MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

Regulatory impact statement

Tenant liability for damage to residential tenancy properties

newzealand.govt.nz

Agency disclosure statement

This Regulatory Impact Statement has been prepared by the Ministry of Business Innovation and Employment (MBIE). It provides an analysis of options for setting a level of tenant liability for damage to residential rental properties in response to a Court of Appeal decision.

The analysis has been constrained by the limited time available and information gaps affecting the analysis. It is not possible to determine an average amount of insurance claims by landlords for tenant damage to rental properties made prior to April 2016 (when the Court of Appeal decision was issued which affected tenant liability for damage to rental properties). A sample of 100 Tenancy Tribunal decisions with a damage claim element was used as a proxy for this average.

Neither has it been possible to determine how often insurance companies pursue tenants for damage costs paid out to landlords under landlord insurance policies where the damage was caused negligently.

Anecdotal evidence from landlords suggests that they are experiencing increased costs for damages as a result of the consequences of the Court of Appeal decision but it has not been possible to verify this or quantify such increases.

Landlord insurance has a bearing on tenant/landlord damage liability settings but MBIE does not hold data on the percentage of landlords who hold insurance for their rental properties nor the percentage of tenants who hold personal liability insurance.

As a consequence, it is difficult to predict landlord and tenant responses to different interventions, the implications for insurance and the likely cost distributions for landlords and tenants, of the options considered.

The preferred option may have compliance costs for landlords and property managers, because of the requirement to hold and disclose insurance excess information to tenants and in disputes heard by the Tenancy Tribunal.

Authorised by:

Claire Leadbetter
Manager, Construction & Housing Policy team
Building, Resources & Markets

10 Nov 2016

Contents

Executive summary

1. Prior to April 2016, the tenancy sector operated on the basis that a residential tenant is obligated to pay for the costs of damage to rental premises which he or she intentionally or carelessly causes (beyond fair wear and tear) in accordance with section 40(2)(a) of the Residential Tenancies Act 1986 (RTA), which provides a tenant "shall not intentionally or carelessly damage … the premises".

2. However, in April 2016 in *Holler and Rouse v Osaki and Anor* [2016] NZCA 130 the Court of Appeal ruled that tenants are immune from a claim by the landlord where the rental property suffers loss or damage caused carelessly or negligently by the tenant or tenant's guest – to the extent provided in sections 268 and 269 of the Property Law Act 2007 (the "exoneration provisions"). Those provisions essentially provide that a landlord cannot require a tenant to meet the cost of damage (caused accidently or negligently by the tenant) either by

    a. "fire, flood, explosion, lightning, storm, earthquake, or volcanic activity" whether or not the landlord is insured or

    b. "any other peril" and the landlord is insured or has agreed with the tenant to be insured.

3. Central to the decision was section 142(2) of the RTA, which provides that the Tenancy Tribunal may look to Part 4 of the PLA "as a source of the general principles of law".

4. Post *Osaki*, if damage is caused by carelessness and the damage is covered by the landlord's insurance, the tenant will not be liable for the cost of repairs (unless it was the result of an imprisonable offence). The landlord is responsible for the insurance excess costs and cannot pass these costs on to their tenants.

5. The balance of liabilities has now tipped too far in favour of tenants, who are now largely immune from the cost of damage they cause. There is a balance to be struck between encouraging tenants to take a high degree of care and not exposing them to excessive risk and cost.

6. MBIE's preferred option for setting damage liabilities for residential rental properties is to set the level of a tenant's liablity for careless or accidental damage up to the cost of the landlord's insurance excess and limited to four weeks' rent - for each damage incident. Where the cost of the damage is below the insurance excess, the tenant would be liable for the cost of the damage. The option best balances the objectives of incentivising tenants to take care and not exposing tenats to excessive cost and risk. There is a broad correlation between a tenant's maximum level of liability - four weeks' rent and their ability to pay.

7. It is possible that a consequence of implementing the preferred option is that insurers increase premiums and landlords pass on these costs to tenants in rent increases. In order to aid transparency of tenant liability, the option would require landlords to disclose insurance excess to tenants at the start of a tenancy and during the tenancy if insurance arrangements changed, in order to make tenants aware of their potential liability for damage.

8. MBIE undertook targeted consultation from 26 – 28 October 2016 with key tenant and landlord stakeholder groups and with the Insurance Council of New Zealand.

Status quo and problem definition

Background

Rental market

9. Approximately 450,000 New Zealand households live in rental properties[1], including approximately 64,000 households who rent from Housing New Zealand Corporation. Nationally 30 percent of households now rent their home, increasing to 35 percent in Auckland and 58 percent of low-income households in Auckland.[2]

Legal framework for tenant liability

10. Provisions relevant to tenant liability in the Residential Tenancies Act 1986 (RTA) and Property Law Act 2007 (PLA) are set out in appendix 1.

11. Prior to April 2016, the tenancy sector operated on the basis that a residential tenant is obligated to pay for the costs of damage to rental premises which he or she intentionally or carelessly causes (beyond fair wear and tear) in accordance with section 40(2)(a) of the RTA, which provides a tenant "shall not intentionally or carelessly damage … the premises".

12. Landlords and tenants mutually agreed the level of a tenant's liability for their careless damage. If they could not agree, they had the option of attending mediation or lodging an application to the Tenancy Tribunal. There was no express limit to a tenant's liability for damage. A sample of around 100 Tenancy Tribunal claims with a successful damage claim award against a tenant suggests the average damage claim awarded against tenants was approximately $915.

13. The insurance arrangements of landlords were not considered as a matter of course by the Tenancy Tribunal in damages disputes.

Court of Appeal decision in Holler and Rouse v Osaki and Anor [2016] NZCA 130

14. The Court of Appeal's decision in *Holler and Rouse v Osaki and Anor* [2016] NZCA 130 ("the *Osaki* decision") in April 2016 and the Tenancy Tribunal's subsequent Practice Note in August 2016 changed the balance of liabilities between landlords and tenants for careless damage caused by a tenant.

15. In the *Osaki* decision, the Court of Appeal considered whether residential tenants were immune from liability for the costs of substantial fire damage to a rental premises (caused when the tenant left a pot of boiling oil on the stove), in the same way in which a commercial lessee is immune from claims for damages under sections 268 and 269 of the PLA. Central to the decision was section 142(2) of the RTA, which provides that the Tenancy Tribunal may look to Part 4 of the PLA "as a source of the general principles of law".

16. The landlord had insurance on the property with AMI which covered the repair costs of $216,413.28. AMI indemnified the landlords and then sought to pursue the tenants for the costs they had incurred in paying out the insurance (exercising their right of subrogation to pursue a third party for costs).

[1] Census 2013

[2] Household income of under $20,000 annually.

17. The Court of Appeal ruled that tenants are immune from a claim by the landlord where the rental property suffers loss or damage caused carelessly or negligently by the tenant or tenant's guest – to the extent provided in sections 268 and 269 of the PLA (the "exoneration provisions").

18. Applying the rationale of the PLA exoneration provisions in the *Osaki* decision, the Court of Appeal found the tenants to be immune from liability for the fire damage they caused.

Practice Note of Tenancy Adjudicator

19. In August 2016, in response to the *Osaki* decision, the Principle Tenancy Adjudicator issued a Practice Note to guide Tenancy Tribunal adjudicators when deciding damages claims by landlands against tenants.

20. The Practice Note stipulates that if it can be established that the damage to a rental property by a tenant (or his/her guest) was caused carelessly and not intentionally and the landlord has insurance, the tenant is exonerated from paying for the damage. If the damage was caused by one of the events in section 268(1)(a) of the PLA (fire, flood, explosion, lightning, storm, earthquake or volcanic activity) the tenant is exonerated from liability for damages whether or not the landlord has insurance.

21. Although not specifically addressed by the Court of Appeal in the *Osaki* decision, the Practice Note states that the landlord cannot be awarded the insurance excess in damages claims, which is part of the cost of "making good the destruction or damage" (section 269(2) of the PLA) and is the amount of risk which the insured agrees to accept.

22. Advice to landlords on the Tenancy Services website is now:

    If damage is caused by carelessness and the damage is covered by the landlord's insurance, the tenant will not be liable for the cost of repairs, unless it was the result of an imprisonable offence. The landlord is responsible for the insurance excess costs and cannot pass these costs on to their tenants.

Insurance arrangements for residential properties

23. Residential tenancies are governed by the RTA and most parties to a tenancy use the standard Tenancy Services "Residential Tenancy Agreement". Although residential landlords are likely to hold landlord insurance, this is not a legal requirement under the RTA and landlords and tenants might not discuss insurance at all at the start of a tenancy. The Residential Tenancy Agreement therefore does not specify whether landlords or tenants should have insurance.[3]

24. As having insurance for a property is a condition of obtaining a mortgage and many rental property managers will only manage a property that is covered by an insurance policy, it is estimated that a high number of landlords hold insurance for their rental properties. Landlord insurance for residential properties generally provides landlords with cover for:

    a. loss or damage to a rental property

    b. the contents that are provided by the landlord for the tenant's use and/or

    c. loss of rent.

[3] Post-*Osaki*, the standard Residential Tenancies Agreement does note that "Tenants may be immune from claims by landlords where they or their guests caused careless damage to the property but the landlord's insurance covers the damage."

25. Careless damage by tenants is generally covered by landlord insurance. However, whether or not 'malicious', 'reckless' or 'intentional' damage by tenants is covered depends on the policy: some policies only cover such damage if an additional premium is paid while others do not cover such losses. Generally insurance cover is conditional on landlord obligations, such as obtaining satisfactory references and carrying out regular property inspections.

26. Tenants who hold contents insurance are usually covered for personal liability insurance (which may cover risk of damage to the property), as this is usually incorporated into contents insurance. However, many tenants do not hold contents insurance, so will not be covered for the risk of damage to rental properties.

27. Up until the *Osaki* decision, there was uncertainty about liability for careless damage to rental properties by tenants. Many tenants may have assumed that risk for damage (particularly for catastrophic damage) was covered by their landlord's insurance so would not take those risks into account when making decisions about their own insurance cover.

Insurance arrangements for commercial leases

28. Unlike residential tenancies, commercial leases (governed by the PLA) specify what the landlord will hold insurance for, usually at least damage from fire, flood, explosion etc. as the PLA specifies tenants are fully exonerated from this type of damage (even if they negligently caused a fire, for example). Commercial tenants are incentivised to take care of properties through the strict terms and conditions of their leases, including the requirement that they pay or contribute to the cost of their landlord's insurance excess payments. Moreover, tenants usually pay for their landlord's insurance premiums as an explicit outgoing as a term of their lease, making insurance a transparent commercial transaction between parties.[4] Commercial leases are highly prescriptive and parties are likely to obtain legal advice before signing.

Problem definition

There is a tradeoff between incentives to take care and exposure to high cost of catastrophic loss

29. The balance of liabilities has now tipped too far in favour of tenants, who are now largely immune from damage they cause to rental properties. Prior to *Osaki*, tenants were liable to the landlord for all careless damage and there was no limit to that liability. This provided tenants with incentives to take care of the landlord's property as they were liable to pay for damage caused through carelessness.

30. The current situation post the *Osaki* decision is that tenants are not liable for any careless damage. This protects tenants from the high costs and risks of catastrophic loss but also reduces their incentive to take due care of the landlord's property.

Encourage cost effective insurance arrangements

31. It is likely that tenants would have been unclear about the extent of their liability prior to the *Osaki* decision. Many would have believed that accidential catastrophic loss to the landlord's property would be covered by the landlord's insurance. Also, many would have been unaware that landlord insurance companies were able to sue tenants using their right of subrogation to recoup costs paid to the landlord. In effect, insurance companies have been treating tenants as third parties, for the sake of landlord insurance policies.

[4] The Auckland District Law Society standard Deed of Lease specifies that the tenant is responsible for insurance premiums and meeting the insurance excess in respect of a claim to a maximum of $2,000.

32. Where the liability framework is uncertain, it is possible that both landlord and tenant will take out insurance for the same risk of careless damage to rental properties. This was demonstrated by the *Osaki* decision, where AMI's decision to pursue tenants for the costs of significant fire damage appears to have been based on the tenants' means to pay.

33. But the rationale for the PLA provisions (in particular the "exoneration provisions") which was applied in the *Osaki* decision is to allocate risk in such a way that enables cost efficient insurance arrangements which will reduce disputes and litigation – a single insurance policy effectively protecting both landlord and tenant from specified risks. Tenants, who contribute to their landlord's insurance premiums through rent payments, should be covered by their landlord's insurance.

Consequences for quality of rental properties and for insurance

34. Property managers and landlords are advising anecdotally that in order to mititgate the risk of damage costs, landlords are:

    a. leaving properties empty until they can find tenants who they believe will exercise extreme care

    b. refusing to carpet rental properties and

    c. letting rental properties run down rather than carry out repairs, causing a general decline in the overall quality of rental stock.

35. Insurance companies have speculated that it is possible insurers may change the way they price the premiums landlords pay, as they take their tenants' risk profiles into consideration with the possibility of higher premiums for landlords; these will be passed on to tenants in the form of rent increases.

Expeditious dispute resolution

36. Tenancy Services have advised the *Osaki* decision is adding to time, cost and resources. This is because mediators and adjudicators are having to explain to parties the implications of the *Osaki* decision for their dispute and request evidence as to landlord insurance.

Objectives

Outcomes/objectives

37. The objective of the proposal is to provide a fair and efficient legal framework for residential tenant liability for damage to rental properties.

38. In doing so, the solution should focus on balancing two key criteria: encouraging tenants to take a high degree of care and not exposing tenants to excessive risk and cost. The preferred option should also aim to:

    a. encourage cost effective insurance arrangements

    b. have no or limited unintended consequences (for rental properties and insurance) and

    c. support the expeditious resolution of disputes.

Options and impact analysis

Options considered

39. Four options for tenant liability for damage were assessed against the criteria above as follows:

    1. *Tenant has a high degree of immunity from liability for careless damage (status quo)*
    2. *Tenant liable for careless damage with no express limit*
    3. *Tenant liable for careless damage up to the value of the landlord's insurance excess and limited to four weeks' rent per damage incident*
    4. *Tenant liable for careless damage limited to specified amount per damage incident (e.g. $3000)*

40. Under all options, damages would be able to be claimed from a tenant's bond.

41. Also under all options, tenants would remain liable for damage if:

    a. the damage was intentionally done by tenant (or tenant's guest) or

    b. the damage was the result of an act or omission by the tenant (or their guest) which constitutes an imprisonable offence or

    c. the insurance money is irrecoverable because of tenant's (or tenant's guest's) act or omission

Option 1 – tenant has a high degree of immunity from liability for careless damage (status quo)

42. Under this option, no legislative change would be required. Tenants would continue to be immune from liability for careless damage if the landlord held insurance for the damage, including any insurance excess payments.

Analysis against criteria – option 1

43. The status quo does not appropriately balance protecting tenants from excessive risk and cost and incentivising tenants to take care, because of the high degree of immunity that tenants now have for their careless damage. On the other hand, it does support cost effective insurance arrangements because costs are allocated on the basis of the landlord's insurance cover (the tenant does not need to hold insurance for the same risks).

44. Option one could have unintended consequences such as:

    a. decreased quantity of rental stock (landlords leave properties empty until they can find tenants who they believe will exercise extreme care)

    b. landlords may be less likely to take on families because of the perceived risk of children causing damage, or other tenant groups perceived as high risk, such as students

    c. a decline in the quality of rental stock (landlords stop carpeting rental properties and let rental properties run down rather than carry out repairs)

    d. insurers may increase premiums for landlords which are passed on to tenants in the form of rent increases (anticipating more claims from landlords in general)

e. landlords could be incentivised to pay higher premiums in order to have lower excesses which could be passed on to tenant in form of increased rent

45. Lastly, the status quo does not support the expeditious resolution of disputes because the Tribunal has to take into account when and how a landlord's insurance policy is relevant to liability. Additionally, it may increase disputes at the Tribunal over whether damage was careless or intentional as this changes who is liable to pay.

Option 2 – Tenant liable for careless damage with no express limit

46. Under this option, the RTA would be amended to require residential and boarding house tenants to compensate the landlord for careless damage, and section 142(2) would be removed (reference to the principles of Part 4 of the PLA). The RTA would remain silent as to the limit to a tenant's liability.

47. As the Tenancy Tribunal does not have jurisdiction to require any party to pay any sum, or to do any work to a value, or otherwise to incur any expenditure, in excess of $50,000 (section 77(5) of the RTA), claims for higher damages would need to be escalated to a higher court.

Analysis against criteria – option 2

48. Option two does not appropriately balance protecting tenants from excessive risk and cost, and incentivising tenants to take care. While it would incentivise tenants to exercise a high degree of care it would also expose tenants to excessive cost and risk for careless damage – they could be bankrupted if they did not hold personal liability insurance (by an uninsured landlord or an insurance company exercising right of subrogation).

49. Neither does this option encourage cost effective insurance arrangements, as landlords and tenants would be incentivised to have insurance for the same risks.

50. Option two may have the unintended consequence that landlords could "double dip", by making a successful insurance claim and also succeeding in claiming against the tenant for the same damage.

51. However, this option is likely to make the resolution of damages disputes easier than under the status quo, as tenants would be liable for both intentional and careless damage and the Tribunal would not need to look into insurance policies as a matter of course.

Option 3 - Tenant liable for careless damage up to the value of landlord's excess and limited to four weeks' rent per damage incident

52. Under this option, the RTA would be amended to require residential and boarding house tenants to compensate landlords for careless damage up to the value of their landlord's insurance excess but not exceeding four weeks' rent for each incident of damage. Section 142(2) would be repealed (reference to the principles of Part 4 of the PLA).

53. If the landlord held insurance that covered the damage, the tenant would only pay the excess in respect of the damage claim. If the landlord did not hold insurance the tenant would be liable for the damage amount, capped at four weeks' rent. If the landlord did hold insurance but the damage was below the excess amount, the tenant would be liable for the damage amount.

54. If damage to a rental premises was caused by a catastrophic event (e.g. fire, flood, earthquake) outside a tenant's control, the tenant would not liable for any cost of the damage, unless the event was caused through a careless act, for example carelessly causing a fire, in which case the tenant may be liable up to the landlord's insurance excess. This is different from the provisions in the PLA, which provide that commercial tenants are always immune from the the specified events listed in section 268(1)(a) (fire, flood, explosion, lightning, storm, earthquake, or volcanic activity).

55. Under this option, the landlord would be required to disclose their excess costs to the tenant at the start of a tenancy, and notify the tenant in writing of any amendment to the policy, including a cancellation during the tenancy. This is important given the explicit link of a tenant's careless damage liability to the level of a landlord's insurance excess.

Analysis against criteria – option 3

56. Option three would appropriately balance protecting tenants from excessive risk and cost, and incentivising tenants to take care. Landlords would have no (or very little) costs if fully insured. Because damage is capped at four weeks' rent per incident it is roughly relative to a tenant's ability to pay. Based on September 2016 private rent data (from bond forms):

    a. for 25% of renters nationwide, payment would be capped at more than $1996 per damage incident

    b. for 50% of renters nationwide, payment would be capped at a maximum amount between $1116 and $1996 per damage incident and

    c. for 25% of renters nationwide, payment would be capped at less than $1116 per damage incident.

57. It would also support cost efficient insurance arrangements by allocating risk transparently between landlord and tenant and limiting the ability for insurance companies to exercise rights of subrogation in matters of careless damage.

58. However, an unintended consequence could be that insurers increase premiums for landlords which are passed on to tenants in the form of rent increases (anticipating more claims from landlords in general). Also, landlords could increase insurance excesses to level of four weeks' rent to limit their risk, but not pass on savings to tenant in terms of rent reductions. This is mitigated by the need for landlords to disclose their insurance arrangements to the tenant at the beginning of the tenancy and during the tenancy if there were changes to the policy.

59. Lastly, option three does not support the expeditious resolution of disputes; Tribunal applications may take longer because of the need to examine insurance policies and there may be disputes over what "incident of damage" means (Tenancy Tribunal may have a different definition to that of insurance companies). There may also be increased litigation about whether damage is careless or intentional, as this impacts on who is liable to pay.

Option 4 – Tenant liable for careless damage limited to specified amount per damage incident (e.g. $3000)

60. Under this option, the RTA would be amended to require residential and boarding house tenants to compensate the landlord for careless damage with a limit of $3000 per damage incident. Section 142(2) would be removed (reference to the principles of Part 4 of the PLA).

Analysis against criteria – option 4

61. Option four would balance protecting tenants from excessive risk and cost and incentivising tenants to take care, depending on the specified level of liablity. If set too high, it would incentivise tenants to take care, but would expose tenants (particularly low income tenants) to excessive cost and risk. Low income tenants are less likely to hold personal liability insurance and would be unable to meet the costs of significant damage. Under this option, there is no relativity between liability and a tenant's ability to pay.

62. Whether or not this option would encourage cost effective insurance arrangements would again depend on the specified level of liability. Tenants would be more likely to consider liability insurance if the amount was reasonably high for each damage incident, such as $3,000 (this would be higher in most cases than landlord's insurance excess or four weeks' rent).

63. Option four may have the following unintended consequences:

    a. Landlords could increase insurance excesses to the around the level of liability, for example $3000 if that is the tenant's liability limit, but not pass on savings in premiums to tenant in terms of rent reductions.

    b. Landlords may "double dip", that is make a successful insurance claim and also succeed in claiming against the tenant for same damage.

64. The option is likely to make the resolution of damages disputes reasonably straightforward. However, there may be increased litigation about whether damage is careless or intentional, as this impacts on who is liable to pay (beyond the specified level of liablity).

Additional "contracting out" proposal for options 3 & 4

65. An additional proposal was considered: that a different level of liability could be mutually agreed between tenant and landlord if specifically provided for in the tenancy agreement. This would enable the tenant, if they wished, to take out their own insurance and would be intended for the higher end of the rental market where landlords and tenant are likely to obtain legal advice before entering agreements.

66. However, enabling a different level of liability may result in landlords "defaulting" to standard higher levels of liability in tenancy agreements. Such a situation would disadvantage vulnerable tenants, low income tenants and those in tight rental markets, who may feel compelled to agree to higher tenant liability terms in tenancy agreements. Vulnerable and low income tenants are less likely to take legal advice before signing a tenancy agreement and have limited bargaining power.

Table

67. An overall assessment of the options against the status quo (option 1) is set out in the table on the following page.

Options assessed against status quo - tenant liability

Options assessed against status quo for setting tenant liability	Option 2 Tenant liable for careless damage with no express limit	Option 3 Tenant liable for careless damage up to the value of the landlord's insurance excess and limited to four weeks' rent per damage incident	Option 4 Tenant liable for careless damage limited to specified amount per damage incident (e.g. $3000)
Avoid excessive cost/risk for tenants	û û û	ü ü ü	ü ü
Encourage tenants to take care	ü ü ü	ü ü	ü ü
Encourage cost effective insurance arrangements	û û û	ü ü	û
Not have unintended consequences	ü ü	ü	ü
Support expeditious dispute resolution	ü ü	û	ü

Consultation

Agency consultation

68. The following agencies were consulted on this Regulatory Impact Statement: the Treasury, the Ministry of Health, the Ministry of Justice, Housing New Zealand Corporation, the Ministry of Social Development, the Ministry of Justice, Te Puni Kokiri and the Department of Internal Affairs. The Department of the Prime Minister and Cabinet was informed.

Stakeholder consultation

Tenancy sector

69. Targeted consultation was undertaken with the following key tenancy sector stakeholder representatives in Auckland, Wellington and Christchurch:

    a. New Zealand Property Investors' Federation

    b. Tenants Protection Association (Auckland and Christchurch)

    c. Manawatu Tenants' Union

    d. Citizens' Advice Bureau

    e. Community Law Centre

    f. New Zealand Union of Students Associations

    g. New Zealand Christian Council of Social Services

    h. Property management companies from Auckland, Hamilton, Wellington and Christchurch.

70. Overall, landlord and tenant stakeholders felt that amendments are needed and agreed that while the outcome of the *Osaki* case was fair – that the tenants should not have been pursued for costs from the insurance company – the broader implications it has had on the rest of the rental market is unfair.

71. Discussion centred on ensuring that the limit of liability for tenant damage struck the right balance between incentivising tenants to take due care and covering costs of reasonable damage, and not exposing tenants to significant financial risk. It was also important to stakeholders that the limit did not create unintended consequences for how landlords insure their properties and for whether they continue to maintain them.

72. One of the most important factors for many stakeholders was that insurance companies should be prevented from using their right of subrogation to pursue tenants who may not be able to pay and should not be liable. It was broadly agreed that landlords ought to have insurance for their rental properties – particularly against catastrophic risks, and many felt that being able to recover the excess from the tenant would ensure that holding the insurance policy remained a sustainable cost.

73. Some stakeholders (both landlords and tenant groups) believed linking a tenant's liability for a damage incident to their landlord's insurance excess would make for a complicated system, both because the Tenancy Tribunal may have a different definition of "damage incident" to that of insurance companies, and because it would be administratively cumbersome. Their preference was for the proposal to simply limit a tenant's liability to four weeks' rent, and not refer to insurance excess at all.

74. Most stakeholders who commented on the proposal to allow landlords and tenants to agree to a separate limit of liability (in the tenancy agreement) thought that it was unnecessary and would create a default that most landlords would use. Agreeing to a separate liability was counter-productive to the intentions and objectives of the policy proposal and impact on vulnerable tenants or those in tight rental markets who would not have high bargaining power.

Insurance Council of New Zealand (ICNZ)

75. ICNZ does not agree with the proposal as it considers that a limit of liability aligning with the landlord's insurance excess will not incentivise tenants to take care of their landlord's property. As most landlord insurance excesses are around $400, ICNZ believes such a limit of liability provides no incentive for a tenant to take due care at all.

76. ICNZ prefer an unlimited cap on liability because it considers that without an effective incentive on tenants to take care of their landlord's property, the incidence and cost of tenant damage is likely to rise over time. These costs will be passed on to tenants in increased rents and ultimately make tenancy less affordable or create a housing problem.

Conclusions and recommendations

77. Option three is MBIE's preferred option for providing a fair and efficient legal framework for residential tenant liability for damage to rental properties. Under this option, tenants would be liable for careless damage up to the cost of the landlord's insurance excess and limited to four weeks' rent for each incident of damage.

78. The option best balances the twin objectives of incentivising tenants to take care and not exposing them to the potentially high costs of catastrophic damage. In setting an appropriate damage liability limit, option three assumes a broad correlation between the level of a tenant's rent and their means of paying for damage. The cap of four week's rent for tenant liability for a damage incident is only in cases where the landlord does not have insurance or the insurance excess is more than four weeks' rent.

79. Similar to the commercial leasing regime, in which both tenant and landlord share an allocation of risk, option three incentivises the most cost efficient insurance arrangements by reducing the likelihood of a tenant needing a separate insurance policy against the same risk of damage. This is a more efficient system and reduces disputes and litigation between two insurance policies.

80. An appropriate analogy is insurance arrangements in respect to rental cars: the rental car business arranges for insurance over the rental car and the renter accepts liability for the excess if he or she causes an accident. A person renting a car does not need to take out their own insurance cover.

81. As compared with the situation prior to the *Osaki* decision, option three will provide clarity as liability rules will be specified in legislation. The requirement for landlords to disclose insurance arrangements to tenants will ensure the specific level of a tenant's liability is clear for the duration of the tenancy and will also incentivise tenants to take care. It will also help prevent the possible consequence of landlords increasing their insurance excesses by reducing premiums, without an associated decrease in rent.

82. It is acknowledged there may be some "bedding in" time while the tenancy sector, insurance companies and the Tenancy Tribunal develop an understanding about the new framework and how it applies to individual tenancies. This may result in an increase in Tribunal hearing times.

Implementation plan

83. The final policy option agreed by Cabinet for implementation would require amendments to the RTA. No regulations would be required to be made in order to give effect to the policy options.

84. MBIE would publicise the proposed amendment, and further details once the RTA amendments were in force. The policy would be publicised through the Service Centre, website, ephemera and other options as decided by Government.

85. MBIE will also work with the Tenancy Tribunal to ensure staff understand the implications for their business and are ready to deal with applications under the new legislative framework.

86. There is a risk that landlords and tenants will be unclear about who is responsible for damage and for the landlord, how to best insure against the risk of damage which is not careless (e.g intentional). The risk of uncertainty in the rental market can be mitigated by publishing clear, plain-english guidance on the policies, including scenarios.

87. Under the preferred option, landlords will be required to notify tenants of their insurance arrangements. Apart from this requirement, we do not anticipate any significant increase in compliance costs to landlords and tenants. It is also anticipated that this proposal will, over time, reduce costs to the Tenancy Tribunal as hearings for damages claims will be simpler to adjudicate.

88. This proposal would repeal section 142(2) of the Residential Tenancies Act 1986 which provides for the Tenancy Tribunal to look to Part Four of the Property Law Act as a source of the general principle of law.

89. The enforcement of Tenancy Tribunal Orders would not be affected by this proposal.

Monitoring, evaluation and review

90. A plan to monitor and evaluate the effectiveness of the proposal will be developed once legislation has been passed. The plan will utilise existing monitoring activity such as MBIE's tenant and landlord engagement strategies.

91. Further areas for assessing the impact of the proposal include monitoring the number of contact centre calls about tenant liability for damage, analysing Tenancy Tribunal decision and bond forms (which includes rent information), liaising with Tenancy Services staff (including mediators and adjudicators) and seeking feedback from tenancy stakeholder groups.

Appendix 1

Provisions relevant to tenant liability

Residential Tenancies Act 1986

Provisions of the **Residential Tenancies Act 1986** (RTA) relevant to tenant liability for damage listed below.

1. Section 11 provides that any rights or powers conferred on the tenant by the RTA may not be waived.

2. Section 39 (Responsibility for outgoings) subsection (2), which states:

the landlord is responsible for the cost of

...

(b) insurance premiums payable in respect of the premises

3. Section 40(2)(a) (Tenant's responsibilities) which states:

the tenant ... shall not intentionally or carelessly damage, or permit any other person to damage, the premises.

4. Section 41(1) (Tenant's responsibility for actions of others), which states:

The tenant shall be responsible for anything done or omitted to be done by any person (other than the landlord or any person acting on the landlord's behalf or with the landlord's authority) who is in the premises with the tenant's permission if the act or omission would have constituted a breach of the tenancy agreement had it been the act or omission of the tenant.

5. Section 85 (Manner in which jurisdiction is to be exercised) which states:

Subject to the provisions of this Act and of any regulations made under this Act, the Tribunal shall exercise its jurisdiction in a manner that is most likely to ensure the fair and expeditious resolution of disputes between landlords and tenants of residential premises to which this Act applies.

6. Section 142 (Effect of Property Law Act 2007) which states:

*(1) Nothing in **Part 4** of the Property Law Act 2007 applies to a tenancy to which this Act applies.*

*(2) However, the Tribunal, in exercising its jurisdiction in accordance with section 85 of this Act, may look to **Part 4** of the Property Law Act 2007 as a source of the general principles of law relating to a matter provided for in that Part (which relates to leases of land).*

Property Law Act 2007

Part Four of the **Property Law Act 2007** (PLA) relates to leases of land. Provisions relevant to tenant liability for damage are sections 268 - 271 as set out below.

7. Read together, sections 268 and 269 ("the exoneration provisions") essentially provide that where damage or destruction to leased premises is caused or contributed to by a lessee (whether or not negligently), by

a. "*fire, flood, explosion, lightning, storm, earthquake, or volcanic activity*" whether or not the lessor is insured or

b. "*any other peril*" and the lessor is insured or has agreed with the tenant to be insured. (emphasis added),

a lessor cannot require a lessee to meet the cost of damage or destruction nor required the lessess to indemnify the lessor for damage/destruction.

However, a lessee could still be liable, if:

a. the damage was intentionally done by the lessee (or lessee's guest) or

b. the result of an illegal act/omission on premises or

c. the insurance money is irrecoverable because of lessee's (or lessee's guest's) act or omission.

8. Section 269 (Exoneration of lessee if lessor is insured) exonerates the lessee from:

a. the cost of making good the destruction or damage;

b. indemnifing the lessor against the cost of making good the destruction or damage; or,

c. paying damages in respect of the destruction or damage.

9. Section 270 (Rights of lessor if insurance for leased premises or land is affected by negligence of lessee or lessee's agent) essentially provides that despite section 269 (Exoneration of lessee if lessor insured), if a lessee's negligence caused damage, the lessor may:

a. terminate the lease with the required notice (if not a fixed term) if the lessor's ability to obtain/retain insurance cover is prejudiced by damage or

b. recover from the lessee any increased insurance costs for the premises incurred by lessor as a result of damage (including increases to premiums or any increase in the insurance excess that the lessor is required to pay in relation to future claims of the same kind)

10. Section 271 (Lessee may acknowledge lessor has not insured, or fully insured, premises) provides that despite section 269, a lessee may expressly acknowledge in a document (e.g. lease agreement) that the lessor does not have insurance or only has partial insurance for the rental premises for damage caused by fire, flood, explosion, etc. or any "other peril" as specified in document. In such a case, the lessor and lessee may agree that the lessee will meet the cost of repairs for such damage or indemnify the lessor for the cost of such damage to the extent that:

a. at the time of the damage, the lessor is not entitled to be insured for such damage and

b. the lack of insurance cover has been acknowledged by the lessee in the document.