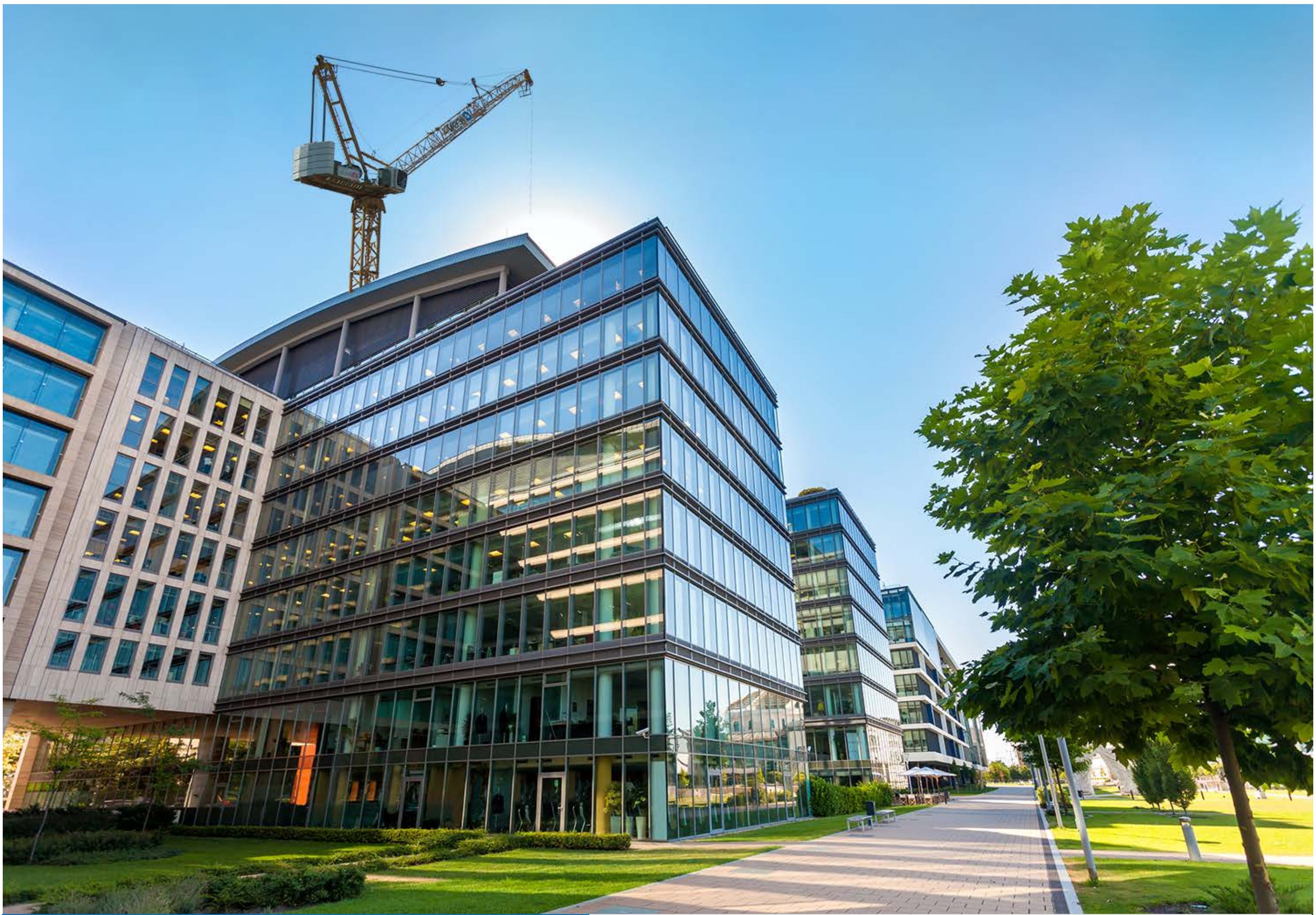
PROJECTS AND REAL ESTATE NEWS

JANUARY 2020



WELCOME

to Issue No. 6 of Projects and Real Estate News, Bell Gully's monthly digest on regulatory developments, together with cases and news of interest in the **projects** and **real estate** sectors.

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Need more information?
Projects and Real Estate News is a monthly digest on regulatory developments, together with cases and news of interest in the projects and real estate sectors.

For more information, please contact Sonia Ng, or your usual Bell Gully contact, or visit our website.

CASE NOTES

✱ REAL ESTATE

Interpreting the sunset clause in pre-sale agreements
Ling v Northwest Developments Ltd [2019] NZCA 630

In summary: When a property does not have title yet and is sold off the plans, it is typical for such pre-sale agreements to contain a "sunset clause".

The purpose of a sunset clause is usually to provide certainty for the vendor and purchaser that, if for any unforeseen reasons, title to the property does not issue by a specified date, then either party can cancel the agreement. This ensures a party is not committed to an agreement that runs indefinitely.

In this case, the Court was asked to interpret the following sunset clause:

> *"Should title have not issued by 31 March 2018 then either party may cancel the agreement by giving written notice to the other party notifying them that the agreement is now terminated.* ***Provided however that in the event that the vendor has submitted the survey plan for approval to LINZ the vendor may at its sole discretion, prior to 31 March 2018, notify the purchaser that the time for satisfaction of this condition has been extended for a further 6 months.****" (emphasis added by Bell Gully)*

The contentious point arose in this case from the fact that the vendor had submitted a survey plan (**the first survey plan**) to Land Information New Zealand (**LINZ**) for approval before 31 March 2018, and the vendor extended the time to satisfy the sunset clause for another six months on that basis. The purchaser did not object to that extension. However, the vendor also needed the consent of its neighbours to the first survey plan. Difficulties in obtaining that consent, combined with complications with subdivisions that other neighbouring owners were undertaking on their properties, led to the vendor submitting a revised survey plan (**the second survey plan**) after June 2018. The second survey plan reflected cadastre changes for neighbouring land and no change for the vendor's lots. The titles were issued on the basis of the second survey plan.

The purchaser sought to cancel the agreement. His position was that in order for the vendor's extension to the sunset clause to be effective, the survey plan submitted before 31 March 2018 must be the survey plan that led to the issue of titles. Otherwise, the purchaser argued, the vendor could gain an unfair advantage by, for example, lodging a "dummy" survey plan simply so it can exercise the right to extend time under the sunset clause.

The purchaser failed to settle, and the case reached the High Court, which ruled in the vendor's favour. The purchaser appealed the High Court's decision.

In the Court of Appeal, the judges agreed with the High Court. The judges' reasoning was as follows:

- The key to interpreting the sunset clause in this case must be based on the purpose of such a clause. The clause was intended to ensure that by 31 March 2018, both parties would be able to determine with certainty whether the clause was extended, satisfied, or could be cancelled. The court considered that no reasonable vendor or purchaser would contemplate the clause could create a situation where you have to wait until titles actually issue to determine whether a purported extension was valid.
- The suggestion that the vendor could gain an unfair advantage by lodging a "dummy" survey plan was not realistic because the agreement contained other terms that contemplate the survey plan might be amended anyway. Such terms are common in pre-sale agreements, due to the nature of the subdivision process. The court determined that in the context of the agreement as a whole and

the subdivision process, a reasonable person having the relevant background knowledge would understand the survey plan referred in the sunset clause is the plan that had been submitted to LINZ for approval by 31 March 2018, irrespective of whether it was that plan that ultimately led to the issue of titles.

The takeaways:

- The purpose of a clause and the overall context of the agreement may be used by the court to determine a clause's meaning. In this case, the court examined carefully the purpose of the sunset clause, how the subdivision process works, and the other terms in the agreement, to reach its conclusion.

- Care needs to be taken when drafting or reviewing pre-sale agreements for properties sold off the plans, due to the complexities and uncertainties inherent in undertaking a subdivision.

Bell Gully specialises in all types of subdivision and development transactions and acts regularly in large-scale development projects. Please contact one of our real estate lawyers if you have an issue that requires attention – we would be happy to assist.

Residential tenancies that are in commercial premises or not compliant with building laws *Want v Parblu* [2019] NZCA 674

In summary: This case highlights recent amendments to the Residential Tenancies Act 1986 (**the Act**), which has implications for owners who rent out premises that do not comply with building or health and safety laws, or who rent out all or any part of a commercial/industrial/other non-residential building for residential purposes.

In this case, part of a commercial building was leased out as a residential tenancy in November 2015 by the landlord. The landlord had, many years ago, obtained a resource consent from the Council so that part of the commercial building could be used as living quarters for an onsite caretaker. However, the tenant in this case was not employed as a caretaker, so the tenancy breached the resource consent condition.

When the tenant fell into arrears, the landlord took her to the Tenancy Tribunal, seeking termination of the tenancy and orders for payment of the arrears. But the landlord's actions led the tenant to make enquiries with the local authority, and she discovered the tenancy was not lawful. She sought orders that the rent and bond she paid be returned.

The Tenancy Tribunal followed a previous High Court decision[1] and concluded the tenancy was unlawful. Applying that decision, the Tribunal said it has no jurisdiction to decide cases concerning premises that could not legally be used for residential purposes, and in these cases it could only make an order under the Act which required the landlord to refund all the rent paid by the tenant.

The landlord appealed to the District Court. However, the District Court agreed with the Tribunal's decision. The landlord then appealed to the High Court, which disagreed with the District Court, and set aside the Tribunal's decision. This present proceeding in the Court of Appeal concerned the tenant's application to restore the Tribunal's original order.

The Court of Appeal dismissed the tenant's appeal, and concluded that the High Court decision was correct based on the text, purpose, and scheme of the Act. In short, the Court of Appeal agreed that the Act appeared to focus on whether the object of a tenancy was for residential purposes, rather than the strict formality of whether it was lawfully permitted to be used for residential purposes.

[1] *Anderson v FM Custodians Ltd* [2013] NZHC 2423

In addition, as one purpose of the Act was to establish the Tenancy Tribunal as a less costly and less formal dispute resolution forum than the courts, excluding certain residential tenancies from the Act's coverage simply because they did not comply with a legal requirement would force a class of landlords and tenants to go through the more expensive court process rather than the Tenancy Tribunal. It will also exclude a class of tenants from being able to enforce minimum standards imposed by the Act (such as those concerning cleanliness, insulation and smoke alarms) in the Tribunal. That, the Court of Appeal noted, could not have been the Act's intent.

It is noteworthy to point out that the Court of Appeal's conclusion in this case is reflected in legislative amendments made to the Residential Tenancies Act. Those amendments came into effect from 27 August 2019. As such, rather than reverting to case law there is now a clear legislative framework to govern unlawful residential tenancies.

The takeaways:

- Legislative amendments that came into effect on 27 August 2019 have made it clear that the Tenancy Tribunal has full jurisdiction to hear cases, make orders and impose penalties regarding premises that are rented out for residential purposes, regardless of whether the premises are legally allowed to be used for human residence or not.

- This means compliance with the Act is essential for owners who rent out, for example:
  - all or part of a commercial/industrial/other non-residential building for residential purposes. Some owners of commercial premises rent out a mezzanine floor for residential purposes. The Act would now capture those tenancies;

  - dwellings that do not comply with building or health and safety laws for residential purposes. For example, a converted garage that does not have the requisite building consent or code compliance certificate approving its conversion to a habitable space for humans.

- Compliance with the Act has become a lot more complex to navigate with recent government reforms in this area. A raft of minimum standards has been imposed on the insulation, ventilation, draught stopping, heating and drainage aspects of residential tenancies. Landlords who rent out unlawful residential premises can also be ordered to make the premises compliant with the relevant building and health and safety laws.

- Non-compliance with the Act can expose the landlord to a range of orders that the Tenancy Tribunal can make, including an order for exemplary damages, and/or a refund to the tenant of some or all of the rent paid.

- Investors looking to purchase properties to rent out for residential purposes should be prepared to investigate the extent to which the property complies with the standards under the Act and, if applicable, the costs to bring the property up to being compliant.

Please feel free to contact us if you have any questions on how the recent changes to the Residential Tenancies Act might affect you.

PROJECTS

Funds paid by clients to project manager for on-payment to contractors: does the project manager hold them on trust for the clients?

Bethell, McKay and Gower (as liquidators of Arrow International (NZ) Ltd) v Papanui Properties Ltd [2019] NZHC 3169

In summary: This proceeding concerned applications for court directions by the liquidators of Arrow International (NZ) Limited (**Arrow**). The directions related to the status of funds paid to Arrow by six of its clients (**the Clients**) before Arrow was placed into voluntary administration. Separate questions also arose concerning the status of retentions deducted by Arrow from payments to contractors/suppliers.

Arrow had acted as agent for each Client under a Project Management and Construction Management Contract (**PMCM Contract**). The following diagram illustrates the general relationship between Arrow, the Clients, and the contractors and consultants in this case:

PMCM Contract between "the Client" and the Trade Contractor/Consultant with Arrow acting as the Client's agent. PMCM Contract states Arrow is not liable for any obligation of the Client under the Agreement.

Under the PMCM Contracts and the Construction Contracts Act (**CCA**) regime, Arrow would receive Payment Claims from the trade contractors, which Arrow would review and then issue a Payment Schedule back to the trade contractors. Arrow then issued monthly tax invoices to the Clients, which included the amounts to be paid to the trade contractors. Also included in this system of invoicing were contracts made by Arrow with consultants on behalf of the Clients, although such contracts adopted a different form of contract.

Under the arrangement, the Clients made payments in one lump sum to Arrow. Arrow then paid the trade contractors and consultants and then retained its margin, project management fees and other costs in the invoice. In paying the trade contractors and consultants, Arrow was acting as agent of the Clients as it was meeting the liability of the Clients.

In January 2019, Arrow issued its monthly invoices to the Clients, and the Clients paid the invoices before Arrow was placed into administration. At that time, Arrow retained approximately $1.358m that it had received for payment to the trade contractors. Those funds were held pending the outcome of this proceeding. As the Clients have a direct contractual liability to trade contractors, in many cases the Clients have paid the amount outstanding to the trade contractors before the outcome of this proceeding was decided.

At issue in this proceeding was, in respect of the money collected by Arrow to pay the Client's creditors (the trade contractors and consultants), was Arrow a trustee of those funds, and therefore required to hold the money on trust for payment to the trade contractors and consultants (or refund to the Clients if the Clients have paid the trade contractors and consultants directly)? Or was this an ordinary debtor/creditor relationship whereby once the Clients pay Arrow's invoice, the money becomes Arrow's property to do with as it wishes?

The court concluded that Arrow was a trustee in respect of those funds. The purpose of the Clients paying the money they owe to trade contractors and consultants to Arrow was so that Arrow could fulfil its role as paying agent to those third parties. The court considered it would be contrary to the provisions and spirit of the PMCM Contracts and the commercial context that the parties had intended for Arrow to be able to use as part of its cash flow, the funds it received for the purpose of paying trade contractors.

A number of arguments were advanced to support the position that the funds were paid on an ordinary debtor/creditor basis, including:

- that as Arrow's invoices contained many components, some of which were debtor/creditor payments (such as Arrow's margin and project management fees), this indicated that all components on the invoice were intended to be paid on a debtor/creditor basis. The court rejected this argument, and was of the view that it was for administrative convenience only. The fact that Arrow's invoices particularised the amounts due from each contractor (rather than setting out an unparticularised lump sum) reinforced the court's view that Arrow was only collecting the amounts due to each contractor on a pass-through basis;

- that the PMCM Contracts did not require Arrow to keep the funds to be paid to the Clients' creditors separate, nor did the PMCM Contracts expressly state there is a trust in respect of those funds. The court again rejected this argument, citing legal authority that the existence of a trust does not depend on an express contractual term to keep a separate bank account;

- that the account the Clients paid into was a standard current account used for Arrow's normal trading operations. The Court considered this point to be neutral because, while the account was not styled as a trust account, neither was it labelled as a current account. Furthermore, there was no evidence that the Clients were aware that the account they were paying funds into was a standard current account. If the true nature of the relationship between Arrow and the Clients meant those funds were trust funds, then if those funds were used for other purposes then that was a breach of trust by Arrow, albeit one that in the past came to nothing because Arrow was able to pay the Clients' creditors from other funds; and

- that the PMCM Contracts allowed Arrow to charge interest on late payment of its invoices indicated a debtor/creditor relationship. The court had no difficulty finding that Arrow could not charge interest on funds that it received for on-payment to the contractors. If a Client had paid a trade contractor directly and deducted that amount from its payment to Arrow, could Arrow have changed interest on that amount? The court noted Arrow would in such a case suffer no loss in not receiving that money.

The court concluded the funds paid by the Clients to Arrow for the purpose of paying the trade contractors were held on trust by Arrow for the Clients. Where a Client has directly paid the trade contractors amounts that they have already paid Arrow, Arrow must repay the amounts it had received from the Client back to the Client.

Retentions

A separate issue arose in respect of retentions. Arrow had deducted retentions from the funds it received from the Clients for paying trade contractors.

Since 1 April 2017, the CCA has required retentions under commercial construction contracts to be held on trust. While funds were paid on trust into Arrow's current account prior to 1 April 2017, those trust funds were lost when the current account went into overdraft.

Post-1 April 2017 retentions were treated by Arrow as being trust funds (in accordance with the CCA) and were paid into a separate retentions bank account. The court confirmed that those retentions were held on trust for the trade contractor entitled to the retention or, where the contractor had been paid directly by a Client, those retentions were held by Arrow on trust for that Client and must be repaid to the Client.

The case is also noteworthy as the second decision on the retentions regime. The Court adopted the same framework for analysis as in the earlier *Ebert* decision.

Bell Gully has lawyers with specialist experience in construction law and procurement projects. Please feel free to contact one of our team if you need assistance with a construction law related matter.

REGULATORY UPDATES

✱ REAL ESTATE

Stricter laws for lenders to make affordability and suitability assessments on borrowers

The Credit Contracts Legislation Amendment Act 2019 (**the Act**) came into force on 19 December 2019 and was passed with the intent to protect consumers by imposing new obligations on lenders to lend responsibly. It will affect banks and other lenders in the business of providing mortgages, credit cards and cash or personal loans. Lenders will have a cap on the amount of interest and fees that they can charge on high-cost loans. There will also be a requirement for lenders to keep records substantiating that they have made certain suitability and affordability assessments on the borrower before making a loan. The Act has a phased commencement with new enforcement and penalty provisions that came into effect on 20 December 2019, and the rest of the provisions coming into effect on specified dates in the Act. All provisions in the Act will be in operation from 1 April 2021.

OTHER NEWS

✱ REAL ESTATE

Forecasts for the 2020 housing market

The *New Zealand Herald* reported on a number of real estate commentators' forecast on what the 2020 housing market may bring. Included in the list is the rise of housing prices, as Westpac chief economist Dominick Stephens reflected on factors such as current low home loan interest rates and continued migration to the country. Nick Goodall from property analytics provider CoreLogic also tipped we may see "growth of at least 5%" nationally and more houses being sold overall. The optimism was shared by OneRoof data analyst Valocity's James Wilson, who tipped prices to climb by 2-5%. Real estate firm Colliers International polled 4518 New Zealanders and found a net 49% believed Auckland prices would increase in 2020, showing the optimism for the housing market was not limited only to property commentators and analysts.

In terms of matters that could slow the market, both Stephens and Goodall predicted the pace of house price increase may slow by the second half of 2020, as mortgage rates are forecasted to increase from the second half of the year and new laws require banks to, from 1 July, keep more cash in reserve as a safety net for emergencies. The general election, to be held on 19 September 2020, is also tipped to slow down growth as buyers and sellers apply a "wait and see" mentality in the lead-up to the election, Wilson said.

On the other hand, the new Infrastructure Funding and Financing Bill, which proposes to levy benefitting homeowners for the costs of roads and other infrastructure needed for new housing developments by way of a levy collected by the council over typically 25-50 years, has been considered an exciting new measure that can speed up housing supply and ultimately reduce the housing shortage to keep prices down. The bill is in its early stages and has had its first reading in Parliament.

Click here for the full article

Purchasers recommended to make insurance enquiries early due to rise in "risk-based" insurance

An increase in insurers using risk-based pricing in the property insurance market has been noted in causing a reduction of insurance affordability and even availability in higher risk regions such as Wellington and Christchurch. Premiums for these areas can rise sharply and property purchasers are encouraged to make enquiries on insurance early in the purchase process. Banks will not lend on a property that cannot be insured.

The insurance affordability and availability issues caused by risk-based insurance have been identified as a concern by Finance Minister Grant Robertson when he spoke at the Insurance Council of New Zealand conference last November. He said that the government "is currently investigating pricing and access issues in property insurance markets, and the drivers behind those changes", noting that risk-based pricing could "severely hamper" the speed of a city's recovery from disasters. He used the example of Christchurch where high insurance coverage rates at the time of the earthquakes assisted significantly in the recovery of impacted properties.

Click here for the full article

PROJECTS

Government announces NZ$12 billion to be spent on infrastructure

The government has announced a NZ$12 billion package for infrastructure projects around New Zealand. Roads, rail, hospitals and schools are all included in the package. Roads in particular are in line for a major spending boost as they alone comprise NZ$5.3 billion of the NZ$6.8 billion earmarked for transport projects. Three large rail projects also form part of the package, with mainly the Auckland and Wellington networks benefiting.

The top of the North Island will receive the bulk of the transport package – with Auckland receiving $3.48 billion, Northland with $392 million, and Waikato and the Bay of Plenty region receiving $993 million. Wellington will also benefit with 1.35 billion, together with Christchurch and Queenstown, although the South Island regions will receive less in comparison with the North Island.

The roading projects were selected for the spend based on how quickly they could be funded and built. Major roads to be funded and brought forward include the Penlink corridor and Mill Road connection in Auckland, the Meiling Interchange in Wellington, and the Tauranga Northern Link in Waikato and the Bay of Plenty.

The government announcement will see a boost of activity in the construction and infrastructure sectors. "It makes sense to do this now because we've managed the books wisely and have historically low interest rates, which makes our programme affordable," Prime Minister Jacinda Ardern said.

However, the infrastructure spend is not without controversy, with environmentalists criticising that the focus on roads (thereby increasing the number of cars on the road) in comparison to developing public transport will undermine the government's environmental commitments and accelerate climate change.

Click here for the government's media release

Click here for the *Stuff* article

State of new building guarantees uncertain for two major players

Stamford Insurance and New Zealand Certified Builders have both lost their 10-year building guarantees for new builds after their underwriter, a subsidiary of Lloyds of London, withdrew from the global market. Both organisations have advised that coverage for existing policies will not be affected, but new guarantees cannot be offered until they can secure new insurers.

This will leave purchasers of new builds with fewer building guarantee options in the meantime. The Master Build Guarantee is still available and builders may also choose to offer their own in-house guarantee. Consumer protection provisions under the Building Act also guarantee a 12-month defect repair period and a 10-year "implied warranty" for residential building work, regardless of whether the building contract provides for the warranty. However, difficulties with activating the Building Act warranties and in-house guarantees provided by builders will arise if the builder goes bankrupt.

Last year, the Government released several major building law reform proposals for public consultation, and the idea of a mandatory building insurance product was entertained. However, feedback received indicated the building insurance market is not in a position to meet the demand of a mandatory guarantee at present. The Government is considering other options to address risk, insurance and liability issues in the building system.

Click here for the article

Bell Gully's projects and real estate team is across the current developments and trends in the industry. If you have an issue related to real estate or construction law that requires attention, we would be happy to assist.

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