

Tax Working Group Public Submissions Information Release

Release Document

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.



28 September 2018

Sir Michael Cullen
Chair
Tax Working Group

submissions@taxworkinggroup.govt.nz

Dear Sir Michael.

TAX RELIEF FOR OWNERS OF EARTHQUAKE-PRONE BUILDINGS.

The Whanganui Earthquake-prone Building Community Taskforce (Taskforce) was established by the Whanganui District Council (Council) in February 2012 to be an independent advisory group to the Council to guide their responses to earthquake-prone building issues. The members of the Taskforce include representatives from various parties that are keenly interested in the issue including architects, engineers, building owners, council officers, real estate operators, academics, builders and property developers, heritage advocates and community organisations.

The Taskforce is heartened by the comments in *“Appendix B: Design Features for extending the taxation of capital gains”* of the Tax Working Group’s Interim Report published on 20 September 2018. However, we would like to see the comments made in clauses 68 to 72 under the heading Building Depreciation Deductions and observations in Box 14.1: The treatment of seismic strengthening become a recommendation as part of the Working Group’s final report.

The most significant issue for owners of earthquake-prone buildings in regional centre is the inability to attain a rental return that makes the cost of strengthening economically viable. The majority of owners of earthquake-prone buildings, particularly those that are heritage buildings, take pride in their buildings and the value they provide to the community’s culture. However it is simply unrealistic to expect an owner to invest significant capital into strengthening and refurbishment with no prospect of an economic return.

In smaller centres the rents are determined by what the tenant can afford to pay rather than by an owner looking to achieve a reasonable return on investment. Attached is a copy of research carried out by QuakeCoRE – New Zealand Centre for Earthquake Resilience. In the report Olga Filippova of University of Auckland and Ilan Noy of Victoria University of Wellington looked at the issue of earthquake resilience in Whanganui and used two earthquake-prone heritage buildings as case studies on the viability of achieving a return on the cost of strengthening.

Their conclusions demonstrate that building owners simply cannot achieve a return on the cost of strengthening without some further incentives. We believe that being able to expense the strengthening costs for buildings in the year in which they are incurred along with the reinstatement of building depreciation will make a significant difference to the viability of strengthening earthquake-prone buildings. Ideally this should apply to all earthquake-prone buildings but at least to those that are heritage listed.

Recommendation 1: That depreciation on commercial buildings be reinstated.

Recommendation 2: That the cost of strengthening earthquake-prone buildings be treated as an expense in the financial year in which the costs are incurred.

The Taskforce is happy to provide further information or case studies to support our submission if required.

Yours sincerely

[1]

Trevor Goodwin

Chair

Whanganui Earthquake-prone Building Community Taskforce



Financial Incentives (or lack thereof) for Earthquake Strengthening Away from the Urban Centres

Professor Ilan Noy (Victoria University of Wellington)
Dr Olga Filippova (The University of Auckland)





Increasing earthquake resilience

Increase resilience and promote EQ strengthening

Demographic and economic decline of Small Town NZ¹

2/3 of TAs are set to experience stagnation or decline

Declining and ageing populations and challenging economic circumstances

Provincial CBDs are in decline

Big retailers are moving to the fringes

Government and corporate tenants are shying away from buildings below 70% NBS

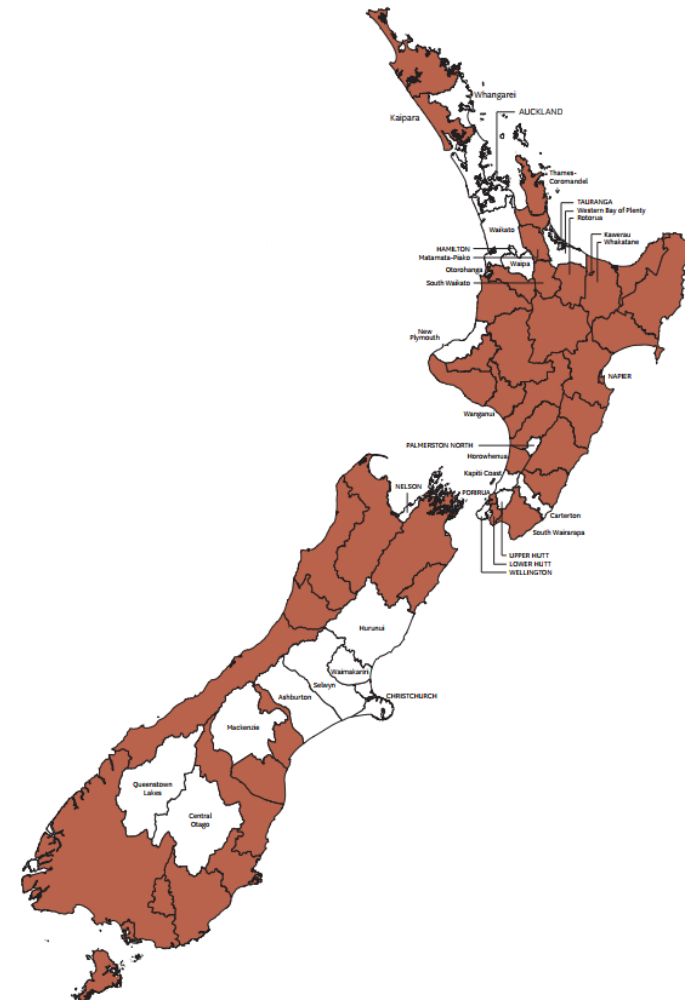
Older buildings make up majority of the stock

Potential loss of heritage

EQ-prone buildings – asset or liability?

Obstacles in securing financing from banks, limited and expensive insurance, unable to attract tenants

We need a better understanding of problems faced by such towns and estimate the necessary level of incentives as economic and social consequences will be more severe



¹Wood, J. (2017). Growing Beyond Growth: Rethinking the goals of regional development in New Zealand. Maxim Institute discussion paper.

Increasing earthquake resilience

Whanganui – The River City

One of the oldest towns in NZ, 5th largest until 1936

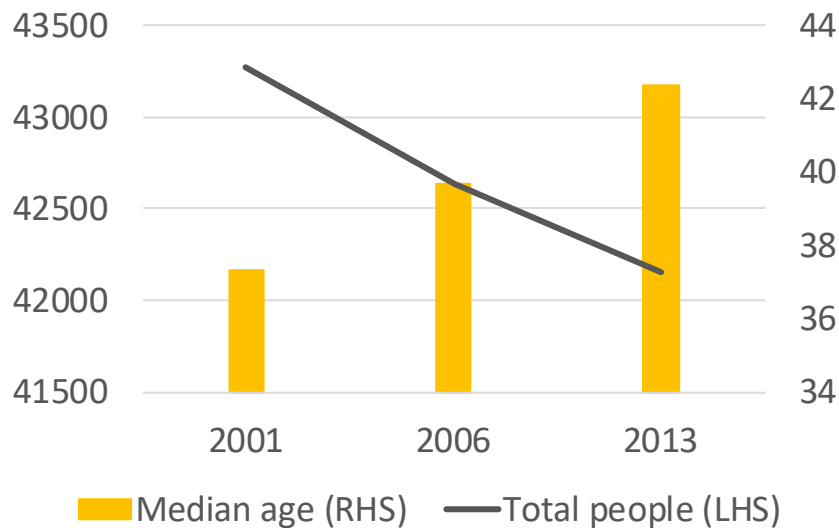
Since the 1960 the town appears to be in economic decline

Loss of key industries, loss of jobs, ageing population

Estimated to contain 11% of the country's at-risk (EQP) buildings



Demographic trends - Whanganui District





Central Commercial Zone



Cooks Gardens Area Unit

Increasing earthquake resilience

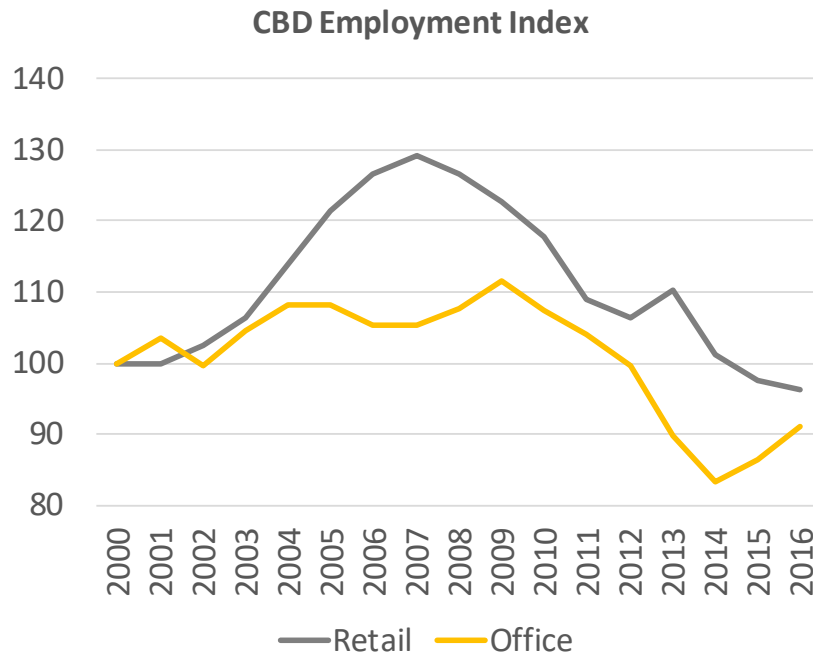
Whanganui's Commercial Centre – Victoria Avenue

Majority of the potentially EQPBs are located in the centre

Buildings tend to be occupied by tenants, therefore building owners derive their income from rents

Seismic strengthening is expensive (~\$750-900/m²)

Loss of office jobs and reduced retail trade drives vacancy



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Sizing Whanganui's EQPB stock

Strengthening will be centered around Victoria Ave

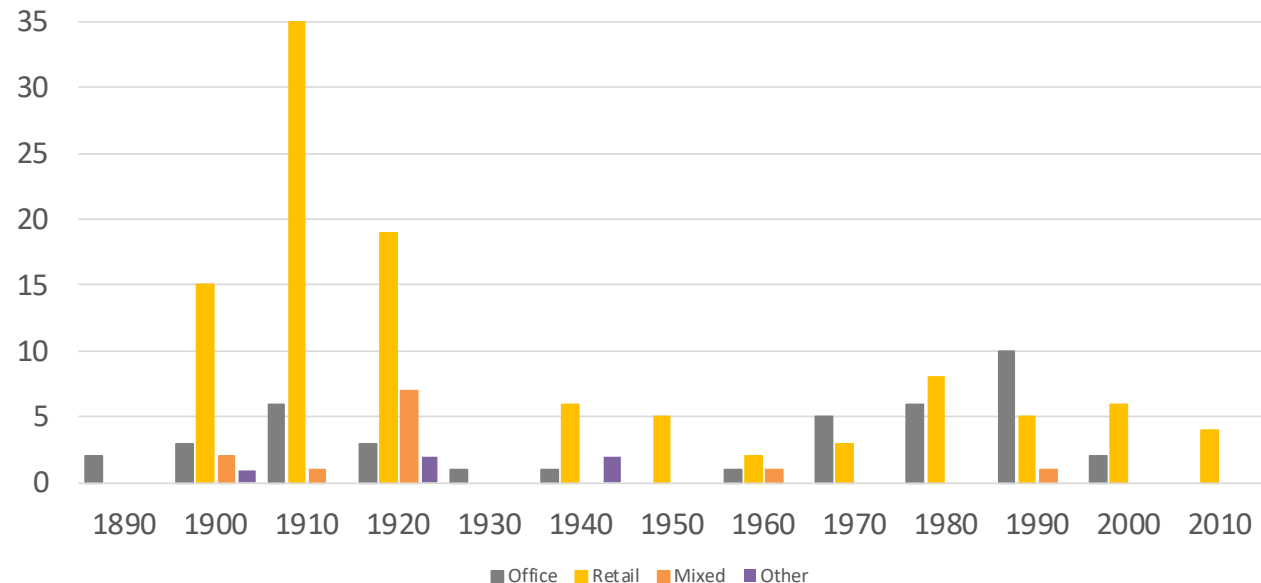
Building stock in the central zone is dominated by retail buildings (64%) followed by office (24%)

2/3 of all commercial buildings in the CBD are from 1940's or earlier

- Potentially over 85,000 m² would require strengthening costing around \$70M



Number of buildings by decade of construction



Increasing earthquake resilience

State of the property market

Typically around half of all commercial transactions are financed by banks

Since the EQs, that dropped to 37% for pre-1976 buildings

Vintage	% Mortgagee Sold		Average % difference (SP-CV)	
	Pre-quake	Post-quake	Pre-quake	Post-quake
Pre-1976	11%	26%	1.8%	-29.8%
Post-1976	0%	0%	-8.9%	4.4%

Nearly 30% of Victoria Ave retail shops on the ground floor are vacant

Limited market for first floor tenancies

Rental rates ~\$120 per m², range b/w \$80-\$250



The Avenue Buildings by Wallace Developments

Increasing earthquake resilience

Whanganui's champions

Champion #1 – seismic strengthening to 34% nearly completed, built in 1909, 380 m²

Retail tenancies on the ground floor,
own residence 1st floor

Estimated cost of seismic upgrade \$215K but this ballooned to ~\$290K and 1 year of delays - \$760 per m²

In addition to strengthening, the owner is restoring the building to a very high standard bringing the total cost to nearly \$800K – ALL costs funded by the owner

Recipient of Heritage EQUIP retrofit grant - \$15K

The owner is driven by passion to preserve 'a fine asset' and is not looking to make financial gains

Income from rents ~\$19K, property rates \$10K – with tenants paying their share of rates and insurance, the owner would clear ~\$14K

Would take approx 20 years to recover the investment!



Increasing earthquake resilience

Whanganui's champions

Champion #2– plans seismic strengthening to 67%,
Category 2 Heritage NZ, built in 1910

Two storey stand-alone office building, ground floor vacant
since Nov 2014 (low NBS)

Rental income from both floors \$71,600 (\$127 per m²)

Estimated cost of seismic upgrade is \$500K (\$885 per m²)
plus \$250K for restoration

Applying for Heritage EQUIP major works grant which
could provide up to 50% of seismic strengthening costs

Strengthening must be financially viable – rental income
post remediation needs to be sufficient to cover the debt
servicing of retrofit + return on the building



	Scenario 1 - GO (100% occupancy, \$250K EQUIP grant)	Scenario 2 - Break-even (100% occupancy, \$220K EQUIP grant)	Scenario 3 - NO GO (100% occupancy, NO EQUIP grant)
Annual Cash Flows			
Rental income	89,615	89,615	89,615
Debt service	49,025	51,967	73,538
Return on the building	37,883	37,883	37,883
Cash flow to owner	2,707	-235	-21,806

Increasing earthquake resilience

Whanganui's future

Whanganui falls in the medium seismic risk area, requiring councils to identify EQPBs w/in **5-10** yrs and owners to strengthen or demolish w/in **25** yrs

Given the long-term 30-yr horizon of regulatory obligations, owners take a 'wait and see' approach

EQPBs cannot attract investment-grade tenants (gov't, banks, top-end retailers) AND have higher vacancies

'Champions' are great BUT there are 120 pre-1976 buildings in the central zone that will likely require seismic upgrades

In order to achieve economic viability, significant financial incentives are needed:

- Major works grants (e.g. Heritage EQUIP)
- Subsidised interest-free loans
- Property rates relief (e.g. Tax Increment Financing)
- Equity participation (e.g. HNZ shared equity scheme)
- Allow tax deductibility of retrofit costs
- Extend EQC cover to strengthened comm heritage bldgs





QuakeCoRE
NZ Centre for Earthquake Resilience

Thank you!

www.quakecore.nz

