehold property owners in the red zone to purchase the leasehold interest at a value to be determined, and the dwelling at a 2008 rateable value for Waimakariri District.
- 86 Under this option every Waimakariri District Council leasehold property owner would be eligible for a Crown Offer, whether or not they had insured their buildings. If the Government was to provide assistance to uninsured property owners, it raises a significant moral hazard i.e. incentives to insure in the future would be significantly reduced. Furthermore the extension of assistance to such property owners would be unfair to those property owners that have been paying insurance premiums.
- 87 For the reasons outlined above, CERA does not prefer this option.

Option D: A package for the simultaneous purchase of the leasehold interest and dwelling from the lessee and the freehold interest from the District Council

- 88 Under this option the Crown would extend the offer to purchase the leasehold interest and dwelling from the owner and the freehold interest from the District Council. The benefit of dealing with both the leasehold and the freehold interest at the same time would be that there would be no rent or other obligations under the lease to consider.
- 89 Given there have been no policy decisions around the purchase of Council owned properties, CERA does not believe that this option is appropriate at this time.

Red zone insured residential property owners – uptake barriers to Crown offer

- 90 CERA's Contact Centre has undertaken outbound calling to 928 of the circa 1200 property owners in tranche 1 who have returned their consent forms and received an offer, but who have yet to sign a sale and purchase agreement. The Crown offer to purchase these properties will expire in May 2012. Results from this research are presented in Table 8, below:

Table 8:

Tranche 1 Property Owners, reasons for not progressing with a sale and purchase agreement

| Reason stated (some stated multiple reasons for delay) | Percentage of property owners | Number of property owners (total = 928) |
|---|----------------------------------|--|
| No delays or issues reported | 70% | 647 |
| Total Insurance <i>and/or</i> EQC delays | 24% | 230 |
| Insurance issues only | 13% | 123 |
| EQC issues only | 7% | 66 |
| Insurance and EQC issues | 4% | 41 |
| Problems with land/property availability | 2% | 16 |
| Other issues | 4% | 35 |

- 91 Of the property owners who reported 'other' problems, issues ranged from needing support (referrals were made to appropriate support services) to deceased estate complications. A small number of property owners wished to know what would happen to land once it was remediated before they made a decision.
- 92 In regards to the barriers that are related to insurer and EQC delays, CERA is actively working with insurance companies and EQC to resolve known systemic problems of differences in repair methodology and costing and apportionment. Insurers and EQC are prioritising resolution of those claims nearing the Offer deadline.
- 93 CERA is also actively investigating and advising you and officials on the issues surrounding land availability in Canterbury. The establishment of the Chief Executive Power to Act will assist with any transaction design issues that are hindering tranche 1 property owners.
- 94 As at 21 February 2012, CERA has identified 50 properties for which owners have not returned consent forms and are non-contactable (no contact information is held or can be located). CERA is working with EQC and other relevant organisations to attempt to locate these property owners.

Red zone uninsured residential property owners

- 95 As at the 19th of March CERA was aware of 33 residential properties in the red zones which we know to be uninsured, which do not fit into any of the categories discussed thus far in this paper. These have been identified through the Crown offer process. CERA has received feedback from community forums and other organisations to indicate the final figure may be twice this many.
- 96 The 33 properties have a rateable land value of \$4.53 million and capital value of \$9.11 million.
- 97 Uninsured property owners are being followed up by CERA where appropriate to ensure they are aware of support options open to them. Other avenues are being explored by a range of agencies to identify options to support these property owners.

Transaction design

- 98 The detailed design of the transaction process and the delivery systems, including legal fees, for Crown offers has been established under the existing Crown offer to residential insured property owners in the red zone [Cab Min (11) 27/12 and Cab Min (11) 27/13 refers]. Amendments to this design will need to be made to allow for an offer of purchase to other categories of properties in the red zones. Once decisions have been made in regard to potential Crown offers to other categories

of properties in the red zones, CERA will draft updated transaction designs for these properties and advise you of these.

Implications for future responses and precedent setting

- 99 The Crown has chosen to apply a particular approach to the treatment of the red zones because of the infrastructure damage and the low viability of communities remaining given the residential insured exiting the area.
- 100 The Crown position which led to the original land-zoning decisions and subsequent Crown offer to insured residential property owners in the red zones is about supporting the recovery focus by ensuring that property owners can make decisions with certainty and confidence - as outlined in this paper the treatments suggested herein seek to give action to that focus. CERA does not consider that the Crown is setting precedent for the treatment of any property which lies outside the red zones, as properties outside the red zones are subject to a different set of conditions to those within the red zones. Communications in regards to these red zone decisions will need to be careful, nevertheless.
- 101 An additional consideration relates to whether extending a Crown offer to the properties discussed in this paper would prejudice insurance recoveries from insurance companies and the EQC. CERA does not believe this to be the case, because of the low number of properties included in this extension (146 compared to over 5,000 already with offers), and because there are still properties left uncovered by the Crown offer. The extended offer will be on the same voluntary basis as the original offer.

Financial Implications

- 102 Table 9, below outlines the total financial implications for the Crown purchases suggested in this paper:

Table 9:

Total financial implications for Crown purchases suggested in this paper

| Property category | Number of properties | Acquisition of Properties (\$000) | Transaction Costs (\$000) | Total Cost (\$000) |
|--|----------------------|-----------------------------------|---------------------------|--------------------|
| Residential properties with dwellings under construction | 14 | 8.34 | 0.355 | 8.695 |
| Vacant land | 86 | 14.29 | 2.13 | 16.418 |
| Commercial properties | 28 | 12.7 | 0.684 | 13.384 |
| Non residential properties owned by not-for-profits | 6 | 7.05 | 0.151 | 7.201 |
| Waimakariri leases | 7 | 1.29 | 0.177 | 1.467 |
| Total | 141 | 43.67 | 3.495 | 47.165 |

Next steps

- 103 Following your feedback on this briefing paper, CERA will prepare a Cabinet Paper including financial implications for your consideration.