HOW TO DEAL WITH BUILDING DEFECTS

Proposals prepared by the Construction Defects Alliance and the Apartment Owners' Network

April 2020

1.0 Urgent Challenge

The recent General Election campaign saw all of the State's political parties make important and welcome commitments – in response to ongoing campaigns by the Construction Defects Alliance and the Apartment Owners' Network – to tackle the issue of latent defects in our Celtic Tiger era housing stock, especially apartments.

The importance of taking such action has been reinforced by a recent article by Eamon O'Boyle – fire engineer and one of the expert witnesses on the defects issue before the Oireachtas Housing Committee back in 2017 – in the *Engineer's Journal* (bit.ly/2Q9mCix). In the article Mr O'Boyle says: *"Fire safety of apartments is one of the many 'legacy issues' faced by Government and it cannot be long-fingered until there is a tragedy."*

Eamon O'Boyle also states in his piece in the *Engineer's Journal* that:

"It is essential that high-risk buildings be identified, and the initial focus should be on buildings where people sleep overnight. These include apartments, hotels, hospitals, dormitories and student accommodation blocks."

In terms of the metrics of the problem in Ireland, Eamon O'Boyle's assessment in the *Engineer's Journal* largely mirrors that of the Construction Defects Alliance – he estimates that 75% of Celtic Tiger era apartments are affected by fire defects – which would mean, based on CSO statistics, that almost 100,000 apartments have legacy defects.

It's important to note that the UK Government is now taking active steps to tackle fire safety issues in its multi-unit developments. In their recent Budget, a £1 billion Building

Safety Fund has been created to tackle fire defects. So the need for action on this issue has been recognised by our near neighbours.

In order to assist those involved in negotiating a new Programme for Government to prepare proposals for Government action on the issue of building defects – which would build on the commitments made by all parties during the recent election – the Construction Defects Alliance and the Apartment Owners' Network have prepared this paper. It's divided into two parts – the first, setting out how legacy defects (mainly from the Celtic Tiger era) can be tackled and the second, focuses on protecting homeowners into the future.

2.0 Tackling Legacy Defects

In order to tackle the major problem of legacy latent defects a number of steps need to be taken including:

- Establishment of a remediation scheme – as proposed by the Oireachtas Housing Committee's *Safe As Houses?* report – to be administered by a Latent Defects Remediation Board (LDRB) with the support of a State body such as the Housing Agency (in the same way the Pyrite Resolution Board is).
- Creation of an information, advice and mediation service for OMCs and owners of defective homes (to mediate between OMCs/owners and builders/developers) via the LDRB, mirroring the Pyrite Resolution Board process.
- Undertaking of a systematic assessment by OMCs – in conjunction with the LDRB and the appropriate State body – of pre-2014 multi-unit developments in relation to compliance with the Building Regulations to determine the extent of the defects problem and to put in place a remediation process to rectify the defects concerned.
- Remediation process to be funded by the State and the construction industry as proposed in the *Safe As Houses?* report. There is a clear precedent for such a proposal as those affected by pyrite and mica are having their remediation works funded by the State. In addition, apartment owners are equally innocent parties in terms of the creation of the defects affecting their homes so in justice and equity should not have to pay for remediation works.
- However, it is clear that some of the larger parties in the Oireachtas have concerns about the likely costs of such a remediation scheme, so an alternative – which would be clearly lacking in equity and fairness – would be paying for the remediation works through interest-free 20-year loans to OMCs which will be repaid by the OMC members through levies and against which they can claim a refundable tax credit for their levy payments or get an equivalent financial benefit if they are not in the tax net or on the lower tax rate.

Below we set out in more detail what would be involved in the different elements of this aspect of our proposals.

2.1 Latent Defects Remediation Board

The Oireachtas should legislate for the establishment of a Latent Defects Remediation Board. The LDRB's functions would be to:

- Provide an information and advice service – supported in the same fashion as the Pyrite Resolution Board – for those homeowners affected by non-compliance with the Building Regulations and regulatory failure resulting in latent defects.
- Facilitate mediation between disputing parties in relation to latent defects.
- Administer – with support – the process through which homes affected by latent defects are remediated (see 1.2 below).

Like the Pyrite Resolution Board, the LDRB would consist of an expert, independent Board with staff seconded from the Department of Housing. The administrative aspects of the LDRB's work would be carried out in the same way as the Pyrite Resolution Board, as well as its information and advice provision functions and the facilitation of mediation.

2.2 Assessing Defects and Costs of Remediation

The proposed process for assessing the extent of building defects and the cost of remediating them should mirror closely the operations of the Pyrite Resolution Board as follows:

- OMCs to have dwellings under their management assessed and tested by competent professionals (registered architect, engineer or building surveyor) to determine if there are significant building defects.
- As with the Pyrite Remediation Scheme, a standard should be prepared to define the testing methodology and criteria for assigning a grading system to affected buildings, by reference to the extent of the remedial works required / severity of non-compliance with Building Regulations and/or building defects.
- If significant defects are determined, then the competent professional completes an online application process including a Building/Complex Condition Assessment, in accordance with the standard.
- The LDRB would then validate the application by reference to the criteria identified in the standard and would have an entitlement to inspect / audit buildings for this purpose.
- If LDRB think the application is valid – based on an audit of the Building/Complex Condition Assessment – they refer it to a State assessor body, such as the Housing Agency, for the assessment, verification and recommendation process (this can be appealed).
- The LDRB will then confirm the categorisation/grading of the building and notify the applicants. A further standard should be created, again in the same manner as was done for the Pyrite Remediation scheme, to determine the methodology and specifications for remedial works and to confirm what form of certification will be provided upon completion of remedial works.
- If the apartment complex or housing development is included in the scheme, the assessor will appoint a competent professional to prepare a Remediation Works Plan and specification for the remediation of the apartment complex or housing

development which will be put out to tender to a panel of contractors and the assessor will recommend a contractor to the LDRB.
- The LDRB will issue approval to the OMC to proceed with the remediation works.
- The Remediation Works Plan goes out for tender from the OMC to a panel of qualified contractors recommended by the LDRB. Once the tenders have been received the contract will be awarded by the OMC.
- The building or scheme will then be remediated by the contractor under supervision of the competent professional appointed by the State assessor.
- Financing of the construction works will either be through an industry/Exchequer fund or through loans to OMCs (more information on both routes at 2.3 below).
- Defects arising from the remediation works – arising within the retention period – will be repaired. The application for remediation will be closed by the LDRB once the retention period has ended.

2.3 Funding Remediation Works

In addressing the matter of the funding of such remediation works, it's a crucial matter of principle that home owners are not left to carry the financial burden for defects for which they had absolutely no responsibility. In this context, there are two possible routes forward based on the recommendations of the *Safe As Houses?* report:

- Creation of a remediation fund which is financed by a levy on the construction industry with matching Exchequer funding. The fund would be administered by the LDRB and the monies used to pay for remediation works carried out by OMCs with the approval of the LDRB. As mentioned before, this process would largely mirror how the pyrite remediation process works and would be the appropriate route to follow in equity and justice – given that the owners purchased in good faith and should not be liable for the costs of remediation caused by the incompetence, negligence or deliberate non-compliance of others.
- The second route – which would be much less equitable or just – would involve the provision of interest-free 20-year loans – as owners are already paying interest on the mortgages they took out to buy their defective properties – provided by the State (via the Housing Finance Agency or through the financial institutions backed by a State guarantee) to OMCs to help them cashflow the remediation of fire and other defects.

If the loans route is pursued, it is vital that in order to ensure that home owners are not left financially responsible for the full cost of defects, that their levy payments to the OMC – or if they have already paid for the defects via an OMC levy – should be reclaimed against their tax via a non-refundable tax credit or some other form of financial benefit to ensure that those outside the tax net or those on the lower tax rate get the same benefit as those on the higher tax rate.

From the State's perspective, the spreading of the tax credits over the 20-year term of the interest-free loans also has the effect of reducing/smoothing the impact on the Exchequer of the remediation works over that 20-year period.

In relation to the tax treatment of the levy payments by home-owners, in summary, it would work as follows:

- The OMC owns the common areas where there are defects.
- OMC, as the formal collective of the owners and the party contracting with the builder, incurs VAT inclusive costs of defects remediation.
- The owners indirectly incur the expenditure, through the OMC.
- OMC not a VATable person, meaning it may not claim back VAT.
- OMC has no Corporation Tax liability against which to claim relief.
- Under this proposal OMC members may claim relief as a tax credit against Income Tax or Corporation Tax.
- Relief is for the levy paid to the OMC, separately identifiable from annual management charges (service charge plus sinking fund contribution).
- The OMC certifies the levy, i.e. amount of defect expenditure attributable to and paid by each member. The Revenue Commissioners would prescribe the manner of the certification to be provided by the OMC
- The member claims tax relief, by way of non-refundable tax credit, for the amount certified in a given year.
- A key part of the scheme would be that the State would have to ensure equivalence between home owners in tax treatment – so that owners who are not in the tax net or are on the lower tax rate, would receive an equivalent financial benefit by way of deduction from the amount that they will be paying towards the repair levy.

For those who have already paid their OMC levies or are in an existing payment plan, they can claim for the levies they have paid against their tax over an agreed period of time (five years for example). In support of the claim, the OMC would certify these works.

(More detailed paper on the proposed Tax Relief Scheme for Costs of Defects Remediation is included at Appendix 1)

3.0 Protecting Home Owners into the Future

In addition to tackling legacy defects, it's vital to ensure that the failures that have led to almost 100,000 apartment owners being abandoned to pay for defects that they didn't cause don't happen again. In this context, we are proposing that the following measures be included in the next Programme for Government:

- Adequate funding and powers for the National Building Control Office and local authorities so that all new multi-unit developments can be independently (independent of the builder/developer) inspected for compliance with the Building Regulations during the construction process.
- Investment in local authority building control to improve enforcement, including greater use of the provisions of the Building Control Acts providing for personal liability for serious breaches of the Building Regulations of managers, directors of the companies or partners in the partnerships responsible for the breaches concerned.

- Amendment to the Statute of Limitations to introduce an additional limitation period of two years from discovery of a defect for bringing of proceedings.
- Law reform, including enforceable legal duties from developers/builders to first and subsequent purchasers, as well as minimum mandatory terms to ensure a fair balance between the rights of the developer/builder and those of the purchaser.
- Introduction of a system of licensing and bonding for developers – similar to that which applies in the travel industry – to be operated by a State body such as the Housing Agency. In the event of defects being identified in future, the bonds can be used to pay for future remediation works OR Introduction of Latent Defects Insurance – to be paid for by builder/developers – to be made mandatory for all new homes in the way that car insurance is for owners of motor vehicles.
- Amending Section 35 of the 2000 Planning Act so that planning authorities can take into account failures to comply with building control requirements in deciding whether to grant planning permission to applicants.
- A bar on the awarding of publicly-funded construction projects to developers, builders and/or construction professionals found to be in serious breach of building standards or fire safety regulations.

Appendix 1

TAX RELIEF FOR COST OF DEFECTS REMEDIATION

1. Executive Summary

1.1. The OMC owns the common areas where there are defects.

1.2. OMC, as the formal collective of the owners and the party contracting with the builder, incurs VAT inclusive costs of defects remediation.

1.3. The owners indirectly incur the expenditure, through the OMC.

1.4. OMC not a VATable person, meaning it may not claim back VAT.

1.5. OMC has no Corporation Tax liability against which to claim relief.

1.6. Under this proposal OMC members may claim relief as a tax credit against Income Tax or Corporation Tax.

1.7. Relief is for the levy paid to the OMC, separately identifiable from annual management charges (service charge plus sinking fund contribution).

1.8. The OMC certifies the levy, i.e. amount of defect expenditure attributable to and paid by each member. The Revenue Commissioners would prescribe the manner of the certification to be provided by the OMC

1.9. The member claims tax relief, by way of non-refundable tax credit, for the amount certified in a given year.

2. Background Tax Analysis

2.1. The mechanics of the tax relief mirror the recent Home Renovation Incentive ("HRI") scheme under section 477B Taxes Consolidation Act 1997 ("TCA 1997"). The legislative amendments modify the HRI relief for expenditure on defects remediation. The modifications assume the enactment of separate legislation giving effect to a scheme of interest-free loans to OMCs to fund remediation, working title "Latent Defects Remediation (Owners' Management Companies Credit) Act 202X". The, Latent Defects Remediation Board legislation would define "defects" and other construction technical matters, mirroring the Pyrite Resolution Act 2013.

2.2. Tax relief, in the form of a tax credit, is afforded to OMC members in respect of qualifying defects remediation expenditure incurred by OMCs on the owners' behalf.

2.3. OMCs are the collective vehicle hiring and paying the contractor. OMCs incur the expenditure on the defective common areas, considered to be "qualifying premises" under the legislation.

2.4. The OMC cannot claim back VAT, because it is not, in VAT terms, in the "course or furtherance of a business". Similarly, an OMC is not subject to Corporation Tax on surpluses because it is a not-for-profit, non-trading company.

2.5. In the normal course of events in order to qualify for tax relief, an owner (occupier or landlord) would be required to pay the contractor directly. However, this fails to take account of the shared nature and costs associated with common areas, and the funding vehicle for the remediation.

2.6. Because the OMC, rather than the members (owners), is directly incurring the expenditure and paying the contractor a mechanism is required to allow the owners to access the tax relief.

2.7. The structuring of the relief allows OMC members a tax credit in respect of expenditure incurred by an OMC on their behalf, and which in all other respects meets the conditions of the scheme. The mechanism is much like the old method of claiming tax relief under section 477 TCA 1997, now inoperative, for refuse charges, as a component of management fees paid to the OMC.

2.8. Relief is available for defects remediation only, as defined by the Latent Defects Remediation Board or in the Latent Defects Remediation (Owners' Management Companies Credit) Act 202X. Relief is not available for repairs or maintenance associated with normal wear and tear paid for from annual service charges under section 18 of the Multi-Unit Developments Act ("MUD Act"), or for sinking fund expenditure under section 19 of the MUD Act.

3. Changes to Legislation and Tax Technical Issues/Barriers Arising

3.1. Legislative amendments are required to adapt the HRI relief for expenditure incurred by OMCs, such that OMC members may receive tax relief. The amendments confine the relief to defects remediation costs only. Below are proposed amendments below to the relevant section of TCA 1997 ("Principal Act").

3.2. The HRI relief is amended so that a tax credit is available in respect of all of the defect remediation expenditure paid by the owner, rather than just the VAT element. There is no upper limit on the qualifying expenditure paid by/attributable to an owner.

3.3. There is no de minimis or floor to expenditure, as was the case with HRI which had a €5,000 floor.

3.4. The relief will need to reflect that it applies to expenditure certified (as opposed to incurred) by OMCs in current/future tax years. If this is not done, levies for remediation paid/incurred in the past will not qualify. This technical change is not addressed below.

3.5. The relief will need ensure that an unused proportion of a tax credit is available for carry forward into subsequent years of assessment, to exhaustion. This technical change is not addressed below.

3.6. There may be an objection to the principle of taxpayers having a nil tax liability in a year as a result of the relief, where for example the full levy is paid upfront. This could be addressed by placing a ceiling on the amount of the credit allowed in any one tax year of assessment, while providing for excess carry forward to exhaustion. The period of carry forward could match the term of the OMC credit under the Latent

Defects Remediation (Owners' Management Companies Credit) Act 202X. In any event, a tax credit may not generate a refund in excess of tax paid.

3.7. The sunset clause of the HRI will need to be amended so that the relief is reinitiated for current/future tax years. This technical change is not addressed below. It is intended that the relief should not remain on the statute book indefinitely. A sunset clause, perhaps to mirror the term of credit under, or the period for which is in force, the Latent Defects Remediation (Owners' Management Companies Credit) Act 202X, may be appropriate.

3.8. Provision is made for the Revenue Commissioners to make regulations for the manner in which the OMC provides to the owner evidence (certification) of the levy paid, in order for the owner to claim the tax relief.

3.9. Rather than introduce the relief by way of amendments to an inoperative section of legislation, it may be cleaner and simpler to draft a new section. The inoperative HRI section will still deliver a very effective starting position for the provisions of a new section.

3.10. As OMCs are bodies corporate, albeit not-for-profit, State Aid issues may require consideration. Such concerns are addressed in the Apartment Owners' Network HBFI memo of 26 March 2019, contained in the Network's Pre-Budget Submission of 9 July 2019- https://apartmentownersnetwork.files.wordpress.com/2019/07/aon-dof-pre-budget-2020-090719.pdf.

Adaptation of section 477B of Principal Act (Home renovation incentive)

Section 477B of the Principal Act is amended—

(a) in subsection (1) by inserting the following before the definition of "contractor":

"'owners' management company annual charges' means the expenditure described in subsection 2 of section 21 of the Multi-Unit Developments Act 2011;",

(b) in subsection (1) by inserting the following after the definition of "housing authority":

"'individual' includes an owners' management company of which the individual is a member;

'levy' means qualifying expenditure or an amount of the owners' management company annual charges in respect of qualifying expenditure;

'member' means member of an owners' management company;

‘multi-unit development’ has the same meaning as it has in subsection 1 of section 1 of the Multi-Unit Developments Act 2011;

‘owners’ management company’ has the same meaning as it has in subsection 1 of section 1 of the Multi-Unit Developments Act 2011;

‘payment’ or ‘payments’ in respect of qualifying expenditure by an individual shall include a payment or payments of qualifying expenditure made by an owners’ management company of which the individual is a member;”,

(c) in subsection (1) by inserting the following subparagraph after subparagraph (b) in the definition of “residential premises”:

“(c) the common areas of a multi-unit development within the meaning of subsection 1 of section 1 of the Multi-Unit Developments Act 2011;”,

(d) in subsection (1) by deleting “, renovation or improvement” after “repair” from the definition of “qualifying work”;

(e) in subsection (1) by inserting the following after the definition of “qualifying work”:

“ ‘repair’ means repair within the meaning of the Latent Defects Remediation (Owners’ Management Companies Credit) Act 202X”

(f) in subsection (1) by inserting the following after the definition of “residential premises”:

“ ‘residential unit’ has the same meaning as it has in subsection 1 of section 1 of the Multi-Unit Developments Act 2011;”,

(g) in subsection (1) by deleting from the definition of “specified amount”:
(i) “13.5 per cent of” after “means”, and
(ii) the words after “charged”;

(h) in subsection (1) by inserting the following after the definition of “unique reference number”:

“ ‘unit’ means residential unit;”,

(i) in subsection (3) by deleting paragraph (c)

(j) in subsection (3) by deleting paragraph (d);

(k) by inserting the following after subsection (3):

“(3A) For the purposes of this section, an owners’ management company shall certify-

(a) the levy incurred in relation to qualifying expenditure, and
(b) the proportion of the amount in paragraph (a) attributable to a unit."

(l) in subsection (4) by inserting the following after "claimant," in subparagraph (iv) of paragraph (a):
"or the owners' management company of which he is a member,",

(m) in subsection (14)—

(i) by deleting "and" in subparagraph (iii) of paragraph (a), and

(ii) by inserting the following subparagraph after subparagraph (iii) of paragraph (a):

"(iiia) specify the manner in which an owners' management company shall undertake the certifications required under subsection (3A), and".