

Office of the Minister for Building and Construction

Cabinet Economic Growth and Infrastructure Committee

Building Act Review: Proposals for Reform

Proposal

- 1 As part of the government's regulatory reform programme agreed in February 2009 [CAB Min (09) 6/5A refers], this paper seeks agreement to consult with industry stakeholders and the public on a package of options to reform the building regulatory system arising from the review of the Building Act 2004 (the Act).

Executive summary

- 2 As part of the government's regulatory reform programme, in August 2009 I announced a review of the Building Act 2004 to reduce the costs associated with the building regulatory system without compromising building quality.
- 3 The review has found that the changes made by the Building Act 2004 have contributed to needed improvements in the quality of building work, but have resulted in a building regulatory system that is more costly than necessary and less efficient and effective than it could be. It has also found that there are weaknesses in certain parts of the system such as consumer protection, and that the relationship between certain system components (e.g. between inspections by local authorities and builder licensing) is unbalanced.
- 4 Agreement is sought to consult on a package of options as an input to the development of detailed policy proposals for consideration by Ministers in June 2010. The package would:
 - provide in legislation and regulation for a risk-based approach to building regulation
 - clarify responsibilities between builders and homeowners to enable parties to better manage their risks, and address weaknesses in the system of residential consumer protection and remedy.
- 5 Agreement is also sought for officials from the Department of Building and Housing in consultation with the Department of Internal Affairs to undertake work to explore and advise Ministers on ways to improve the institutional arrangements and administration of building control functions by local authorities.

Background and sector context

- 6 The Building Act review responds to concerns about:
 - the Act's implementation at local government / consent authority level
 - the costs and complexity associated with the building consent process
 - consumer confidence in the technical capability of practitioners
 - the allocation of responsibility for risk.
- 7 The aim of the review is to identify reforms to the Act and its associated regulation and administration to reduce the costs associated with the building regulatory system without compromising building quality. Specifically, the review seeks to achieve the following results:
 - a more risk-based approach to the administration of building regulations
 - quality homes and buildings produced through a business-enabling and efficient regulatory framework
 - consumers able to make informed decisions and participate with confidence in the building and housing market
 - homes and buildings that are produced cost-effectively by a productive sector with the right skills and knowledge
 - a regulatory system that provides for innovation in building design and construction practices.
- 8 The review's scope includes all building work covered by the Act. It excludes administration of the New Zealand standards system.

Building sector context

- 9 The building and construction sector is critical to New Zealand's economic performance. The sector contributes more than 5% of GDP and has a significant impact on overall consumption. Productivity is low, however, and innovation – essential to sustained productivity growth – is hindered in part by the current regulatory environment. Home ownership rates are also declining and housing affordability – which is linked to productivity as well as land values – is an issue for an increasing number of people.
- 10 The Building Act 2004 was introduced in response to the systemic failure which led to the weathertightness problem. It sought to change regulation of building work with the aim of providing greater assurance to homeowners and consumers and rebuilding confidence in the building and construction sector. The changes provided for included:
 - a comprehensive review of the Building Code (the Code)
 - an occupational licensing scheme for building practitioners
 - a strengthened building consent system
 - accreditation of building consent authorities (local authorities or private businesses undertaking consenting functions)

- the introduction of a set of statutory warranties implied into every residential build contract
- a product certification scheme.

11 These changes are now largely in place. In August 2009 the Government announced its support for the building practitioner licensing scheme, defined the scope of restricted building work which will have to be carried out or supervised by licensed building practitioners, and determined that this requirement will come into effect in March 2012.

12 Partly as a result of these changes there has been a general improvement in building quality but sector performance remains poor. There is consensus that while the building regulatory system is not 'broken' and that improvement has been achieved, it is more costly than necessary and less efficient and effective than it could be. There are weaknesses in certain parts of the system and the relationship between certain system components is unbalanced.

Critical Issues

13 Building work, particularly new home construction, is one of the largest investments an individual homeowner makes in their lifetime. Building, like other economic activity, involves risk. Particular features of the building construction sector that result in risk and uncertainty, and costs for consumers, include that:

- building is a complex process
- it typically involves a number of different practitioners, and can involve complex contracting and sub-contracting arrangements
- in New Zealand most new builds are bespoke
- homeowners contract infrequently for building work, presenting difficulties for them in assessing the quality of building work they are commissioning (or purchasing from another owner)
- it is difficult for homeowners to judge the skills of practitioners, the quality of products and other inputs to the building process, and the adequacy of third party inspection
- defects can be difficult to detect, can take years to become evident, and can be costly to fix.

Problems with the allocation of responsibility for risk

14 While cost can arise from risk taking so too can benefits from innovation and improved productivity. Parties are best placed to manage and make decisions on risks when they face both the benefits and the costs of risk.

15 The review has found that there are problems with the allocation of roles and responsibilities for managing risk within the building sector that underpin both the earlier concerns with quality (in particular weathertightness) and the current regulatory burden, and that there is over reliance on the role of local authorities.

- 16 Currently, roles and responsibilities for management of risk among residential consumers, building practitioners and building consent authorities are poorly defined and not well aligned with each party's ability to influence risk. In particular:
- residential consumers face risk in purchasing building work that they are not always well equipped to manage, and they sometimes find it hard to hold building producers to account for their work
 - local authorities, because of the duty of care to residential consumers imposed on them by the courts combined with the rule of joint and several liability, are exposed to the costs of building failure but not the benefits. This leads them to adopt highly risk averse behaviours that result in high compliance costs and reduced innovation
 - building practitioners are sometimes able to avoid or significantly mitigate the costs of building failure and poor performance that they are responsible for through the use of sub contracting arrangements, limited liability companies or limited means to meet associated costs when they arise.
- 17 Similar problems are not so prevalent in the commercial market because of the greater experience of parties, commercial contracting arrangements and more sophisticated risk management practices.

Inefficiency in building control processes and administrative arrangements

- 18 Because of their exposure to risk and liability (exacerbated by experiences with weathertightness failures) local authorities have generally become very risk averse in their approaches to granting building consents, inspecting building work and issuing code compliance certificates. That risk averse approach, compounded by a lack of skills in some areas within local authorities and their low level of confidence in the capability of building practitioners, is the source of many of the frustrations and delays being experienced by industry and consumers in interacting with the building regulatory system. It has also contributed to a general increase in compliance costs (eg, documentation requirements, number of inspections) and over-regulation of low risk building work.
- 19 Inefficiency within the building control system is exacerbated by the devolved administrative arrangements, under which building control functions are currently spread across 75 local authorities. While efforts are being made to consolidate building consent functions in some metropolitan areas, overall the pace of consolidation is slow. The current institutional arrangements make it difficult to achieve national consistency, to introduce risk-based approaches to building regulation without legislation, to develop and embed national approaches to implementation and exercise of enforcement functions, and to develop effective flows of information about the performance of the regulatory system.

Comment

- 20 There are opportunities to improve the performance of the building regulatory system. This paper outlines options for reducing the cost of the regulatory system and better defining responsibilities across consumers, industry and regulators. The aim is to improve the overall efficiency of the system, the management of risk and

the distribution of associated costs, without undermining building quality. The options are inter-related and build on existing regulatory mechanisms such as builder practitioner licensing. The package includes options to:

- clarify and simplify regulatory requirements and require a risk-based approach to their administration
- find efficiencies through changes to the institutional arrangements currently in place to administer the regulatory system
- re-balance responsibility for risk, and address weaknesses in the system of residential consumer protection.

PROPOSALS

21 In order to develop detailed policy proposals aimed at addressing the above issues, Ministers are asked to agree to the options outlined below as a basis for further policy development including public consultation. Ministers are asked to agree to the release of the attached consultation document as the basis for public consultation and to authorise the Minister for Building and Construction to make minor editorial changes that may be required to the consultation document prior to its proposed release on 26 February 2010.

Options to clarify the Act's purpose and principles

22 The Act includes a purpose statement and principles to guide those performing functions or duties or exercising powers under it. The purposes in the Act relate to various aspects of safety of building use as well as sustainable development. The Act also contains 16 principles covering a diverse range of matters such as energy efficiency, reduction in waste, disability access etc.

23 In order to provide better guidance to those administering the Act, agreement is sought to consult on:

- the implications and appropriateness of the current reference to sustainable development in the Act's purpose statement, and whether it should instead be replaced by a more specific purpose statement to the effect that buildings should be designed and built to ensure their suitability for their intended purposes
- whether the purpose and principles statements should apply to local authorities in their administration of all of their building functions (currently this is the case only in very limited circumstances, as the purpose and principles provide guidance primarily to the Minister and Chief Executive). To the extent that local authorities have discretion in how they exercise their functions, doing so would provide them with clearer guidance on how Parliament intends them to exercise this discretion
- whether all 16 of the existing principles should remain, or whether some of the existing principles relate to policy judgments rather than fundamental principles that need to be embodied in legislation

- whether there should also be reference in the principles to other matters such as the importance of national consistency and/or the need to take a risk-based approach to regulation to ensure costs are proportionate to risks and benefits.

Better specify and improve access to Building Code requirements

24 The New Zealand Building Code sets national performance requirements that all building work must meet. It is important that these requirements are clear and understood by all persons responsible for building work.

25 The Department's previous review of the Code identified a number of issues with how these performance requirements are specified and presented: some Code provisions, such as those related to fire, are open to wide differences of interpretation in their application; and it is difficult for consumers and practitioners to access the Code, and supporting information they need to meet Code requirements, in ways that are convenient to them.

26 To ensure clearer and better guidance on the performance requirements that building work is required to meet, Ministers are asked to direct the Department of Building and Housing to report back to Cabinet in June 2010 on its progress in:

- improving the specification of parts of the Code where performance standards are unclear and open to wide interpretation
- improving presentation of and accessibility to the Code and its associated acceptable solutions, verification methods and standards so that persons wanting to build particular types of buildings are easily able to access the information they need in ways that are convenient to them
- improving the interface between the building regulatory system and the standards system, and proposals to address any unresolved issues (in consultation with the Ministry for Economic Development)
- the implications of any changes to the Act's purpose and principles for the scope of the Code.

Provide for risk-based administration of building regulation

27 Ministers are asked to agree to consult on options to provide for a risk-based approach to consenting and inspecting building work. This would mean that, where the risks and consequences of building failure are low and/or the skills and capabilities of licensed building practitioners can be relied on, there would be less reliance on oversight and inspection by local authorities.

28 The review has identified opportunities to expand the range of building work exempt from building consenting requirements where that work has a low risk of failure and the consequences of failure (especially for health and safety) are small. In some cases this would need to be subject to a requirement to notify the local authority of the work to ensure adequacy of publicly accessible property information. The consultation document suggests specific items that might be added to the current list of Schedule 1 exemptions in order to test whether it is correct to assume these items are low risk and whether some items should

continue to be lodged with local authorities for compliance, land information or other necessary purposes.

29 For building work that continues to require a building consent, agreement is sought to consult on options to require building consent authorities to take risk-based approaches to their decision making processes for granting consents and issuing code compliance certificates. If implemented the options would result in streamlined approaches to the processing of consent applications, inspections and issuing of code compliance certificates for:

- simple residential (category 1) buildings and other low-risk buildings that are designed and built by licensed building practitioners
- complex commercial (category 3) buildings when they are designed and constructed by registered and licensed professionals and building practitioners, and subject to requirements for professional oversight and peer review.

30 Moderate complexity commercial and less conventional residential (category 2 buildings) are not included in the streamlining proposal at this time as the review concluded that the higher risk of failure of these buildings means there is currently benefit in retaining full third party building consent authority review.

31 In considering options to introduce a risk-based approach to administration of building controls, it is also proposed that officials will consider and consult on options in relation to the following:

- The role of the New Zealand Fire Service Commission in advising on building consents. The Act currently requires that certain applications for building consent must be provided to the New Zealand Fire Service Commission for its advice to building consent authorities on the adequacy of proposed provisions for means of escape from fire and access by fire-fighters. The current process is not working well and results in delays in the processing and issuing of building consents. The principle issues relate to differences in interpretation of Building Code requirements between consent applicants and the New Zealand Fire Services Commission. Agreement is sought to consult on options that would see consent applicants seek advice from the New Zealand Fire Service Commission on its requirements prior to submitting a consent application, as an alternative to the current process.
- Necessary connections to the resource management system. As part of the work being undertaken for the Resource Management Act review, officials from the Department of Building and Housing and the Ministry for the Environment will consider options to:
 - improve consistency of definitions, terminology and provisions between the Building Act and the Resource Management Act
 - achieve more certainty for applicants, for example through declaratory decisions by consenting authorities for 'simple' consents with restricted appeal rights
 - speed up the process of issuing resource consents by, for example, providing for a 'simple' consent category for matters such as boundary

encroachments and site coverage and providing for earthworks to be considered as part of the building consent process.

- Improvements to the building warrants of fitness and compliance schedule regime. This ensures specified life safety systems (eg, sprinkler systems, fire alarms and lifts) are inspected and maintained in accordance with procedures set out in compliance schedules. Officials will consult on proposals to ensure that the regime is focused on critical life and safety systems and reduce unnecessary compliance and enforcement costs associated with the scheme's administration, by exploring options for more standardised and simpler approaches.
- Whether the building regulatory system should continue to regulate all types of public works infrastructure, or whether some types, such as tunnels and bridges connected to the land transport network, might be best regulated through other means such as the procurement and commissioning process.

Measures to further improve efficiency through administrative reform

32 Building regulations are currently administered and enforced by 75 local authorities. This devolved approach to administering compliance and enforcement of national performance requirements for buildings causes difficulties in:

- achieving national consistency
- introducing risk-based approaches to building control functions without legislation
- developing national approaches to implementation and exercise of functions and enforcement of legislative requirements
- developing effective flows of information between the administration of the regulatory system and its design.

33 There are also questions about the cost and administrative efficiency of the current arrangements. As a result of the above streamlining proposals, as well as the implementation of national multiple-use approvals by the Department of Building and Housing, the overall volume of consenting work is expected to fall. This raises questions of the viability of multiple local authorities continuing to maintain capacity to undertake building regulatory roles.

34 It is therefore proposed that officials from the Department of Building and Housing in consultation with the Department of Internal Affairs be directed to develop options to improve the administrative efficiency of current institutional arrangements and to report back to Cabinet EGI committee in June 2010 on the costs, benefits and risks of these options relative to the status quo. This would provide the basis for a decision by Ministers as to whether to continue with the current devolved approach to administration of building regulations by local authorities, or whether to instead work to achieve greater consolidation or centralisation of building regulatory functions.

Streamlining the BCA Accreditation Scheme

- 35 The BCA accreditation scheme is being implemented in three stages over six years.
- 36 The Department will report separately in June 2010 on opportunities to streamline and improve the accreditation system, especially in light of proposals to streamline consent processes and actively facilitate further consolidation of BCA functions across local authorities.

Measures to re-balance risk and responsibility for risk, and address weaknesses in the system of residential consumer protection

- 37 Agreement is sought to consult on options, as a basis for developing detailed policy proposals for consideration by Ministers in June 2010, to:
- improve contracting practice in the residential building market and assist consumers to make more informed decisions, by requiring contracts for residential building work to be in writing, requiring those contracts to include certain minimum provisions that cannot be contracted out of (including warranties), requiring certain disclosures to be made by building producers to consumers, and taking a more proactive approach to consumer education and information
 - make the existing statutory warranties effective in practice, by reducing the current extensive but ineffective warranty obligation, and focusing it on the critical performance elements of the building work (for ten years instead of six at present) while providing an effective mechanism for homeowners to obtain warranty service (provided the builder is still in business)
 - provide access to prompt and efficient mechanisms for resolving building-related disputes including consideration of requiring dispute resolution mechanisms to be provided for in contract, the adequacy of existing means to enforce contracts, and viable alternatives
 - provide a financial backstop to warranties through surety arrangements, so that if a building producer defaults on providing warranty service, their surety provider would step in to promptly remedy the defect at its own cost. The two main options proposed for consultation are a disclosure regime and a mandatory surety regime, which may require initial underwriting by industry and/or the Crown.

OTHER MATTERS

Certificates for Public Use

- 38 The Act addressed the Cave Creek Inquiry's recommendations by requiring councils to confirm the safety of the parts of premises intended for public use that are affected by building work. The certificate for public use, provided for under s363, allows public activity to occur concurrently with building work, which makes it business enabling.

- 39 A subsequent amendment to the Act requires owners of public premises where building work was undertaken between 1 July 1992 and 31 March 2005, for which a building consent was required but a code compliance certificate was never granted, to apply for a code compliance certificate or certificate of acceptance (or a certificate for public use if the work has not been completed), or face a fine of up to \$200,000. To provide adequate time for owners to meet this requirement, the Act provided for a five-year transition that ends on 30 March 2010.
- 40 The Building Act review has identified, in discussion with local authorities, several issues with this requirement and its implementation including that:
- while the policy intent of the requirement is to remedy non-compliant building work that poses a risk to public health and safety, the requirement is expected to capture a far broader range of non-compliant building work that poses little risk to public health and safety
 - despite the transitional period, there may be several thousands of owners of public premises who will be in breach of the requirement by 31 March 2010 due to low awareness of the requirement, exacerbated by the fact that there has been little if any communication with building owners about this issue by local authorities and the Department of Building and Housing
 - it is uncertain whether local authorities will take active steps to proactively enforce the provision
- 41 It is clear from the work to date that retrospective application of the certificate for public use requirements is not the best way of addressing the underlying risk of there being uncertified historical building work that poses a public health and safety risk. However, further work is required to determine the best solution. It is expected that any solution will require legislative amendment and so a decision is sought now to amend the Act, subject to a report back by the Department of Building and Housing on the findings and recommendations of that further work. This work would be prioritised as part of the Building Act review, with a report back by 30 June 2010.

The Building (Dam Safety) Regulations 2008

- 42 The Building (Dam Safety) Regulations 2008 take effect on 1 July 2010. The regulations will affect an estimated maximum of 1,150 dams of which an estimated twenty percent (classified as high or medium potential impact) will be required to put in place an ongoing safety assurance programme.
- 43 Federated Farmers has questioned the need for ongoing compliance requirements for farmers, particularly those with low potential impact dams. Other stakeholders have also raised concern as to whether there is a sufficient number of recognised engineers able to undertake ongoing dam audits once the regulations come into force.
- 44 It is proposed that Ministers note that the Department of Building and Housing intends to commission an independent review of the regulations by a suitably qualified and experienced person prior to their coming into force. The review will clarify issues relating to dam safety and the causes of these, determine whether

the scope of the Dam Safety Scheme is appropriate, and recommend any changes to the design and implementation of the regulations to ensure efficient and effective implementation. The department will report back to Ministers by the end of April 2010 on whether changes are required and if so, what changes are proposed.

Preliminary cost/benefit analysis of the package

45 A preliminary regulatory impact statement is attached as Appendix 1. A full regulatory impact analysis will be presented at the point where decisions are sought from Cabinet in June 2010 and will be informed by feedback obtained during consultation with the public and industry stakeholders. Overall, the options are expected to result in net benefits. Preliminary analysis is summarised below.

Reduction in compliance costs

46 Proposals to simplify and streamline the building regulatory system are expected to result in a significant reduction in the volume of consents and inspections required, and therefore in the direct costs of building work as well as potentially significant indirect cost savings associated with reduced time delays. It is expected that compliance costs will be more commensurate with the risk of building work, with cost savings being particularly significant for low-risk work.

47 Reducing consent and inspection volumes is expected to enable building consent authorities to focus their resources on higher risk work and lead to improvements in the quality and efficiency of decision-making.

48 Consolidation or centralisation of building consent administrative arrangements offers significant scope for productivity-enhancing investments in systems and processes, and for achieving economies through better utilisation of labour.

49 Simplification, streamlining and consolidation of the building control system, along with proposals to better specify building performance requirements would reduce transaction costs for building producers and would be especially beneficial for those operating across multiple jurisdictions.

Wider economic benefits

50 Measures to better allocate responsibility for risk, and to better equip residential consumers, are expected to strengthen building practitioners' incentives to perform work 'right first time' and to quickly remedy defective work without cost to the consumer, while providing adequate protection in the event that a building producer defaults. Over the medium-term the expectation is that consumers, building practitioners and surety providers will face stronger incentives to address the underlying issues that drive cost (eg, practitioner competence and scope of practice, risk management practices, industry structure). It is also expected that innovation will be better enabled.

Costs and risks

- 51 Depending on the detailed design of options, the package may involve costs for consumers, building practitioners, ratepayers and taxpayers, in particular associated with the price effects of warranties and any surety requirements, the costs associated with upgrading the skills of the workforce, and any additional dispute resolution requirements. Measures to simplify and streamline the building consent process will also impose one-off transition costs.
- 52 Key risks, which will be mitigated through detailed design work, include:
- the incentives on building practitioners and surety providers to take an overly conservative approach to managing risk, resulting in additional costs on consumers
 - the requirements for certain work to be undertaken by licensed building practitioners and warranty and surety requirements might raise barriers to entry and/or the costs of ongoing participation in the industry
 - the dependence on the competency of licensed building practitioners and of there being sufficient uptake of the licensed building practitioner scheme. This risk is being addressed through a joint promotion campaign with the sector scheduled for 2010.

Consultation

- 53 The following Departments have been consulted and agree with the contents of this paper: the Treasury, the Department of Prime Minister and Cabinet, the Ministry of Economic Development, the Department of Internal Affairs and the Ministry for the Environment.
- 54 A Sector Reference Group and Sector Working Group comprising members of the building industry, local authorities and consumer advocates have provided strategic and operational input to the review, ensuring that the sector's issues are being addressed and that the Department's analysis is robust when viewed from sector perspectives.

Financial implications

- 55 There are no financial implications arising directly from this paper. The costs of the proposed consultation and further work to advise on the detail of specific proposals arising from this review will be met by the Department of Building and Housing from within existing appropriations.
- 56 The proposed report back in June 2010 will include detailed advice on the costs and funding of all proposals.

Human rights

- 57 There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Legislative implications

58 The legislative and regulatory implications of the proposals in this paper are set out below, in the order in which they are expected to occur:

- certificate for public use provisions (s363B) require amendment at the soonest opportunity, ideally before the end of the transitional period on 30 March 2010
- subject to the findings of the proposed independent review of the Building (Dam Safety) Regulations 2008, to be reported to Cabinet by the end of April 2010, those regulations may require amendment prior to their commencement on 1 July 2010
- the remaining proposals in this paper will, if agreed following the report back in June 2010, involve substantial amendments to the Act. There are a number of options for effecting those amendments during 2010.

Implementation

59 The proposed report back in June 2010 will include detailed advice on the sequencing and implementation of preferred options. There is a strong relationship between the various options proposed in this paper and implementation of the licensed building practitioner scheme.

Regulatory impact analysis

60 The Department of Building and Housing confirms that the principles of the Code of Good Regulatory Practice and the regulatory impact analysis requirements, including the RIS consultation requirements, have been complied with.

61 A preliminary RIS is attached as Appendix 1 for the Building Act Review package of options. The RIS is preliminary because no final policy decisions are sought now and because the overall impacts of the package depend on high-level design choices, and the overall shape of the package, which are the subject of consultation and ongoing policy development. Additional work on benefits, costs and risks of the package will be undertaken in parallel with further policy work, with the planned public consultation informing this analysis. A full RIS will be presented at the point where decisions are sought from Cabinet in June.

62 The preliminary Regulatory Impact Statement was circulated with the Cabinet paper for departmental consultation.

Industry and public consultation process

63 Consultation is proposed as part of the work to develop and advise on detailed policy proposals.

64 The approach to consultation involves the Department of Building and Housing consulting with the three broad groups affected by the proposals - the building and construction sector, local government and consumers. Others, including the insurance industry, will be consulted on specific options. A layered approach to consultation is proposed:

- targeted – identifying organisations and individuals within each broad group with specific knowledge and perspectives and actively engaging with them
- general – providing the opportunity and access for any interested party to comment on any aspect.

65 Active engagement with targeted organisations and individuals will include direct communication and workshops with local government, building and construction sector representatives and consumer representatives.

66 It is proposed that authority to sign off the final version of the consultation paper be delegated to the Minister for Building and Construction.

67 It is also proposed that this Cabinet paper and the attached Regulatory Impact Statements, be made publicly available on the internet at the same time as the consultation paper is released.

Publicity

68 It is proposed that the Minister for Building and Construction announce Cabinet decisions and consultation on 26 February 2010 as part of a series of announcements about positive steps towards a more cost-effective building system.

69 The 26 February announcement would be followed up with an ongoing communications campaign to raise awareness of the opportunity to have input into the review of the Building Act. This will include an online introduction to the review that can be distributed through electronic media as well as articles and advertising in mainstream media and specialist magazines.

Recommendations

70 I recommend that the Committee:

- 1 note that on 22 July 2009 Cabinet Economic Growth and Infrastructure Committee (EGI) approved the terms of reference for the review of the Building Act, and invited the Minister for Building and Construction to report to EGI in early December 2009 with proposals to immediately simplify and streamline the current regulatory system, and with options for more fundamental reform of the regulatory system [EGI Min (09) 14/10 refers]
- 2 note that the review of the Building Act 2004 has concluded that the changes made by the Building Act 2004 have contributed to improvements in the quality of building work, but have resulted in a building regulatory system that is more costly than necessary and less efficient and effective than it could be, and that there are weaknesses and imbalances between components of the regulatory system
- 3 agree, for the purpose of developing detailed policy proposals, to the Department of Building and Housing consulting with industry stakeholders and the public between February and April 2010 on a package of options to:

- i) clarify and simplify building regulatory requirements and require a more targeted, risk-based approach to their administration by building consent authorities
 - ii) clarify the responsibilities of building producers to residential consumers and better equip residential consumers to transact with confidence for building work
- 4 authorise the Minister for Building and Construction to approve the release of the attached consultation document on 26 February 2010 and to make any minor editorial changes they may be required prior to its release.
 - 5 authorise the release of this cabinet paper on 26 February 2010
 - 6 direct the Minister for Building and Construction to report to Cabinet Economic Growth and Infrastructure Committee by the end of June 2010 with policy recommendations arising from the consultation authorised in 4 above
 - 7 direct the Department of Building and Housing to report to Cabinet Economic Growth and Infrastructure Committee by June 2010 on its progress in:
 - improving the specification of areas of the Building Code where performance requirements are poorly specified
 - improving the presentation and accessibility of the Building Code so that persons wanting to build particular types of buildings are able to easily and for a low cost identify all relevant Building Code clauses, compliance documents and standards in ways convenient to them
 - improving the interface between the building regulatory system and the standards system, and proposals to address any unresolved issues (in consultation with the Ministry for Economic Development)
 - the implications of any changes to the Act's purpose and principles for the scope of the Code

Building Act administration

- 8 note that as a result of the proposals in this paper to introduce a risk based approach to administration of building regulatory requirements, and previous decisions to centralise multi-use consent approvals, the volume of consent applications across 75 local authority authorities is expected to decline, adding to existing concerns regarding building consent authority capabilities and the cost effectiveness of devolved administration
- 9 direct the Department of Building and Housing in consultation with the Department of Internal Affairs to report to Cabinet Economic Growth and Infrastructure Committee in June 2010 on options to improve the administration of building regulatory functions including their consolidation across local authorities or centralisation, and on the expected benefits, costs and risks of these options compared to proceeding with current institutional administrative arrangements

Certificates for Public Use

- 10 note that section 363 of the Building Act requires owners of premises that had building work undertaken between 1 July 1992 and 31 March 2005, for which a building consent was required but no code compliance certificate issued, to obtain

council approval for the building work by 31 March 2010 or face a fine of up to \$200,000

- 11 note that several issues have been identified with the retrospective application of section 363 and that it is clear that the current provision in the Act is not the best way of addressing the underlying risk of non-compliant and dangerous work in buildings built between 1 July 1992 and 31 March 2005
- 12 direct that the Department of Building and Housing to review the retrospective application of section 363, including consideration of an effective means of identifying and addressing non-compliant and dangerous building work in buildings built between 1 July 1992 and 31 March 2005, and report to Cabinet Economic Growth and Infrastructure Committee on the findings and recommendations of that review by the end of June 2010
- 13 agree that the Act will need to be amended to give effect to the findings of the review of section 363
- 14 note that the Department will communicate with local authorities regarding an appropriate enforcement policy to take in light of the decisions in 12 and 13 above

Dam safety

- 15 note that the Department of Building and Housing intends to appoint an independent and suitably qualified and experienced person to review the Building Act 2004's dam safety regulatory requirements prior to them coming into force, and to make recommendations on any necessary changes to the scheme's design and implementation to ensure its effectiveness and to ensure that administrative and compliance costs are proportionate to the risks being regulated
- 16 invite the Minister for Building and Construction to report back to Cabinet Economic Growth and Infrastructure Committee on the findings of the review in 15 above by the end of April 2010

Announcement

- 17 invite the Minister for Building and Construction to announce Cabinet's decisions on 26 February 2010

Hon Maurice Williamson
Minister for Building and Construction

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Appendix 1: Preliminary Regulatory Impact Statement

Building Act Review: Proposals and Options for Reform Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the Department of Building and Housing.

It provides a preliminary analysis of options to address concerns regarding the effectiveness and efficiency of the system of building regulation, in particular concerns regarding higher than necessary costs and complexity of the building controls system, weaknesses in the system of consumer protection, and unbalanced allocation of risk and responsibility across consumers, building practitioners and building consent authorities.

Regulatory Impact Analysis is at a preliminary stage because the impacts depend on design choices which are yet to be made and on the overall shape of the package. A full regulatory impact analysis will be presented at the point where decisions are sought from Ministers in mid-2010. This will be informed by further work on the benefits, costs and risks of the key elements of the package. The planned public consultation is intended to inform analysis of the benefits, costs and risks of individual elements of the package, as well as its dynamic effects.

As well as net benefits, the package components have the potential to impose additional costs on businesses and affect labour market and business dynamics in the building sector. These impacts, and the offsetting benefits, will be explored in detail as part of further policy work. The proposals are not expected to impair private property rights, significantly affect market competition, or impair incentives on businesses to innovate or invest. The options proposed for public consultation would not override fundamental common law principles.

Michael Mills, Programme Director, Building Act Review

3 February 2010

Status quo and problem definition

The Building Act 2004 was introduced in response to widespread weathertightness failure in the residential housing sector, which resulted from systemic problems including:

- Lack of responsibility and accountability for building quality (due to fragmentation, sub-contracting and use of corporate and other tools to avoid risk)
- Poorly articulated standards interpreted by poorly skilled regulators
- Questions regarding the desirability of competition in the provision of building consent services
- Inadequate regulatory oversight by the Building Industry Authority, the then central regulator
- Inadequate focus on consumer interests.

The government's response was to tighten regulation of the sector by introducing a series of reforms, notably reinforcing and introducing new input controls, that have progressively been implemented since 2004. Key elements of the reforms included:

- Strengthening the role of the central regulator
- Reviewing the Building Code, increasing the amount of guidance in support of the Code, and providing for bans or particular ways of building in particular circumstances
- Ensuring that there is a base of capable (qualified and knowledgeable) people to undertake building design and critical elements of building work and inspection, notably by providing for the licensing of building practitioners and requiring accreditation and audit of building consent authorities
- Strengthening the independent scrutiny that plans and construction work receive in the building consent and inspection process
- Strengthening consumer protection for homeowners through mandatory warranty terms implied in all contracts for building work, making builders liable for latent defects in their work (although the reforms did not go so far as to mandate the means of delivering on these warranties).

Key aspects of the 2004 reforms are still being implemented, notably the licensing of building practitioners, accreditation of building consent authorities (BCAs) and the statutory product certification regime. The full impacts of the 2004 reforms are, therefore, yet to be felt.

In part due to the reforms, and as a result of changes within the sector, there has been a general improvement in building quality since 2004:

- With regard to weathertightness, there have been significant changes in building design and construction practice such that most new dwellings are constructed with a good prospect of performing well (eg, drainage cavities within the external wall

are a common feature of new dwelling construction but were not a common feature of “leaky buildings” built prior to 2004). There have been few claims through the Weathertight Homes Resolution service for houses built since 2004. Pricewaterhouse Coopers recently reported that homes constructed after 2005 have a low failure rate of 0.2%, implying less than 150 homes built between 2006 and 2008 are likely to be leaky.

- Since 2004, volume builders have increased their market share from around 22% in 1997 to approximately 35% in 2009. While all builders have incentives to ensure quality construction, volume builders have a particularly strong interest in maintaining their brand. Further, most volume builders are members of the Registered Master Builders Federation or the Certified Builders Association, and offer home warranty insurance products that provide limited ‘first resort’ cover. These insurance products, which have been estimated at covering around one third of residential building work, help to ensure these builders face the economic consequences of poor building work subject to the scope of cover provided.

Nevertheless, there remain significant issues with the economic performance of the system of building controls, which impacts negatively on productivity in the construction sector, the responsiveness of housing supply, and, ultimately, raises the costs of building work for consumers. Because the construction sector is large (representing 5% of GDP) and is an important intermediate input into other sectors of the economy, the economic performance of the sector is important for the performance of the wider economy.

Information gathered during the course of this Review, supported by previous research and analysis, highlights the following problems with the status quo:

The building controls system is not sufficiently “risk-based”

Current regulatory settings are based on a low tolerance for risk and a strong emphasis on the role of government in protecting home owners from risks of building defects and failures.

There is a heavy reliance placed on the building controls system in protecting consumers from defective building work. This heavy reliance results from a combination of:

- The statutory role played by Building Consent Authorities (BCAs) (ie, issuing consents, undertaking inspections, and issuing code compliance certificates)
- The duty of care imposed by the courts by on local authority BCAs in respect of residential homeowners combined with the rule of joint and several liability
- The use of risk avoidance techniques by developers and builders (eg, limited life companies)
- The fact that local authority BCAs are “deep pockets” backed by the power to rate with limited options to effectively manage that risk.

The heavy reliance on BCAs is misplaced because their control over final building quality is limited and because it has a number of perverse effects:

- BCAs take a highly risk-averse approach to regulatory decision making, which has resulted in a general increase in compliance costs (eg, documentation requirements, number of inspections etc) and over-regulation of low-risk building work. Common concerns relate to:
 - Perceptions that documentation requested to support consent applications is onerous and excessive
 - Slow processing of consent applications, including delays in granting consents due to requests for additional information that effectively ‘stop the clock’, thereby enabling councils to meet statutory timeframes
 - A large number of on-site inspections that are required in the course of construction, and time wasted arranging inspections and waiting for building officials to complete inspections before work can proceed
- The increase in regulatory oversight has also reduced processing times for consents and reduced responsiveness to requests for inspections. While around 83% of building consents are issued within statutory timeframes, there is a widespread perception amongst builders and developers that timeframes are not always met, and that there are significant costs associated with delay due to stopping the clock while additional information is sought.
- Anecdotal evidence suggest that innovation may be hampered by this approach because there are lower compliance costs associated in low-risk building designs and building systems that comply with Compliance Documents (acceptable ‘stock’ solutions rather than alternative ‘design led’ solutions).

Multiple-jurisdiction exacerbate inefficiencies in the building controls system

Currently, 75 local authorities process around 70,000 consents per year, representing an average of less than 1,000 per authority. Further, the average annual number of consents processed outside of the metropolitan territorial authorities is considerably lower than this.¹

Each authority must be accredited by International Accreditation New Zealand (IANZ), and registered and monitored by the Department of Building and Housing. Almost all separately establish and manage their own systems and processes, and they compete in the labour market to maintain sufficient capacity and capability to carry out their functions. Each must also meet any costs of litigation. All of these costs are passed on to building consent applicants and recovered through a system of fees and charges, with any shortfall borne by ratepayers.

While efforts are currently been made to consolidate building consent functions in some metropolitan areas, overall the pace of consolidation is slow. Given the low volume of consents processed in some centres, and the nationally standardised

¹ Based on data for 2008/09, 17 BCAs issued less than 500 consents, 21 BCAs issued between 500 and 1,000 consents, and 26 BCAs issued between 1,000 and 2,000 consents. Only 9 BCAs issued more than 2,000 consents.

process involved, there may be significant economies of scale in a more consolidated approach. That is because the consenting and inspection workload at a local level is likely to be lumpier than at a national level. The economics of investing in productivity-enhancing technologies, systems and processes may also improve with scale. These potential efficiencies are being forgone under the status quo.

There are inconsistencies in the interpretation of regulatory requirements across BCAs, which can cause frustration to consumers and building practitioners and increase the costs in doing business on a national basis. While in absolute terms the incidence of these costs are relatively low, they are borne disproportionately by individuals and firms that deal in new or novel products, building systems, and designs. This may also result in a potential loss of innovation, by encouraging businesses to rely on acceptable or prescribed means of construction.

Weaknesses in consumer protection mechanisms

While consumer protection was emphasised in the Building Act 2004, through a purpose statement and implied warranties, no specific measures were included to assist consumers to understand their rights, enforce their rights, or hold practitioners to account other than through the disputes tribunal (for small claims) and the courts.

Some non-regulatory initiatives have been undertaken since the passage of the Act to strengthen consumer protection, notably the provision of consumer guidance and information through, for example, the Consumer Build website.

However, consumers continue to face considerable risk and there is a gap between what was intended by Parliament in the 2004 Act and the outcomes that have resulted in practice. This gap is a function of:

- Building is a complex process – it is characterised by a large number of small firms, extensive sub-contracting arrangements, and sometimes ill defined supply chains – and consumers therefore face difficulties in making informed decisions
- Residential consumers contract infrequently for building work and lack experience in contracting relative to building contractors
- Frequently there is no formal written contract setting out the nature of the agreement and the rights and obligations of each party – many consumers and builders are unaware of implicit warranties
- It is difficult and costly for consumers to hold practitioners to account – the consumer has little leverage over the practitioner once building work has been paid for
- There is little incentive for a practitioner to repair defective work or pay compensation, as doing so is costly and practitioners often face little risk of sanction
- Residential consumers have limited access to speedy, cost effective mechanisms to help them resolve disputes
- Residential consumers have limited options for managing their risks through products such as home warranty insurance, although such products are increasingly available

These issues are exacerbated by the fact that some developers, designers and builders actively manage or mitigate (and in some cases avoid) their risks, for example through the use of 'development specific' and 'limited life' company structures.

Unbalanced allocation of risk and responsibility

A combination of the above factors means that there is an unbalanced allocation of risk and responsibility. In practice:

- Residential consumers and BCAs bear the brunt of the risk associated with building work that fails to perform, despite having the least control over the quality of that work.
- Building practitioners, on the other hand, are able to manage, mitigate and in some cases avoid their risks, for example through the use of limited life companies
- While BCAs face high risk they do not realise any benefits from risk-taking within the context of a building project, so rather than making appropriate trade-offs between the costs and benefits of risk they tend to be highly risk averse

As a result:

- A negative dynamic is created whereby those best placed to manage risk (ie, building practitioners and consumers) are less likely to actively manage it
- Incentives for good practitioner performance are relatively weak with potential implications for the rate of defective building work, the costs of the inspection process, and incentives for practitioners to improve skill levels
- Risk averse behaviour on the part of BCAs adds significant direct and indirect costs to the building process which are ultimately borne by consumers
- Rates of innovation are likely to be lower because the costs associated with the building control system are higher where new, novel or innovative products, systems or designs are used

Despite the above problems, the overall conclusion reached by this Review is that the building regulatory system is broadly aligned with international best practice and is not "broken". Although the system is not missing critical elements, there are weaknesses in certain parts of the system, and the relationship between certain system components is "out of balance".

Objectives

The overarching outcomes sought from the package of options include:

- Improving the efficiency of the building consent, inspection and Code compliance process, in particular through a more targeted, risk-based approach to consenting, and by addressing the underlying causes of the highly risk-averse approach currently taken by building consent authorities
- Achieving a more efficient allocation of responsibility for risk across the different parties involved in the building process so that building practitioners in particular

face stronger incentives to ensure building work is performed 'right first time' and to efficiently remedy defects when they occur

- Better equipping residential consumers to make informed decisions and strengthening the protections available to them, so that they can participate confidently in the building and housing market
- Ensuring the regulatory system does not impose barriers for innovation in design and building practices they allow homes and buildings to be produced cost-effectively by a productive sector with the right knowledge and skills

The development and analysis of options has been undertaken in accordance with the EGI approved Terms of Reference for the Building Act Review approved by the Cabinet Economic Growth and Infrastructure Committee (EGI).

Regulatory impact analysis

Options to simplify and streamline the building regulatory system, through a more targeted, risk-based approach and consolidation of building control functions

The following options have been considered:

1. Changes to the principles and purposes statements in the Act, to ensure regulators have clarity as to Parliament's intent and to provide guidance to the courts in interpreting the legislation
2. Ensuring that building performance requirements are clearly specified, so that building practitioners, consumers and BCAs have greater clarity regarding the performance requirements that building work must adhere to
3. providing for a risk based approach to building regulation, including:
 - extending the scope of building work that is exempt from consent requirements
 - introducing streamlined consent and inspection processes for category 1 buildings (simple houses) and other low-risk buildings
 - introducing an alternative building consent process for category 3 buildings (complex commercial buildings)
 - considering whether or not all infrastructure building work should continue to be covered by the Act
4. A package of changes to address any issues identified through consultation and review regarding the requirements for building warrants of fitness and compliance schedules, dam safety regulation, and requirements for BCAs to seek the advice of the New Zealand Fire Services Commission on specified consent applications
5. Initiatives to explore the net benefits of options to encourage or require consolidation or centralisation of building regulatory functions

The above options, which are not mutually exclusive, are proposed for public consultation.

Of the above options, those with the most material potential impacts include the proposal to extend the scope of building work that is exempt from consent requirements and to introduce streamlined consent and inspection processes for category 1 buildings.

A preliminary assessment of the impacts of the package of options to require a risk based approach to the administration of building regulatory requirements is set out below:

Reduction in compliance costs

Increasing the scope of exempt building work, through Schedule 1, is conservatively expected to reduce consenting volumes by between 10% and 15%. Officials are currently working with a number of councils to more precisely quantify the expected reduction in consenting volumes, which will ultimately depend on the exact extensions that are agreed following consultation.

Streamlining the consenting process for category 1 exemptions is also expected to generate a significant reduction in the consenting and inspections workload of BCAs. Consents for category 1 buildings and other low risk building work currently represent approximately 70% of all building work.

A reduction in consents and inspections not only reduces the direct costs of building work, in the form of reduced fees and charges, but also reduces the indirect compliance costs associated with time delays caused by the consenting and inspection process. Initial modelling by NZIER suggests that introducing an accelerated and more streamlined consenting process for Category 1 buildings would generate large savings for consumers. While there are benefits in terms of administrative efficiency, the bulk of the savings would come from reduced time delays and associated “deadweight costs” incurred by households. These deadweight costs include home owners having to rearrange their affairs while building work is completed (eg, rent alternative accommodation) as well as holding costs. It is premature to quantify the costs at this stage and the analysis will be further tested as part of ongoing policy work.

Reducing consenting and inspection workloads may have knock-on benefits for BCAs, although the extent of these requires further exploration and depends on detailed policy design work. One possible impact of the proposed streamlined consent processes is that BCAs would focus principally on higher risk work, where the consent and inspection system currently adds most value. By specialising in this work, the quality of regulatory decision-making would be expected to increase, and there may be further gains in administrative efficiency as a result.

Proposals to develop a streamlined consenting process for category 3 buildings (complex structures) could further reduce consenting volumes for high value projects, although any gains in administrative efficiency are expected to be minor as this building work represents a low proportion of consents, and most BCAs contract out third party review functions because of the complexities and specialised skills involved.

A consequential impact of the reduction in workload and the associated building fees and charges is that BCAs will need to significantly reduce their building inspection workforce. As a result, the changes will not result in BCAs having surplus capacity. Further, it is possible BCA revenue may decline by proportionately more than the reduction in consenting and inspection volumes, since there is a fixed cost element to BCA cost structures.² Consequential increases in building consent fees for category 2 building work, and other building controls work that remains with the BCAs, may therefore be required following the changes.

Significant reductions in consenting volumes are likely to raise questions about the viability of the current distribution of building control functions across 75 local authority BCAs. Each BCA incurs fixed costs associated with accreditation, registration and monitoring by the Department of Building and Housing and the maintenance of their own systems and processes. Further, the small scale of BCAs mean there may be savings associated with alternative institutional arrangements for building control administration.

Other compliance costs associated with the fragmentation of building control functions relate to inconsistent decision-making across BCAs. This increases transaction costs for producers operating across multiple jurisdictions (eg, national operators), particularly where novel designs, building systems or products are involved. In particular, manufacturers and distributors of certain types of building products incur significant costs because of the need to “educate” each BCA about their product’s scope of use and its relationship to the requirements of the building code. There are potentially significant reductions in compliance costs associated with a more nationally consistent approach.

A number of the options are designed to clarify the purpose of building regulation, improve the specificity of building performance standards and their presentation (eg, around building types), and improve accessibility to the building code, compliance documents and other standards. These changes will benefit both producers and building officials and are expected to reduce transaction costs associated with establishing code compliance. It is not possible to quantify these benefits, or even estimate their magnitude, but further work will explore the potential for gains in this area.

Savings in compliance costs associated with simplifying, streamlining and consolidating the building controls system would directly benefit consumers and producers.

Wider economic benefits

The package of options to simplify, streamline and consolidate the system of building controls is expected to have wider economic benefits beyond the saving in compliance costs. Many of these wider benefits are dependent on the interactions between elements of the whole package, including those elements relating to the rebalancing of

² The building consent and inspection fees on low value work tend to represent a higher proportion of the value of work than the fees on higher value work.

risk and responsibility, and the strengthening of consumer protections. We discuss these issues later in this RIS.

Costs

There are costs associated with further development of the package of options, consultation on those options, and their implementation.

BCAs would be expected to incur transition costs in implementing a risk based approach to consenting or in moving to consolidated or centralised administrative models. The extent of these transition costs depends on detailed design.

The Department of Building and Housing would also incur implementation costs for some options.

Some or all of these costs would be passed on to consumers, and may fall disproportionately on those consumers who undertake higher risk building work. However, the overall reduction in compliance costs is expected to more than offset these gains.

Options to rebalance risk and responsibility and address weaknesses in the system of residential consumer protection

The following options have been considered for rebalancing risk and responsibility and strengthening consumer protection mechanisms in the building sector:

1. Requiring written contracts between consumers and building producers for residential building work, with certain minimum conditions
2. Requiring building producers to disclose information about their qualifications and experience before entering into a contract, potentially extending to their surety arrangement (if any)
3. Education and information initiatives to better inform consumers and producers about their respective rights, obligations, and good contracting practice
4. Changes to the statutory warranty to bring them into line with commercial practice and providing for their explicit inclusion in contracts for building work
5. The establishment of an alternative dispute resolution mechanism to the courts
6. The introduction of surety requirements as a financial 'backstop' for the producer's warranty

Most of the above options are subject to high-level design choices which mean that regulatory impact analysis is at a very preliminary stage for these options. The package of options is designed to operate as a system, including interacting with existing elements of the system including the Licensed Building Practitioners regime.

For that reason we discuss the impacts of the package as a whole rather than focusing on the impacts of individual elements.

Other options

Consideration will be given during the next stages of work to the costs and benefits of the options proposed for consultation, relative to other options such as the application of 'proportionate liability' rather than joint and several liability in the building industry and amending the Act to reduce the duty of care that councils owe to residential homeowners. It is not proposed to consult on these options now as a proportionate regime would be a major change to judicial practice in negligence cases and would leave successful claimants without full redress in cases where a culpable party defaults. It is hard to see a justification for a change affecting residential building and construction in isolation. It is highly likely that these options will be raised by industry and other stakeholders during the course of the proposed consultation.

Reduction in compliance costs

BCAs currently face significant risks associated with building regulatory decision-making but none of the benefits from risk-taking within the context of a building project. Rather than making appropriate trade-offs between the costs and benefits of risk, they tend to be highly risk averse. The highly risk averse approach adopted by BCAs manifests as significant compliance costs in the form of:

- Onerous documentation requirements
- Frequent requests for further information
- Over inspection of relatively low risk work
- A general reluctance to approve new or novel building designs, systems and products
- Slower processing of consents, with consequent indirect costs for consumers

The package of options is intended to reduce these costs by addressing the underlying cause of this risk aversion, namely the high exposure of BCAs to financial liability. Changes designed to lessen BCA financial exposure include:

- BCAs being involved in fewer consents and inspections and, hence, being a "lesser party" to building work transactions
- Clearer contracts between consumers and producers with written warranties and an expectation that "first resort" will be speedy resolution of defective building work by producers
- Where a building practitioner defaults, next resort would flow from the financial backing of warranties through any requirement for private insurance or a surety provider/fidelity fund
- It is also plausible that the courts may reinterpret the duty of care owed by BCAs to home owners in light of their lesser role and increased provision for disputes to be resolved through contract and warranties

BCAs would still face appropriate incentives to perform their statutory functions well, as they will still be able to be sued in tort for negligence.

At this stage of the policy development, it is difficult to say to what extent these changes will reduce compliance costs and this is an area for further investigation.

Wider economic benefits and costs of the package

Impacts on consumers

The package is intended to better equip consumers to recognise risks associated with building work and to take responsibility for the decisions they make to contract for building work, while simultaneously strengthening mechanisms for their protection.

The wider economic benefits to consumers are expected to include:

- Consumers will be supported, and face stronger incentives, to make informed decisions about building work and to properly contract for that work
- The provision of explicit warranties in building contracts will make consumers more aware of their rights and obligations, and better able to seek remedy for warranted defects
- Access to a cost-effective dispute resolution service would further enable consumers to enforce a producer's obligation to perform warranty service and thereby support prompt remedy of defect, as well as providing an efficient mechanism for resolving disputes outside the scope of the warranty
- Any provision for surety arrangements as a financial backstop would cover the risks of non-performance of the producer's warranty service obligations
- Better decision making by consumers, since limits on warranties and reduced recourse to councils when things go wrong, will incentivise a more careful selection of building practitioners and, potentially, greater use of agents who are qualified to manage risk on their behalf.

Stronger consumer protections are expected to strengthen building practitioners' incentives to perform work right first time and to quickly remedy defective work without cost to the consumer. If a building practitioner defaults on those obligations, or dies, disappears or becomes insolvent, the strengthened mechanisms provide more effective and efficient means of remedy for consumers.

These benefits will almost certainly involve some additional costs in the short-run, as warranties, dispute resolution mechanisms, and surety arrangements all involve costs.

The extent of these costs will depend on the nature of the final package. For example, a mandatory surety plan would cost more than a requirement to disclose what if any surety is being provided, and require more complex supporting elements such as a default provider (underwritten by the Crown and/or industry/BCAs) and a regulatory regime for private surety plan providers. Factors that may contribute to the high cost of surety include the small size of the New Zealand residential building market, the market share of current providers of warranty products, and a lack of good data and information about building quality.

The net impact of the package on consumers depends on the interaction of a number of factors including:

- The reduction in compliance costs associated with simplifying, streamlining and consolidation the building controls system
- The extent to which building producers take responsibility for the quality of their work, including promptly fixing defective work under warranty without cost to the consumer
- The cost of purchasing warranties and obtaining surety backing
- The costs associated with dispute resolution where necessary

At this stage it is not possible to say what net impacts would be expected and further work is required to evaluate the benefits and costs in parallel with further policy development.

Impacts on building practitioners

The package of options would be expected to result in building practitioners facing greater risk overall, but this is efficient since they are best placed to manage the risk that building work fails to perform and they have a range of options for managing those risks.

As a consequence of facing greater risk, we would expect building practitioners (and insurers and surety providers) to react cautiously, and it is expected there may be up front increases in costs to consumers with medium to long term benefits from improved quality and performance by building producers.

Over time we would expect building practitioners to adapt to the changed conditions by:

- Taking a risk-based view about what work they undertake to do, taking into account their knowledge and level of competency
- A stronger focus on their contracting practice, both with consumers and suppliers (eg, sub-contractors)
- More explicit recognition of the costs of standing behind their work, and pricing accordingly
- Investing in their own professional development to extend their scope of work and overall level of competence

It is likely that the changes will affect different classes of building practitioners in different ways. Future work will explore the differential impacts on building designers, builders/main contractors, sub-trades, product suppliers, DIYers and new entrants to the industry (eg, apprentices).

One class of building practitioner that will be differentially impacted is Licensed Building Practitioners. Many of the reform options will either only apply where LBPs are involved (eg, streamlined category 1 consent process) or may advantage LBPs over non-licensed practitioners (eg, where LBP status results in lower surety premiums). The package of changes is therefore expected to further encourage the

take-up of licensing. Greater uptake of licensing would have additional benefits including:

- Preventing and discouraging insufficiently skilled practitioners from carrying out critical building work without adequate supervision
- Sharpening incentives to put work right if it is not done correctly
- Strengthening incentives to upgrade and maintain knowledge and skills
- Creating better conditions for improvements in building quality and labour productivity
- Improving signalling of builder quality in the market for building practitioners

Impacts on building consent authorities

The package of options is intended to reduce the reliance on BCAs in the building regulatory system and, by reducing their exposure to liability in the event of building failure, enable them to take a less risk-averse approach in performing their statutory functions. This is expected to improve the efficiency and quality of regulatory decision making, while ensuring BCAs continue to face appropriate incentives to perform their statutory role well.

Consequential impacts on skills, innovation and productivity

Anecdotally, the building control system deters and raises the costs of innovation and risk-taking in the building sector, although gathering hard evidence on this is difficult. Innovation is a key means of improving welfare, whether through improving building quality or the introduction of productivity-enhancing new building designs, systems and techniques. It is difficult to estimate the impacts of changes on the rate of innovation, but theoretically, by better allocating risk and responsibility to those best placed to manage it, overall rates of innovation should increase.

The package is also thought to increase incentives for building practitioners to upgrade and maintain the relevance of their skills. This is critical since the overall skill level of the workforce is central to the achievement of the ultimate goal of the reforms, namely to reduce the costs of the building regulatory system without compromising quality.

Further work is required to better understand the likely impact of the reforms on skill levels in the sector but it is expected that the package of options, in addition to the anticipated impacts of Licensed Building Practitioners scheme, will strengthen incentives to train and acquire knowledge.

Costs

The package of options to rebalance risk and responsibility and address weaknesses in the system of residential consumer protection will result in costs as well as benefits. These include:

- The most significant costs are likely to be those associated with the proposals regarding warranties, particularly if backed by a surety plan. Preliminary estimates suggest that a warranty backed by insurance would cost approximately \$2,200 per new average residential dwelling for six years of cover. If backing by a surety plan

was mandatory any need for the Crown to underwrite an industry fidelity fund would involve an underwriting cost for a transitional period. These costs will require further analysis taking into account detailed design options.

- Requirements for written contracts between consumers and building producers for residential building work, and producer disclosure requirements, will impose compliance costs but it is expected that standard contracts and disclosures will become common and will be incorporated into standard business practice. The costs to individual consumers and building producers are therefore expected to be insignificant, although there will be one-off and transition costs associated with these changes.
- Depending on design options, there will also be costs associated with the implementation of regulation of private surety funds, the operation of an alternative dispute resolution service, and providing consumer education and information.
- To the extent that a new dispute resolution service makes it easier for consumers to seek remedies for defective work, the direct costs associated with such disputes may increase.

Risks of the Package

The overall dynamic effects of the package are based on assumptions that the package will result in significant changes in behaviour by consumers, building practitioners and building consent authorities. In short, residential consumers and building practitioners will take more responsibility for their roles in the building process, and less reliance will be played on the system of building controls to manage and safeguard quality in the building process. The package also introduces a greater role for insurers and surety providers in the identification and management of risk, which is expected to significantly alter the dynamics in the sector around risk management.

One risk of the package is that practitioners and their backers, faced by greater exposure to risk and liability, may adopt a very conservative approach. In effect, the highly risk averse approach taken by BCAs may transfer to other parties in the system. The design of warranties and any surety arrangements, and striking the right balance in the overall package, is key to ensuring the costs of the package do not outweigh the benefits.

A further risk of the package is its potential to raise barriers to entry and/or raise the costs of participating in industry. In particular, there are concerns about how new entrants to the industry, small operators, and DIYers will be affected by the changes. It is possible that certain classes of people may be “priced out” of the industry, which can be seen as both beneficial (eg, for practitioners whose skills are not sufficient for the work they are doing) and costly (eg, if this impedes the ability of the industry to respond to increases in demand). The ability of the construction sector to expand in response to increases in demand is an important factor in the overall supply-side responsiveness of the housing market, with implications for the cost of building and housing affordability. The impacts on the package on labour market and industry dynamics will be further explored in parallel with policy development.

Many of the changes to simplify and streamline the consenting process assume that there will be a sufficient supply of competent practitioners to access the new processes, and that these practitioners will have sufficient incentives and abilities to ensure work is performed to a high level. In other words, the changes rely heavily on the entry requirements for the LBP scheme being sufficient to ensure LBPs have the skills necessary to perform category 1 work with a lesser degree of third party review, while not being so onerous that there is an insufficient supply of LBPs when the restricted work scheme comes into effect. If these assumptions are incorrect, then there are risks that the benefits of streamlining will be overstated. The interface between the LBP scheme and other package elements will be a key focus in future policy development work.

Consultation

A Sector Reference Group and Sector Working Group comprising members of the building industry, local authorities and consumer advocates have provided strategic and operational input into the review, ensuring that the sector's issues and concerns are addressed by the options under consideration, and that the Department's analysis is robust when viewed from the sector's perspective. The Sector Reference Group has provided input into regulatory impacts of the options.

An Officials Steering Group has also been consulted throughout the Review process. Limited consultation has been undertaken on this preliminary Regulatory Impact Statement, but relevant departments have been consulted on aspects of the analysis.

Conclusions and recommendations

At this stage officials have not reached firm conclusions on the ultimate shape of the reform package, and the proposal is to consult industry and the public on the general direction of proposed reforms and high-level design choices relating to individual elements of the package.

Regulatory Impact Analysis is at a preliminary stage for most package components, and a full regulatory impact analysis will be presented at the point where decisions are sought from Ministers. This will include further work on the benefits, costs and risks of certain package components. The planned public consultation is intended to inform analysis of the benefits, costs and risks of the package.

Implementation

Implementation risks will be identified as part of further policy work and these will be identified, along with planned mitigations and an enforcement strategy, in the final RIS.

Monitoring, evaluation and review

A monitoring and evaluation plan for the package of reform options will be developed in parallel with further policy development work.