PROJECTS AND REAL ESTATE NEWS

MARCH 2022

WELCOME

to Issue No. 11 of Projects and Real Estate News, Bell Gully's regular digest on regulatory developments, together with cases and news of interest in the **projects** and **real estate** sectors.

IN THIS ISSUE:

BELL GULLY

CONTENTS

Need more information?
Projects and Real Estate News is a regular 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, your usual Bell Gully contact, or visit our website.

CASE NOTES

✱ REAL ESTATE

Vendor alleges automatic termination when condition not satisfied on due date

Birdwood Rodney Trustee Ltd v Blue Moon Ltd [2022] NZHC23

Key Takeaways:

If an ADLS sale and purchase agreement is entered into (which is the form of agreement commonly used in the market for the sale and purchase of properties), and that agreement is conditional, then the agreement is not automatically terminated if a party has not satisfied a condition by the due date for satisfaction.

The agreement will remain on foot until such time as a party satisfies or waives the condition, or terminates the agreement by giving notice. A party may also affirm the agreement, thereby losing its own right to cancel it.

Whether a party wishes to satisfy or waive a condition, or terminate the agreement due to the non-satisfaction of a condition, it should communicate that clearly and unequivocally to the other party.

The Vendor in this case (who asserted that the agreement was automatically terminated when the Purchaser did not satisfy its due diligence condition by the due date) could have avoided costly litigation had it done the simple act of serving a clear termination notice on the Purchaser after the due date for satisfaction of the condition.

In summary: This case concerned a dispute between Blue Moon Limited (the **Vendor**) and Birdwood Rodney Trustee Limited (the **Purchaser**) under a sale and purchase agreement on the standard ADLS/REINZ form.

The agreement between the parties contained a due diligence (**DD**) condition in favour of the Purchaser.

The Purchaser did not give notice to the Vendor satisfying or waiving the DD condition, or terminating the agreement for the non-satisfaction of the DD condition, by the due date. The Vendor also did not give notice to the Purchaser terminating the agreement for the non-satisfaction of the DD condition after the due date. Then, more than 6 months later, the Purchaser gave notice to the Vendor declaring the agreement unconditional.

The Vendor contended the agreement had automatically terminated when the Purchaser failed to give notice satisfying or waiving the DD condition by the due date. The Purchaser disputed this, and lodged a caveat against the property's title.

The Vendor applied to lapse the caveat, and the Purchaser resisted the application by lodging its own application to sustain the caveat. As is typical in these types of cases, the court had to decide whether there was a "reasonably arguable" case that the Purchaser had an interest in the land sufficient to support its caveat. It was not a final determination that such an interest exists – that would need to be settled by a substantive hearing.

The central issue in this case was therefore whether it was reasonably arguable that the agreement had already been terminated by the time the Purchaser declared it unconditional. If the agreement was terminated, then the Purchaser would have no interest to support the caveat.

Was the agreement automatically terminated when the DD condition was not satisfied?

The Vendor argued that the agreement had been automatically terminated when the DD condition was not satisfied by the due date, and that the Vendor was not required to give formal notice to the Purchaser terminating the agreement. This was despite the agreement specifying that if a condition was not satisfied or waived on the due date, either party may at any time before it is satisfied or waived, avoid the agreement "by giving notice" to the other.

Part of the Vendor's argument was that the Purchaser had unilaterally waived the requirement to be notified of any such termination. The Vendor referred to earlier discussions between the parties, where the Purchaser had, when seeking an extension to the DD condition date, advised the Vendor that if the deposit is not paid on the extended DD condition date then "the contract is cancelled and that is the end of the matter". The Vendor agreed to the extension, but the Purchaser did not pay the deposit by the extended DD condition date. The Vendor therefore contended that the Purchaser had, by its statement and subsequent non-payment, waived the requirement for the Vendor to provide formal notice of termination when the DD condition date passed.

The court rejected this argument, noting that it would be "inherently problematic" to allow that there had been a waiver of the Vendor's requirement to give notice of termination of the agreement. In the court's view, this could lead to ambiguity in that a party would not know whether the other party had chosen to terminate the agreement, or had simply left the agreement on foot.

On this basis, the court held that the Purchaser had established a reasonably arguable case to sustain the caveat (on the grounds that the Purchaser had not, and could not, waive the requirement for the Vendor to give notice of termination of the agreement), which should be tested at trial. This was one of the primary grounds for the court to order the Purchaser's caveat not to lapse.

Did the Vendor affirm the agreement?

The Purchaser also argued that the Vendor had affirmed the agreement by its conduct after the date for satisfaction of the DD condition had passed. The Purchaser referred to various emails from the Vendor to the Purchaser after that date, in which the Vendor was seeking payment by the Purchaser of two outstanding rates invoices (which the Purchaser had agreed to pay under the terms of the agreement). The Purchaser claimed this as evidence that the Vendor still considered the agreement to be on foot after the date for satisfaction of the DD condition had passed.

The court did not accept this argument. In order to prove that the Vendor had affirmed the agreement, the Purchaser needed to prove that the Vendor's conduct objectively demonstrated an unequivocal election to affirm and proceed with the agreement. The Vendor merely seeking updates as to payment of rates invoices by the Purchaser was insufficient to demonstrate that. All it showed was that the Vendor considered it was entitled to pursue the Purchaser for breach of the Purchaser's obligation to pay rates under the agreement.

Commentary

As noted above, this case was not a final determination on the matter, as the Purchaser only needed to establish a "reasonably arguable" case in order to sustain its caveat. However, this case is a useful reminder of the requirement to give a clear and unequivocal notice should a party wish to terminate an agreement for non-satisfaction of a condition (where the market-standard ADLS/REINZ form of agreement is used).

Before a condition is satisfied or waived, or terminated due to the non-satisfaction of the condition, an agreement will remain on foot and the parties may simply do nothing for the time being. A party may also affirm an agreement (provided that it demonstrates to the other party an unequivocal election to affirm and proceed with the agreement), thereby losing its own right to cancel it.

REGULATORY UPDATES

✱ REAL ESTATE

Government amends lending rules to curb "unintended consequences"

The government is making practical amendments to responsible lending rules to curb unintended consequences being caused by the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**), Minister of Commerce and Consumer Affairs, David Clark announced this month.

Changes that tightened the CCCFA came into effect on 1 December 2021 and were intended to protect vulnerable borrowers from loans that they could not afford. However, various media outlets such as the *NZ Herald* and *Stuff* have reported that the changes have caused banks and lenders to become "ultra conservative", rigorously scrutinising borrowers' spending and declining mortgages over Netflix subscriptions, going to therapy, or "spending too much on a dog". The changes have been criticised for causing a "credit crunch" and hurting first home buyers in particular.

In the Minister's announcement this month, the proposed amendments to the responsible lending rules which were highlighted included clarification that lenders are not required to inquire into the borrower's current living expenses (beyond recent bank transactions) if borrowers provide a detailed breakdown of their anticipated future living expenses. The government also intends to remove regular "savings" and "investments" as examples of outgoings that lenders need to inquire into. Alternative guidance as well as examples of when it should be 'obvious' that a loan is affordable, will also be provided. These initial proposals are intended to be in place by early June 2022, according to the report on initial findings into the early implementation of the CCCFA changes.

These changes are not the final word. A broader investigation into the early implementation of the CCCFA amendments by the Ministry of Business, Innovation and Employment and the Council of Financial Regulators is ongoing. Minister Clark advised that "any further changes to credit laws and the Responsible Lending Code will be considered as part of the remainder of the investigation which is due next month".

Tax bill that gives advantages to new builds soon to be law

The Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill is an omnibus bill containing various taxation amendments. It has passed its third reading in Parliament on 29 March 2022 and will come into force after receiving Royal Assent, which is expected to occur shortly.

Of note to the real estate sector is that this bill proposes to enact various amendments that disincentivise investment in residential properties (other than new builds) from a tax perspective. These may drive a demand among property investors for new builds, over older properties.

"New build land" is defined in the bill as meaning land that has a self-contained residence or abode with a code compliance certificate (**CCC**) issued for it on or after 27 March 2020. The bill contains other guidance as to what constitutes a new build. Other examples include homes with weathertightness issues which have been remediated on or after 27 March 2020. Remediated earthquake-prone residential buildings and conversions of motels or hotels into residential abodes after 27 March 2020 are also included.

The changes to be enacted by the bill include the following.

- **Shortening the bright-line test from 10 years to 5 years for new builds acquired on or after 27 March 2021.**

  Last year, Parliament passed a law that extended the bright-line test for properties acquired on or after 27 March 2021 from 5 years to 10 years. The bright-line test applies only to residential properties, and

obliges the owner to pay tax on any gains if the property is acquired and sold within the bright-line period (subject to certain exemptions, such as where the property is used as a main home).

Once the new bill is enacted, the position for all properties subject to the bright-line test will be as follows:

- if the property was acquired between 1 October 2015 and 28 March 2018, the property is subject to a two year bright-line test;
- if the property was acquired between 29 March 2018 and 26 March 2021, the property is subject to a five year bright-line test;
- if the property was acquired on or after 27 March 2021, the property is subject to a ten year bright-line test, unless the property is a new build, in which case it will be subject to a five year bright-line test.

To qualify for the 5 year bright-line test available to new builds, a person must acquire the new build within 12 months after the CCC for it has issued, and when the person disposes of the property, the property must continue to meet the definition of "new build land" (unless at the time the property was destroyed by natural disaster or fire).

- **The ability for investors to deduct and offset interest (incurred on or after 1 October 2021) as an expense against residential rental income will be removed.** The intent of this is to reduce investor pressure on house prices and make it less desirable to own residential rental property. However, the bill makes an exemption for new builds in this respect.

  The removal of interest deductibility applies to residential properties acquired on or after 27 March 2021 unless, as noted above, the property is a new build.

  For properties (except new builds) acquired before 27 March 2021, they will be subject to a gradual phased approach where the percentage of interest that can be offset against the rental income is slowly reduced per year, to the effect that by 1 April 2025, 100% of the interest deductibility for these properties will be lost.

  A new build is generally only exempt for 20 years after the earlier of:

  (a) the date that the CCC for it has issued;
  (b) for remediated earthquake-prone residential buildings or residences converted from motels or hotels, the date on which the remediation or conversion of the property is noted as "completed" in the relevant territorial authority's register; or
  (c) for a CCC issued subject to a building consent waiver under the Building Act 2004, the date on which the building work is noted as "substantially completed" in the relevant territorial authority's register.

OTHER NEWS

✱ REAL ESTATE

Commerce Commission reviews retail grocery sector: ban on restrictive covenants ahead?

The Commerce Commission published its final report on New Zealand's retail grocery sector on 8 March 2022. The study took 17 months and investigated whether competition in the grocery sector is working well and, if not, what can be done to improve it.

The report found that competition in the sector is not working well for consumers. It found that there is a market duopoly with two major players dominating the retail grocery sector. Rivals attempting to enter or

expand into the sector face significant challenges because, amongst other things, there is a lack of suitable sites for development of retail grocery stores.

The Commission placed particular emphasis on two contributing factors for the lack of suitable sites for development of retail grocery stores:

- the effect of current planning laws; and

- the practice by major grocery retailers to lodge restrictive land covenants and place exclusivity covenants in leases to prevent competitors from opening stores in proximate premises. Restrictive land covenants typically prohibit or restrict the development of rival supermarket and/or other retail stores (e.g., butcheries, bakeries, fruit and vegetable stores) on nearby premises, whereas exclusivity covenants in leases typically prohibit the landlord from allowing nearby land (commonly shopping centres) to be used for certain uses.

The Commission identified more than 90 land covenants entered into by the major grocery retailers, of which at least 60 were not time-limited or had a term of more than 20 years. It also identified more than 100 instances of exclusivity covenants being used in leases – the majority of which were still active, with more than 90 instances having a term of more than 20 years (taking into account rights of renewal).

The Commission's view was that these covenants are likely to be a significant factor preventing or slowing entry and expansion into the sector by rivals, particularly when used in areas that already have a shortage of land appropriate for retail grocery use. The Commission also noted that these arrangements have the potential to breach sections 27 and 28 of the Commerce Act 1986, which prohibit covenants, contracts, arrangements or understandings that substantially lessen competition in the market.

Overall, the Commission considered the claimed benefits for many of the restrictive land covenants and exclusivity lease covenants are unlikely to outweigh the competitive harm flowing from the restrictions they place on site availability and the subsequent impact on entry and expansion by other competitors.

In its executive summary, the Commission made the following recommendations to improve the site availability issue:

- prohibit the use of restrictive land covenants and exclusivity lease covenants that limit development of retail grocery stores;
- implement a range of possible amendments to planning laws to ensure sufficient land is available for supermarkets to be built, in order to increase certainty for those seeking to develop new retail grocery stores, and limit the grounds on which new developments can be declined;
- monitor land banking by the major grocery retailers, noting that a prohibition on the use of restrictive land covenants could lead to an increase of land banking by industry participants instead; and
- consider the impact of overseas investment rules and alcohol licensing laws on competition in the retail grocery sector the next time the relevant legislation is reviewed.

Following publication of the report, Minister of Commerce and Consumer Affairs, David Clark released a statement noting that the government will "immediately progress work to address the Commission's recommendations. The Commission's findings indicate that restrictive covenants over land are a major barrier to supermarkets accessing new sites, so I want to ban these covenants being used to stop competition."

This area will be monitored with interest as the government works to implement the Commission's recommendations. In the meantime we expect the use of restrictive land covenants and exclusivity lease covenants to continue.

■ PROJECTS

Environment Roadmap for action by the construction sector

In one of its latest features, BRANZ focused on the challenges that the construction industry faces in making meaningful contributions to New Zealand's 2050 climate change targets. BRANZ noted that the Construction Sector Environment Roadmap (the **Roadmap**), created by the Environment workstream of the Construction Sector Accord, is seen as an important step that the Accord could take to identify what actions need to happen to begin the steps towards the climate and environmental goals that New Zealand has signed up to. The targets are significant – the government has committed to reaching a net-zero carbon economy by 2050, amongst other sustainability and environmental targets.

The roadmap identifies four priorities:

- **Changing mindsets** by improving awareness of what is needed and committing the sector at all levels to reducing emissions and better protecting the environment.
- **Scaling up** the good work already being done by some so that all work across the whole industry is on the right track.
- **Demonstrating impact** by measuring the progress the sector is making to the country's climate and environmental goals.
- **Incentivising and aligning** to ensure environmentally sustainable building practices become what people do every day.

In practical terms, this could involve building companies sharing examples of good practices in their circles, and bringing emissions into early discussions when it comes to buying new equipment and building materials.

Other practical steps include encouraging the use of certification schemes and environmental rating tools – for example, Homestar has continued for over a decade now and is in its fifth version. Supporting schemes that promote recycling, reuse and waste minimisation also go a long way towards contributing to sustainable outcomes.

Due to the size and scale of the construction sector in New Zealand, it has the potential to make incredibly meaningful contributions to the government's climate change and environmental goals. However, it will not be a smooth or easy journey. As the Environment Workstream Lead noted in her foreword to the Roadmap, the sector cannot truly contribute to the targets "through tweaks or minor changes to how we operate today. The size and scale of what is being asked of us is huge. It will take determination, steadfast commitment and courage to achieve the level of change required. The first step in any radical change is the creation of a movement and the joining of forces. We need to come together to light that spark – each and every one of us has a part to play". In this respect, the Roadmap is simply a starting point and success will depend on people at every level of the building sector playing a part.

Construction cost rising at fastest rate since Global Financial Crisis

The latest January 2022 *Infrastructure Quarterly* report by the New Zealand Infrastructure Commission, Te Waihanga, found that residential and non-residential construction costs rose by more than 10% last year, and similar increases are forecast for the upcoming year. Construction costs are rising at their fastest rate since the Global Financial Crisis.

The sharp jump reflects rising demand colliding with constrained supply. Infrastructure providers, property developers, and households are trying to build more, but shortages of construction labour, material supply chain bottlenecks, and COVID-19-induced slowdowns have caused notable disruptions.

While other countries are facing similar issues, the report found that New Zealand had the tenth highest construction price inflation in the OECD during this time. But this is not simply a COVID-19-era phenomenon. Over the last five years, New Zealand had the seventh highest construction price inflation in the OECD. The country's residential construction cost inflation averaged 5.2% per annum from 2016 to 2021.

COVID-19 revealed the problems in the sector, but it is not the only cause. Even before the pandemic, New Zealand struggled to scale up to build and relied heavily on international workforce. These "pre-existing conditions" have made New Zealand's construction sector particularly vulnerable to COVID-19.

As the government changed its immigration policy and closed its borders in response to the pandemic, it locked out international workforce that is critical to a sector with an already tight labour market. This worsened the issue, fuelling cost pressure. Supply chain disruptions and cost increases in materials of course exacerbated the situation.

Te Waihanga is considering these matters as it develops a New Zealand Infrastructure Strategy. In its draft strategy it included recommendations that will help address cost inflation, such as ensuring a stronger focus is placed on planning for the construction workforce.

Click here for the full news release by Te Waihanga.

Timber Design Centre launched as government-funded initiative

AsiaPacific Infrastructure News reported on the launch of the Timber Design Centre – a government-funded initiative that aims to increase the use of timber, particularly in structures such as offices, hotels and multi-storey apartments.

The centre is an initiative between Te Uru Rākau – New Zealand Forest Service and a consortium comprising Scion (Crown Research Institute), the Wood Processors and Manufacturers Association (**WPMA**), New Zealand Timber Design Society and BRANZ.

The article noted that the consortium explained the greater use of timber in construction would provide an opportunity for the sector to support the government's commitment to be carbon-neutral by 2050, whilst realising the broader economic and wellbeing benefits of including wood products in multi-storied buildings.

WPMA chief executive Stephen Macaulay said that technological advancements in wood manufacturing provide an opportunity to accelerate the use of engineered mass timber products in medium to high rise buildings across New Zealand.

The government is funding the Timber Design Centre as part of its Fit for a Better World roadmap, one of several key initiatives underway this year to help transform the forest and wood processing sector.

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, please contact us here, we would be happy to assist.

BELL GULLY PROJECTS AND REAL ESTATE TEAM

Karl Anderson
PARTNER
DDI +64 9 916 8845 MOB +64 21 661 726
karl.anderson@bellgully.com

Andrew Beatson
PARTNER
DDI +64 4 915 6770 MOB +64 21 223 9170
andrew.beatson@bellgully.com

Ian Becke
PARTNER
DDI +64 9 916 8795 MOB +64 21 804 096
ian.becke@bellgully.com

David Chisnall
PARTNER
DDI +64 4 915 6966 MOB +64 27 594 8505
david.chisnall@bellgully.com

Toni Forrest
PARTNER
DDI +64 4 915 6524 MOB +64 27 5055 910
toni.forrest@bellgully.com

Natasha Garvan
PARTNER
DDI +64 9 916 8956 MOB +64 27 420 0561
natasha.garvan@bellgully.com

Jane Holland
PARTNER
DDI +64 9 916 8983 MOB +64 21 706 129
jane.holland@bellgully.com

Andrew Petersen
PARTNER
DDI +64 9 916 8622 MOB +64 21 684 533
andrew.petersen@bellgully.com

AUCKLAND VERO CENTRE, 48 SHORTLAND STREET
PO BOX 4199, AUCKLAND 1140, NEW ZEALAND, DX CP20509
TEL 64 9 916 8800 FAX 64 9 916 8801

WELLINGTON 171 FEATHERSTON STREET
PO BOX 1291, WELLINGTON 6140, NEW ZEALAND, DX SX11164
TEL 64 4 915 6800 FAX 64 4 915 6810

BELL GULLY