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Welcome to the Winter issue of *Property Speaking*. We hope you find the articles interesting and are useful to you.

If you would like to talk further about any of the topics covered in this newsletter, please don't hesitate to contact us.

Inside:

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The next issue of Property Speaking *will be published in November.*

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Watching Out for a Leaky Home

Helping to identify common features for home buyers

There has been a great deal of media reporting of the leaky home saga, an issue that has affected thousands of people throughout the country. For most of these people the construction of their homes has ramifications which will affect them for years to come. There are, however, first-time house purchasers who may not know what to look out for when buying property; this article gives some pointers on identifying potential leaky homes.

All homes can leak, rain is insidious and, for most of New Zealand, it's a reliable fact of life! However the leaky house saga did not evolve from missing roofing nails, rusted spouting, missing rain flashings or rotten weatherboards. The leaky house saga evolved from fundamental design and construction flaws endemic with building techniques from the mid-1990s through to 2004 when 'monolithic cladding' was prevalent for the construction of new homes.

Monolithic cladding

Monolithic cladding can be described as plaster wall cladding with the appearance of an unbroken wall surface, rather like traditional plastering. Effectively these were large expanses of plastered cement surface without the ventilation cavities used in earlier home construction.

The absence of the ventilation cavities in the walls can be fatal as any moisture or rain entering the wall is unable to drain away and is caught there and then the rot starts. This, combined with the wide use of untreated timber for construction, allowed a fundamental problem to develop as the untreated timber, once wet and without any form of drying ventilation, provided an ideal breeding ground for rot and mould. The results caused structural damage, leaks, odours and health-damaging mould spores.

The primary construction techniques at that time were: timber framed walls, lined with fibreglass insulation, covered in building paper, covered with sheets of flat polystyrene or cement board, and then coated in a plaster cement finish. The end finish being mono (being single layer) – lithic (appearing of expansive, stone or solid) construction.

The saga commences when water enters the cladding through badly sealed joints, cracks, loose caulking, or badly sealed or flashed windows and doors. In older buildings that water would drain away through the wall cavity, however with monolithic cladding there's no drainage cavity. The only solution is to ensure that water never enters the walls through preventative maintenance.

Indications of a potentially leaky home are that it has plaster cement finish, Mediterranean-style construction (flat roof, flat walls with flush windows and doors), no eaves, internal guttering, modern design shapes with corners, angles and curves, includes internal decks behind parapet balconies, or cantilevered (which appear unsupported) balconies. Not all homes with these features are at risk, however these design features were common at that time.

There has also been a noticeable trend towards the development of a leaky house stigma. It appears that home buyers are avoiding homes which they think fit the 'look' of a leaky house. The concern being both, that it may leak, or more frequently that when they go to sell that others will avoid purchasing due to their concern that the property may be at risk.

Homes are an investment

In considering your new home purchase it's important to consider that as well as your family's home, it is also your investment and future. Monolithic cladding was an industry standard and was used throughout New Zealand during the 1990s to 2004. It's important that you consider all relevant matters and that you do your homework. There are an estimated 75,000–90,000 homes built in New Zealand during that period which may be affected, and someone owns them.

If you're considering buying a house built over that period, do contact us before signing up the Agreement, and we will ensure that you are in a position to do your homework!

Going into Care

Will giving assets away make any difference?

People are living longer and, as a result, increasing numbers will need long-term residential care. Full subsidies help only those unable to pay for themselves. So, can you transfer assets in advance and qualify for a subsidy as a consequence? The asset testing rules are complicated and they could change without warning. Transferring assets, in the hope of qualifying for a residential subsidy later on, is tricky and uncertain.

Is this fair? Our health system provides free hospital care, so why is geriatric care different? Rest home care is a need, not a luxury. The alternative view is that state-funded care is paid for by tax payers – many struggling to get by on low incomes. Even children who deliver newspapers now have to pay their full tax. Should they subsidise residential care for the well off? Is it fair that those who give everything away, well in advance, are entitled to a residential subsidy?

Wills, estates and residential care

These issues often arise after one spouse or partner has died and the other one goes into care. If, for example, the husband has died but has left most of his estate to the couple's children, Work and Income[1] may require his widow to apply to the court for a bigger share of the estate under the Family Protection Act. If she is no longer mentally competent, her EPA attorney or court-appointed manager may have to do this on her behalf. Failure to do so can mean her application for a subsidy is denied.

One option is for a couple to decide they don't wish to own their property jointly because that will mean that, when one dies, the property will pass automatically to the other one. Instead they put the house title in their names as 'tenants in common in equal shares'. This means they can legally each leave their half-share by their respective Wills to whoever they wish.

In the example above, the husband's Will may say that his widow will be entitled to live in the property, but as soon as she goes into care then his estate's half-share of the property passes to the children. Again, Work and Income may defeat this approach by insisting on the surviving spouse applying under the Family Protection Act for a better provision from the estate. If his Will says his widow is to have the income from the property, this may be acceptable to Work and Income.

What are the rules now?

Legislation sets out how much you are allowed to give away each year and still qualify for a residential subsidy.[2] When people apply for a subsidy, they need to be able to show that:

» They haven't given away more than $6,000 in each of the five years immediately before applying for the subsidy (the *gifting period*), and

» They didn't give away more than $27,000 in each year before the gifting period.

There is now no limit to how far back Work and Income can look when applying these rules. If you transfer anything to a trust you are giving it away and may be caught by the legislation. It also applies if you give anything to anyone else – to your children for example.

Gifting programmes – transferring wealth over time

Since most family homes are worth more than $27,000, a way had to be found to transfer property to a trust without getting caught by these rules. The usual method is a notional sale of the property at market value to the trust. The sale price is left owing as a debt. The settlor (who created the trust) can then reduce the debt by forgiving $27,000 each year. This is known as a *gifting programme*. It was a common arrangement when gift duty was applicable. Although gift duty was abolished in 2011, some people still use these gifting programmes in the hope that they will qualify for a residential care subsidy.

Work and Income is required to consider the combined assets of a couple, not just the assets of the person in care. There are also limits to how much you can hold on to while still qualifying for a residential subsidy.

Continued on Page 4

1 Work and Income is the division within the Ministry of Social Development which deals with residential care subsidy applications (sometimes still known by its old name WINZ).
2 Schedule 27 of the Social Security Act 1964 and the Social Security (Long-term Residential Care) Regulations 2005.

« BACK

As from 1 July 2012, these limits are:

» A single person may retain money and assets up to $213,297

» If a couple both need care, they may retain assets and money up to that limit, or

» If one of them needs care, but the other does not, the asset limit is $116,806 but their home and the other partner's car are exempted.

Where the third scenario applies, a couple can choose the higher limit but the house and car are not excluded; you can then have a total of $213,297 *including* your home and car.

We have some examples below that help show how this works. Work and Income has a degree of discretion; we can only indicate how we believe Work and Income is likely to apply the current rules and government policy in typical cases.

Alfred and Annabel

Ten years ago Alfred and Annabel 'sold' their home to a trust at a market value of $350,000. They started a gifting programme; $27,000 each per year (an annual total of $54,000). Three years ago they finished gifting. Both are now in care. During the last five years they each gave $54,000; they have exceeded the maximum $30,000 allowed in that gifting period. They each have other investments in their own names; just under $214,000 each. Between them Alfred and Annabel must contribute $48,000 towards the cost of care before they qualify for a subsidy.[3]

Barbara and Billy

Barbara and Billy are in a similar situation to Alfred and Annabel but they started gifting 20 years ago. Only Billy is in care. Work and Income will look at their combined gifting. In earlier years they gave $54,000 annually between them; $27,000 more than the rules allow. If Billy and Barbara have retained assets worth less than the $116,806 limit, the difference can be deducted from the amount Billy must pay.

Clive and Clarissa

Clive and Clarissa don't have a trust, but they have a home worth $500,000 and $5,000 in the bank. Clarissa is in care but Clive is not. While Clive is living in their home, it's exempt.[4] They haven't done any gifting and may be better off because of this. This would change dramatically if both Clive and Clarissa need to be in care. In that case their home would need to be sold to pay for their care.

Income deprivation

These examples above indicate how Work and Income usually approaches deprivation of assets. There is also the issue of income deprivation. Even if the gifting rules have been complied with, Work and Income can decide that by putting assets in trust, the applicant is deprived of the income from those assets. It may be necessary for the trust to rent out the property to pay for care. Funds should be invested to earn income.

So what can we do?

As the above examples illustrate, meeting the requirements of the asset testing rules is tricky. Timing is a major factor. No one can predict who will need care and when. The rules were changed in this year's budget[5], and more changes are inevitable.

Arrangements designed to meet this year's rules may be totally ineffective in future years. State agencies (including Work and Income when it's dealing with applications for other forms of welfare benefit) already decline state assistance because trust assets are seen as resources available to the applicant.

These are many other reasons to transfer property to a trust – providing for a family member with a disability, ring-fencing an inheritance, claims by a future spouse or partner, protecting your home in the event of an unexpected future business failure or to avoid disputes over your Will. These are just a few examples. Designing a gifting programme solely to meet current residential care subsidy rules may mean you risk failing to achieve the other potential benefits.

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3 If their other investments were below the limit of $213,297, this would reduce the amount they have to contribute.
4 If the home had been transferred into a trust it would not come within the exemption, which only applies where one of the couple is living in the home which they themselves own.
5 The asset limits no longer increase by $10,000 on 1 July each year. They will only be adjusted for inflation.

Property Briefs

Changes to the ADLS/REINZ Agreement for Sale & Purchase

Changes have recently been made to the ADLS/REINZ Agreement for Sale & Purchase; this is the standard form of Agreement used in almost all New Zealand property transactions. Not all of the changes are of significance, but if you are buying or selling property in New Zealand here is a brief note on some of the changes you should know about.

A standard building report clause has been added. The standard builder's report condition has limitations as it must be prepared in good faith by a suitably qualified building inspector in accordance with accepted principles and methods. If the purchaser cancels the Agreement because of an unsatisfactory report then the vendor can insist they are given a copy. To preserve greater flexibility, purchasers should have their own broad due diligence clauses drafted.

The insurance provisions have also been amended so where there is partial damage, the purchaser can deduct for the reduction in value as compensation. The vendor's warranties have been changed; where chattels are sold with a property, they are delivered to the purchaser in reasonable working order. This will cover disappointing cases where, for example, an oven does not work and the purchaser did not know about it. Note however that 'fair wear and tear' is preserved so the amendment is not excessively onerous on vendors. There are also other changes reflective of the new unit titles legislation and other technical amendments to the standard Agreement. This new Agreement will continue to be a work in progress, and no doubt will be subject to a number of changes over time – and court challenges too. You should consult with us before entering into any Agreement for Sale & Purchase to understand those changes and, importantly, the terms of the Agreement you are about to complete.

Finance conditions for Sale & Purchase Agreements

With the standard ADLS/REINZ Agreement for Sale & Purchase containing a 'subject to finance' condition, a purchaser must do all things reasonably necessary to arrange finance on or before the finance date. At what point, however, is the 'subject to finance' condition satisfied? You may be surprised to learn that the Court of Appeal has held in one case[6] that it is when an offer of finance has been made which is sufficiently clear and certain. There need not be any formal documentation in place between the purchaser and their lender, and it is not necessary that the purchaser has accepted the offer of finance.

In this case the court said that it was at the time the offer of finance was made that finance had been arranged and the purchaser was therefore obliged to notify the vendor that the finance condition had been satisfied. The purchaser could not rely on its silence as to the non-fulfilment of the condition when later cancelling the agreement.

There is no requirement in the ADLS/REINZ agreement that the finance also be available on settlement date. This leaves purchasers vulnerable in situations where an offer of finance is withdrawn. Purchasers must ensure that the arrangements with their lender will allow finance to be available on the settlement date.

There are ways to mitigate this risk. If you are concerned about your situation, do talk with us before entering into any contract which is conditional on finance being available.

Repairs and maintenance of unit property

A recent decision of the Court of Appeal[7] has seen a review of how body corporates might be responsible for repairs and maintenance of certain items in a unit title development. Under the s138 of the Unit Titles Act 2010, the body corporate has a duty to repair and maintain common property within the prescribed body corporate area.

The decision in *Berachan Investments* involved replacing the roof of a 12-storey property and a change of the body corporate rules relating to repair and maintenance of the roof. The court held that if the duty to maintain and repair common property fairly and incidentally requires repairs and maintenance to an individual's unit property, then the body corporate may assume responsibility for repairs to the individual's unit property as part of its duties under the legislation. If it's necessary to repair or maintain an individual's unit property in order to protect common property then the body corporate can assume that responsibility in order to fulfil its statutory obligations under s84 of the Act.

This case illustrates the importance of the new unit titles legislation. The characteristics and features of the property need to be considered carefully when the body corporate comes to assessing liability and responsibility for repairs and maintenance of property within a unit title development.

6 Purewal BS & JK Limited v Connell Street Limited [2012] NZCA 42.
7 Berachan Investments Limited v Body Corporate 164205 [2012] NZCA 256 (19 June 2012)