

LOCAL GOVERNMENT FORUM

1. OVERVIEW

- 1.1. This submission is made by the Local Government Forum (the Forum). The Forum is grateful for the opportunity to make a submission on the New Zealand Productivity Commission's draft report on its inquiry into the affordability of housing. (The New Zealand Productivity Commission is referred to below as the Commission.)
- 1.2. The Forum comprises organisations that have a vital interest in the activities of local government. Its members include Business New Zealand, Electricity Networks Association, Federated Farmers of New Zealand, New Zealand Business Roundtable, New Zealand Chambers of Commerce and New Zealand Retailers' Association.
- 1.3. The Forum was established in 1994 to promote greater efficiency in local government and to contribute to debate on policy issues affecting the sector. The Forum's perspective is to advance community welfare through the advocacy of sound public policy.
- 1.4. Local government has a significant influence on the cost of housing. The Forum has taken a close interest in issues that come within the mandate of the Commission's inquiry. It has participated in policy processes relating to the role, governance and funding of local government. The Forum made a submission to the Select Committee on the Affordable Housing Bill in 2008. The Forum and the Property Council of New Zealand published a report on development and financial contributions (*Taxing Growth and Development: A Critical Review of the Role of Development and Financial Contributions*) in 2010, which the Commission drew on in its draft report.
- 1.5. The Chairman of the Commission met with the Forum in August 2011. The Forum wrote to the Commission in advance of that meeting, outlining its interest in the inquiry and attaching some background documents.

1.6. The main thrust of the Commission's draft report is summarised below:

- The Commission concluded that the tax system was not a major driver of the 2001-2007 house price boom. It does not recommend any changes to the tax treatment of housing, explicitly rejecting the suggestion that a capital gains tax be applied to housing alone.
- The Commission identified an urgent need to increase land availability to create opportunities for the construction "at scale" of affordable new homes in rapidly growing cities.
- The Commission considers that there is scope to improve productivity in the construction sector. It endorsed certain work that is underway but makes no substantive recommendations on how productivity might be improved.
- The Commission identified a number of ways in which the infrastructure charging regime (development and financial contributions) could be made more efficient, equitable, transparent and not unduly penalise new development.
- The Commission made some recommendations aimed at improving the processing of resource consents.

1.7. The Forum welcomes the Commission's report and endorses the thrust of its findings and recommendations. In particular, it agrees that unwarranted restrictions on the supply of land for residential housing are the main factor that unduly raises the cost of housing.

1.8. This submission highlights some ways in which certain of the Commission's recommendations might be more effectively implemented and identifies some areas where further analysis by the Commission would enhance its report.

1.9. The Forum's key comments and suggestions are summarised below:

- The Forum believes that the Commission's findings on taxation issues are generally sound. The Forum suggests that the reinstatement of depreciation deductions on long-lived buildings be included in recommendation R6.1.¹

¹ The letters F, Q and R indicate the Commission's findings, questions and recommendations respectively. They are numbered by the relevant chapter number and then sequentially. Thus R6.1 is the first recommendation in chapter 6 of the Commission's report.

- The Forum endorses the Commission's conclusion that unwarranted constraints on the supply of land for housing development should be relaxed to reduce the cost of housing. However, the Forum thinks that the Commission's recommendations on urban planning should have greater regard to existing institutional arrangements. In particular, the Resource Management Act 1991 (the RMA) would need to be amended, a national policy statement would need to be made under the RMA or the incentives facing local authorities would need to be changed if the Commission's recommended strategy, to relax constraints on the supply of land in the short-term, is to be implemented effectively.
- The Forum submits that the RMA needs to be thoroughly reviewed to reduce the cost of housing enduringly. A key problem with the RMA is that it overrides private property rights in circumstances where a valid public policy reason to do so does not exist. Upholding the right to put land to an alternative use (subject to some well-defined but limited restrictions) would increase the supply of land available for housing. The Commission's recommendations do not put enough emphasis on the importance in a system of voluntary exchange of well-defined private property rights, including in the right to determine the use to which land is put. (See, for example the Business New Zealand, Federated Farmers, New Zealand Business Roundtable and New Zealand Chambers of Commerce 2008 publication, *A Primer on Property Rights, Takings and Compensation*).
- The Commission's report should state that the power to take land compulsorily should not generally apply to land for housing purposes. This would avoid any doubt on whether the Commission envisages the compulsory acquisition of land by local authorities or private developers to aggregate land for large-scale brownfield or greenfield development.
- The Forum broadly endorses with the Commission's recommendations on infrastructure charges. It submits that prices rather than development contributions should be charged for goods and services where they are feasible and appropriate (for example, for water supply). The Forum supports the proposal to allow legal challenges to development contributions through a 'merits-based test'.

- While the Commission's recommendations on the regulation of building are generally supported, their scope and importance is limited. The question of whether the benefits of extensive regulation of building outweigh related costs is vital to the inquiry and warrants further examination.
 - A more searching examination of the obstacles to higher productivity in the building industry and of the efficacy of government housing assistance would enhance the Commission's report.
 - There are several places in the report where suggested policies are stated or implied but not subject to any analysis or evaluation. While such policies are not generally reflected in the Commission's findings or recommendations, they leave the impression that there is a valid case for government action without consideration of relevant factors, including related costs.
- 1.10. The balance of this submission focuses on those chapters of the Commission's report that contain findings or recommendations, or both, on which the Forum wishes to comment. For convenience, the Forum's comments are listed under the same chapter headings as those used by the Commission and they are presented in the order in which they appear in the Commission's report. All references to the Commission's draft report are to its full report.
- 1.11. Taxation is addressed in the next section (section 2), urban planning and housing affordability in section 3, charging for infrastructure in section 4, building regulation and housing affordability in section 5, the performance of the building industry in section 6 and where housing affordability bites (housing assistance) in section 7. The Forum's conclusions are presented in section 8.
- 1.12. The Forum notes that its members may make separate submissions. In its separate submission, Federated Farmers of New Zealand recommends a different view from that of other members of the Forum on the supply of land for urban development and charging for infrastructure.

2. TAXATION

The Commission's View

- 2.1. The Commission examined whether the treatment of owner-occupied and rental houses for tax purposes was responsible for the rapid rise in house prices between 2001 and 2007. It found that taxation issues were not a principal cause of the surge in house prices. The Commission also found that housing is less tax-advantaged than is often suggested. It concluded that changes to the offsetting of losses on residential rental investments against other taxable income are not warranted.
- 2.2. The Commission wrote that the deductibility and taxability of the inflation component of interest expense and interest income respectively constitute a tax distortion. It reported that this "general flaw" in the income tax system would be best addressed on a general basis rather than specifically in the context of housing.
- 2.3. Similarly, the Commission concluded that a decision on whether to apply a capital gains tax to housing should be based on a coherent set of principles that have general tax application. The Commission observed that taxation should be approached in a principled way across the economy.
- 2.4. The Commission's sole recommendation on taxation issues calls on the government to monitor the impact of the removal of a deduction for depreciation on commercial properties, including rental properties, for evidence that expenditures relevant to the proper upkeep and safety of buildings are being sustained (R6.1).

The Forum's Comment

- 2.5. *The Forum submits that the Commission's analysis and findings on taxation issues are generally sound.* The Forum does not agree that the inflation component of interest expense and interest income should be omitted in computing income tax. However, it does agree with the Commission that this issue, and any proposal to apply a capital gains tax to housing, would need to be addressed on a general basis. The Forum notes here that the best solution to the problems caused by inflation is to stop inflation. Inflation is a monetary phenomenon and the presence or absence of a capital gains tax is not a cause of inflation. Section 8 of the Reserve Bank Act 1989 specifies that "[t]he primary function of the Bank is to formulate and implement

monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices". Yet, in the December quarter 2011 the Consumers Price Index was 31 percent higher than in the December quarter 2001. The failure of monetary policy to achieve stability in the general level of prices in the last decade should be addressed at its source.

- 2.6. The removal of deductions for depreciation on rental housing and commercial buildings with a life of 50 years or more (by setting the allowable rate of depreciation at zero percent from 1 April 2011) was a doubtful tax policy. While land tends to appreciate in real terms over time, all structures have a limited life as a result of wear and tear, and obsolescence. The present rules that apply to long-lived residential and non-residential buildings are inconsistent with those that apply to most other depreciating assets and are arbitrary (for example, the 50 year rule). *The Forum suggests that the Commission recommend that depreciation deductions be reinstated in recommendation R6.1 rather than recommending that the effect of the existing policy be monitored for possible adverse effects.*

3. URBAN PLANNING AND HOUSING AFFORDABILITY

The Commission's View

- 3.1. The Commission's most important findings and recommendations relate to urban planning and housing affordability. The Commission reported that "urban planning" today requires consideration of a wide range of objectives, including environmental management and economic development goals. According to the Commission, planning practices are not able to adequately manage and balance these multiple objectives.
- 3.2. The Commission found that the prevailing approach to urban planning in New Zealand has a negative influence on housing affordability in its faster growing cities. Through their plans, councils may directly facilitate or impede residential development by regulating the amount of land they allow to be used for the construction of new housing. The widespread planning preference for increasing residential densities and limiting greenfield development to achieve higher densities places upward pressure on house prices.
- 3.3. The Commission recommended that the Auckland Council show in its final Auckland Plan (spatial plan) how it has considered and reconciled the objective of affordable

housing alongside its other priorities (R7.1). It recommended that significant tracts of greenfield and brownfield land be brought to the market in Auckland and that Auckland identifies and assembles land that could be quickly released. It also recommended that Auckland identify significant tracts of land with the potential for (say) 50 years' development, with at least 20 years' worth under preparation for development (R7.2). The Commission further recommended that the Auckland Council should look to collaborative models for the process of identifying, assembling and releasing large-scale tracts of land (R7.3).

3.4. The Commission recommended that territorial authorities should do the following:

- Take a less constrained approach to the identification, consenting, release and development of land for housing in the inner city, suburbs and city edge.
- Adopt a strategy that allows for both intensification within existing urban boundaries and orderly expansion beyond them.
- Develop strategies that promote adequate competition between developers for the right to develop land (R7.4).

3.5. The Commission observed that a longer-term response to the problem of freeing up land for residential housing should include a review of planning-related legislation but it did not make any firm recommendations on this point. It did, however, find as follows:

Current legislation does not appear to provide a framework either within or between the Resource Management Act and Local Government Act whereby councils (and other government agencies) might test the trade-offs among objectives and outcomes associated with the four well-beings to reach a position which clearly establishes defensible priorities.² The Acts both jointly and individually have purposes which may be difficult to fulfil without recourse to such frameworks (F7.3).

The Forum's Comment

3.6. *The Forum endorses the Commission's broad conclusion that unwarranted constraints on the supply of land for housing development should be relaxed to help*

² The 'four well-beings' are social, economic, environmental and cultural. Local authorities are required to promote them by the Local Government Act 2002.

reduce (and subsequently contain) the cost of housing. It does so for the following main reasons:

- The policies adopted by certain local authorities, especially in the larger cities and in relatively fast growing districts, have restricted the supply of land for housing (and commercial) purposes. If such restrictions are binding, they must increase the price of land. The difference between the prices of undeveloped land within urban areas that can be developed for housing and commercial purposes and of comparable land well beyond present urban boundaries indicates the impact of such restrictions.
- The overall well-being of residents is harmed when people are enticed to opt for higher density housing by constraints on the supply of land that push up house prices for no good reason. Single unit dwellings and other low-density housing may be priced beyond the reach of many people. The policy will lead people to choose smaller houses, houses with fewer amenities and houses in less attractive locations than otherwise. Land made unavailable for housing will also be put to an inferior use, further reducing community welfare. The sum of the market values of the favoured land and excluded land is likely to fall as neither category of land is being put to its best use. As a result, the community as a whole would be less able to afford to spend on other goods and services, such as health care, schooling or a cleaner environment. In addition, large, non-transparent wealth transfers will occur that would be difficult to justify on equity grounds. For example, land owners in the favoured areas could gain greatly at the expense of owners of excluded land and of those who do not own land. The latter group will include young people and people with low incomes and large families.
- The absurdity of the artificially high cost of approved land for housing is heightened by the fact that there is no shortage of land in New Zealand that is suitable for housing development. Settlements account for only 1 percent of New Zealand's total land area.³
- There are no valid public policy reasons why land that would have a higher social value in housing should not generally be able to be used for that purpose. If private property rights were upheld, property owners would, except

³ Ministry for the Environment (2010), *Land: Land Use, Environmental Snapshot*, Ministry for the Environment, Wellington.

in limited and well-defined circumstances, be entitled to develop their land for housing purposes. The general presumption in favour of liberty in the Legislation Advisory Committee Guidelines should apply. Governments should not interfere in private property rights without good reason and when they do so the issue of compensation needs to be addressed. The Commission proposes instead that development proposals should generally be tested against the four well-beings – environment, economic, social and cultural. This implicit presumption against liberty reflects a central planning approach to resource use. Indeed this proposition goes much further in that direction than the RMA, which focuses on environmental externalities, but creates major ones of its own by failing to pay compensation when objectors can gain benefits from impeding an owner's ability to put property to its highest valued use without being confronted with the costs to the community of that interference (see below).

- The Forum understands that it is often more expensive to provide additional infrastructure in established areas to cope with intensification than to provide such services on greenfield sites. The key problems with the provision of infrastructure have arisen where government agencies are responsible for services. They are rare where there is competition and private provision of the relevant services. The solution is not more detailed and extensive planning but greater private participation in the provision of services. Moreover, efficient pricing of infrastructure, where appropriate and feasible, offers a better solution to the problem of coordinating the supply of, and demand for, infrastructure.

3.7. *While the Forum endorses the thrust of the Commission's recommendations on urban planning, it does not believe that they would be as effective in their present form as they could or should be. The Forum thinks that the Commission's recommendations need to have greater regard to the institutional arrangements that apply for the reasons outlined below:*

- The Forum doubts whether the freeing up of land for development can be successfully implemented without changes to the RMA, the adoption of a national policy statement under the RMA or modification of the incentives facing local authorities:
 - The present policies affecting land development reflect the decisions of councils, usually made on the advice of officers, within existing statutory

frameworks (which the Commission's report correctly described as complex). Some local authorities have deliberately limited the supply of land available for development in order to achieve objectives, such as urban intensification, that are inconsistent with the promotion of affordable housing. Such councils are aware of the broad effect on house prices of their policies and are conscious of considerable community resistance to such policies. Without action by central government, the Commission's appeal to councils to free up land and adopt its recommended strategies may not be implemented, leaving the problem of affordable housing unresolved, particularly in those urban areas where it most needs to be addressed.

- Unwarranted restrictions on land development are a long-standing problem that has become more harmful over time. It needs to be addressed on an enduring basis. The Commission's recommendations, particularly with respect to Auckland, focus on a short-term response. Changes to the statutory framework are left for possible examination on some other occasion. The Forum believes that the statutory framework is the central problem that must be addressed. It determines the rules within which local authorities work.
- The Commission's recommendations are unlikely to result in timely corrective action, even if councils were persuaded to act by the Commission's report, because of the time required to amend district plans. The Auckland Council's Plan (spatial plan), for example, is required to set out a long-term (20-30 year) strategic direction for Auckland and its communities. The strategic direction will be implemented through the Auckland Council's unitary plan (district plan). The Council's proposed unitary plan or changes to its existing district plans would need to be notified. The weight given to proposed amendments and plans increases as they become closer to adoption.
- The Commission views the RMA and the Local Government Act 2002 (the LGA) as "planning" legislation. While that view is commonly expressed (especially by planners), the Forum believes that it misconstrues the nature of such legislation for the following reasons:

- The RMA was intended to signal a decisive break with prescriptive planning associated with the former Town and Country Planning Act 1977 and the adoption of a more enabling approach. The RMA is an environmental protection statute rather than a planning statute. It focuses on the adverse effects on the environment of an activity (externalities in economic terms). The RMA contains very few references to planning (aside from references to the Town and Country Planning Act which it repealed) and does not use the word plan or planning as a verb. This speaks volumes on the nature of the RMA. The change in focus signalled by the RMA has been strenuously resisted over the years.
- The LGA is primarily concerned with the role, structure, governance, management and funding of local government. It focuses on planning in relation to the activities of the local authority itself. Its regulatory functions are mainly conferred in separate legislation.
- It is unfortunate that the Commission has viewed the RMA and the LGA as planning statutes. This appears to lead to a greater emphasis on central planning of resource use by local government than otherwise. Private property rights, which are vital for prosperity and social harmony, are likely to be compromised under such an approach. Although it is not entirely clear, it seems that the Auckland Council would be responsible for undertaking the tasks noted in recommendation R7.2.⁴ The Commission also recommended the Auckland Council should look to collaborative models for the process of identifying, assembling and releasing large-scale tracts of land (R7.3). Instead the Auckland Council's main role should be to permit land to be developed (except where there are valid public policy reasons for restricting such development). The private sector should play the main role in identifying and assembling land for development. Competition among developers rather than collaborative agreements between developers and councils is vital to maintain the supply of land and minimise costs.
- Prices indicate scarcity. Thus rather than focusing on futile attempts to forecast the likely demand and supply of land (which is the current approach in

⁴ As noted above, recommendation R7.2 states that significant tracts of greenfield and brownfield land be brought to the market in Auckland and that Auckland identify and assemble land that could be quickly released and identify significant tracts of land with the potential for (say) 50 years' development.

some cities), councils should monitor the prices of land available for development and of comparable rural land to assess the extent to which land supply is constrained. This is simpler and more informative.

3.8. One theme in the Commission's report is that large-scale development of greenfield and brownfield sites should take place to ease supply constraints and to exploit economies of scale. The Commission is silent, however, on whether it envisages compulsory acquisition and aggregation of land for this purpose. Valid grounds for compulsory takings of land are limited. They do not include the taking of land from A to give it to B, even when the community might appear to be better off, for instance, by improving housing affordability. Bryce Wilkinson suggested that the government's powers to take land under the power of eminent domain should be limited to the following:

- public good (high transaction cost) problems where the loss of human welfare would be material and widely distributed in the absence of the regulation in all its detail; or
- bilateral monopoly (hold-out) problems where the public use element is similarly high but where one or more individuals could otherwise extract the entire surplus from a necessary project, or thwart it entirely for unworthy reasons.⁵

The first principle does not apply because the benefits are not widely distributed. While a hold out problem may be involved in aggregating land, there is no high public use purpose in land aggregation for residential housing development. *The power to take land compulsory for housing purposes should not generally apply. To avoid any ambiguity, the Commission should include an explicit statement to this effect in its report.*

3.9. The Commission has ducked the issue of changes to the RMA. The 2025 Taskforce described the fundamental problem with the RMA in the following terms:

... it encourages local government to see the changed use of private land as a privilege that they bestow, rather than a right that might be modified only in narrow and well-specified predictable ways.⁶

⁵ Wilkinson, Bryce (2001), *Constraining Government Regulation*, A Discussion Paper Prepared for the New Zealand Business Roundtable, Federated Farmers of New Zealand, Auckland Regional Chamber of Commerce and Industry and the Wellington Regional Chamber of Commerce, New Zealand Business Roundtable, Wellington, p 186.

⁶ Brash, Donald T, Caygill, David, Sloan, Judith and Wilkinson, Bryce (2010), *Focusing on Growth: The Second Report of the 2025 Taskforce*, p 112, retrieved 2 December 2010 from <http://www.2025taskforce.govt.nz/>.

The upholding of private property rights is critical for economic growth and the achievement of social harmony. Secure property rights encourage firms to use resources productively – for example to invest in the expectation that they will benefit from the returns that arise. This applies to housing and other development. *The Forum submits that the RMA needs to be thoroughly reviewed to address the affordability of housing on an enduring basis.*

4. CHARGING FOR INFRASTRUCTURE

The Commission's View

4.1. The Commission made the following recommendations in relation to charges for infrastructure:

- That the government update the Best Practice Guidelines to Development Contributions based on a process that takes account of the experience of both councils and the industry. The principles in the guidelines might be given statutory status by being incorporated into Schedule 13 of the LGA (R 8.1).
- That the government leads training to enable councils to enhance their skills in implementing the proposed Best Practice Guidelines for Development Contributions (R8.2).
- That as part of the process of updating the Best Practice Guidelines to Development Contributions, the government:
 - demonstrate compliance with the Guidelines; and
 - develop a process for regular auditing of councils to assess their adherence to the Guidelines (R8.3).

4.2. The Commission believes that if infrastructure charges are to be retained as a means of funding new infrastructure resulting from development, they should be subject to simplification, greater transparency, and judicious use. The primary objective of the Commission's proposals is to reduce the burden of upfront charging for infrastructure on the cost of new residential development, while retaining the advantages of efficient infrastructure charges.

The Forum's Comment

- 4.3. *The Forum broadly endorses with the Commission's recommendations on infrastructure charges.* They are similar to findings of the report prepared by the Forum and the Property Council of New Zealand that was referred to above.
- 4.4. Infrastructure charges are likely to be inefficient where private goods and services are supplied. The cost of those services can be charged directly to users in the usual way. This applies particularly to water services, which are often funded entirely or mainly from rates rather than use-related charges. It may also apply to wastewater where water use may be a proxy for the use of wastewater services. *The Forum therefore submits that prices rather than development contributions should be charged for goods and services where they are feasible and appropriate.* This principle should also be included in the principles for development contributions noted by the Commission.
- 4.5. The Forum also recommends that those principles should only permit development contributions to be applied where there is a close connection between the subdivision or development on the one hand, and the relevant infrastructure and facilities on the other hand. On this basis development contributions could be used to fund the cost of supplying public goods, such as neighbourhood parks, reserves, outdoor recreation facilities and stormwater systems that exclusively or predominantly service or enhance a development and are located within a development. The Forum also notes that the report of the Regulatory Responsibility Taskforce considered that mandatory charges should, in principle, exceed neither the cost of efficient supply nor the benefit plausibly conferred by those paying the charge (see principle 7(e) in its recommended Regulatory Responsibility Act). The Productivity Commission should consider this aspect when finalising its report.
- 4.6. The Forum's response to questions Q8.1 and Q8.2 respectively, are listed below:
- *The Forum supports the introduction of a 'merits-based test'.* Development contributions are compulsory. They can only be challenged through judicial review where a high threshold applies. Councils have incentives to tax developers to shelter residential property owners generally from higher rates than otherwise. The main effect of a merits-based test would be to discourage local authorities from setting excessive or unreasonable development charges.

- The cost of litigation, including the risk of having costs awarded against the plaintiff, would be the main deterrent to frivolous litigation. This is the main deterrent that applies to other areas of the law. The key point is that the incentives generated by the possibility of a challenge to a council decision on development contributions would reduce the likelihood of litigation generally.

5. BUILDING REGULATIONS AND AFFORDABILITY

The Commission's View

5.1. The Commission made the following recommendations on building regulations and affordability:

- The Department of Building and Housing publish for each Building Consent Authority (BCA), the total time taken between receiving applications and finally granting consents and the number of occasions where each BCA has used the 'stop the clock' provision. The Department of Building and Housing audit the 'stop the clock' information from a sample of BCAs (R9.1).
- The Law Commission has regard to the incentives faced by regulators in its general review of the application of joint and several liability (R9.2).
- The Department of Building and Housing report on its ongoing evaluation of the reforms on the allocation of risks between parties to building work five years after their introduction (R9.3).
- The Department of Building and Housing should provide more specific guidance for BCAs about what is required for an alternative solution to comply with the Building Code (R9.4).
- The Department of Building and Housing should review the multi-proof building consent process with a focus on identifying barriers to its application, and suggesting ways to overcome those barriers (R9.5).
- Statistics New Zealand should consider collecting more information about the quality of New Zealand's housing stock and consumer satisfaction with the residential construction industry (R9.6).

The Forum's Comment

- 5.2. *While the Commission's recommendations are useful and generally supported by the Forum, their scope is limited.* The Commission's report does not evaluate the overall efficacy of the extensive regulation of building. Building regulation is being greatly expanded as shown in Box 23 on page 131 of the report, largely in response to the watertightness problem. However, regulatory failure played a significant role in that problem, and enough buyers have been harmed for it to be reasonable to assume that all buyers and providers would be more careful in future in the absence of attempts to shut the regulatory door after the horse has bolted. The risk of such failure to weight benefits and costs while imposing significant new costs on building activity is generally given little attention in the Commission's report.
- 5.3. The weather-tightness problem highlighted shortcomings with building inspection services. The Commission's report notes, "Concerns regarding the quality, timeliness, cost and consistency of building regulatory functions were common in submissions and consultations during the course of this inquiry." This is consistent with the Forum's understanding. Moral hazard induced by regulation was surely another reason why buyers did not take more care. The Forum questions whether the Commission's recommendations will adequately address such concerns. Some of the problems identified might be addressed by consolidating inspection services.
- 5.4. A vital question, "Are housing standards set at the right level?", is asked in section 9.4 of the report. However, the brief discussion that follows notes that changes to the building code are subject to regulatory impact analysis. This would provide a level of assurance if such analyses were consistently of a high standard but that is not the case. In a 2011 Regulatory Impact Statement on the Regulatory Standards Bill The Treasury reported that "only half of the significant regulatory proposals considered by Cabinet since November 2008 had RISs that met expected standards". *The Forum acknowledges that it is not easy to assess whether the benefits of detailed regulation of building outweigh related costs, but it believes that this question is vital to the inquiry and warrants further examination.*

6. THE PERFORMANCE OF THE BUILDING INDUSTRY

The Commission's View

6.1. The Commission noted the following:

- Industry productivity performance is flat-lining, and this is reflected in growing building costs, and evidence of poor building quality.
- Residential building costs are higher than in Australia. Building materials are more expensive in New Zealand than they are in Australia. In part, the small size of the New Zealand market and the small scale of major material manufacturers can explain this finding.
- The trend in New Zealand toward larger and higher specification housing increases building costs. The small scale and fragmented nature of the New Zealand building industry contributes to high costs.
- The industry is dominated by small firms that build one house at a time, are unable to generate economies of scale and often lack management capability. The industry is fragmented vertically which presents difficulties in the management of the supply chain. New houses tend to be bespoke one-off designs. Building costs can be reduced through greater uptake of standardised designs and building techniques.
- The industry is subject to significant demand cycles, making investment in firm expansion and the recruitment and retention of skilled staff difficult.
- The industry suffers from a number of skill issues, particularly at the management level. The misalignment between industry business cycles and industry training can result in skill shortages during booms and excess staff during periods of downturn.
- The construction industry and government have identified productivity growth as a priority and have established the Building and Construction Sector Productivity Partnership to develop practical proposals to address productivity issues.

6.2. The Commission's only recommendation on performance of the building industry is presented below:

- Given that the Productivity Partnership has a number of relevant work streams in progress, and has an established membership of relevant representatives, the Commission considers that it is well placed to develop practical initiatives to improve industry productivity. In particular, the Partnership should develop, in consultation with the sector, practical responses to the supply chain issues outlined in the report (R10.1).

The Forum's Comment

6.3. The Commission's findings are important for the affordability of housing and for the overall contribution of the industry to economic performance generally. *A more searching identification of the obstacles to productivity growth would enhance the Commission's report.* The Commission does not appear to have focused sufficiently on identifying whether public policies are impeding the productivity of the building industry:

- The small scale of building and manufacturing operations features prominently in the Commission's findings. However, unless there are policy obstacles to the consolidation of existing operations, firms of greater scale would emerge if they were more efficient than small-scale firms.
- While the RMA, the Building Act 2004 and other legislation affects the cost of new houses, we are not aware that such legislation bears significantly more heavily on large-scale housing developments than other proposals.
- While the standardised housing may reduce costs, homeowners may prefer individually designed houses and may be willing to bear the higher costs of constructing such houses. The Forum believes that this matter can be left to the market as people's preferences will differ.
- Are there significant policy impediments to larger scale manufacturing operations (aside from the Commerce Act provisions related to monopoly which would only apply in more extreme cases)?
- Building materials are generally tradeable goods. The price of imported products could be expected to limit the price that domestic producers can charge for their products. New Zealand building regulations could impede

such competition (by making it costly for imported products to be used), but the case would need to be made.

- Limited competition in the distribution of building products could be an issue but the Commission's report indicates that the Commerce Commission has investigated that issue and has not taken any action.

7. WHERE HOUSING AFFORDABILITY BITES

The Commission's View

7.1. This chapter of the Commission's report focuses on housing assistance and on the private rental market. The Commission made two recommendations both related to the Social Housing Unit, which has been established as an interim measure to fund community housing. (Community housing is supplied by local, non-government, not for profit providers.) The Commission's recommendations are listed below:

- The final structure of the Social Housing Unit should be a Crown Entity with an arm's length relationship to the Minister of Housing (R11.1).
- The Social Housing Fund should be increased to better meet the expectations of future social housing provision through the community housing sector (R 11.2).

7.2. The Commission asks submitters the following questions (among others):

- Has the Commission understood current affordability issues in the private rental market (Q11.3)?
- What is required in order for the private rental market to deliver better outcomes, particularly for those tenants who are likely to rely on the market for long-term accommodation (Q11.4)?

The Forum's Comment

7.3. *The Forum thinks that the Commission should be more critical in its analysis of housing assistance.* Its observations are listed below:

- The Commission has identified the main specific programmes that the government provides (subsidised rental accommodation through the Housing Corporation and the Accommodation Supplement). According to the Commission they cost about \$3 billion a year.⁷
- There are no apparent principles guiding the Commission's analysis of housing assistance. More affordable housing, involving increased government assistance and expanded community housing are advanced as desirable goals, apparently in their own right. Yet this appears to confuse the unduly high cost of housing with the distribution of the burden of those costs. Government subsidies, and the taxes to fund them, redistribute costs, they don't reduce them. Indeed they likely increase the costs to the community of providing housing given the deadweight costs of taxes and the weak incentives to spend tax money wisely. What are the objectives of such assistance, who is bearing the burden of the costs, and what are the limits to the level of such assistance? House prices reflect the scarcity of resources. Subsidies for some to buy houses do nothing to reduce scarcity in the community, but they can be expected to raise house prices, thereby transferring wealth to those who owned properties at the time the subsidies were introduced. There is little focus on why housing may be unaffordable to some groups (for instance, unemployment or non-participation in the labour market, and family breakdown). The real problems facing certain groups are found elsewhere, for instance in impediments to employment and a quality education, welfare dependency, or drug and alcohol abuse.
- There is little evaluation of the effectiveness of existing programmes, with the Commission largely reporting recent policy developments. Much of the existing stock of Housing Corporation units (of about 69,000 units, mainly built since World War II) is reported to be obsolete. If true, it illustrates the point that the cost of housing to the community can be raised rather than lowered by government spending on housing.
- The Commission has made no recommendations aimed at improving the effectiveness of existing rental housing programmes yet the following long-

⁷ The Commission omitted general income assistance programmes, such as Working for Families and the main benefits, which enables recipients to spend more on goods and services, including housing, than otherwise.

standing mismatches are acknowledged in the report and, although being addressed, are unlikely to be overcome with the urgency that is required:

- the location of existing rental units are poorly matched to the areas with most pressing social housing needs;
 - the capacity of housing units is poorly matched to the size of families that are most in need of social housing; and
 - the priority given to existing state tenants is at the expense of worthy applicants on the waiting list.
- There is no discussion of the relative merits of providing housing assistance in-kind (for example, the provision of subsidised rental units) rather than in cash (for instance, the Accommodation Supplement). The National government introduced market rents for state rental units in the early 1990s with housing assistance provided to qualifying tenants and others via the Accommodation Supplement. Income-related rents were reintroduced in 1999. (These policy changes may have affected the trends in median rents to disposable income for low-income groups relative to other quintiles highlighted in the report at page 4. These policy changes were not noted as relevant factors.)

7.4. The Commission's assessment on the private rental market includes the following observations:

A range of issues including poor quality, insecure tenure and inadequate income in retirement all indicate that the market is not currently equipped to deliver housing necessary for well-being in the long term. These issues appear to have been exacerbated by the dominance of small-scale investors, who are motivated by expectations of longer-term returns as opposed to growing a loyal client base by providing high-quality tenancy services. The Commission is aware of very few options which might enable the private rental market to deliver better and more affordable outcomes for a growing market. A model where institutional investment is used to deliver long-term leases, where the tenant has some ownership interest in the property and the landlord is focussed on a sustainable ongoing yield appears to be the best approach. However, the Commission understands that prevailing market conditions have prevented such a model from emerging. As such, ongoing improvement in the overall supply of affordable housing for first-home buyers will be central in providing greater tenure choice for intermediate renters.

Most of these views seem to come from the Commission's consultations. They may not have been subject to the scrutiny necessary to warrant policy conclusions.⁸ The key challenge from a public policy perspective is to identify whether there are any policy impediments to the development of the rental market that should be addressed by the government such as the following:

- If there are regulatory barriers to the development of large-scale rental housing providers, they should be identified and evaluated. Government provision of subsidised rental accommodation is an obvious one. Beyond the low-income sector of the rental market where the Housing Corporation is the dominant provider, small-scale providers of rental units may simply be more efficient than larger entities.
- If there were no regulatory barriers to long-term tenancies why would they not develop if there were a demand for them and if they were profitable to provide? Market incentives generally encourage efficient arrangements to be discovered. If the Commission is to support increase regulation of tenancies to provide greater security (along the lines of the suggestion from the New Zealand Council of Trade Unions on the top of page 185 which is reported without comment), it should at least note some of the obvious problems of that approach.
- There are several other places in the report where policy suggestions are stated but not subject to any analysis. While such suggestions are not reflected in the Commission's formal findings or recommendations, they may leave the reader with the impression that there is a valid case for government action without any examination of other relevant factors, including related costs that could be involved.

8. CONCLUSIONS

8.1. The Forum:

- endorses the thrust of the Commission's findings and recommendations. In particular, it agrees that unwarranted restrictions on the supply of land for

⁸ Another statement that is made (at page 184) without any qualification is, "Inquiry participants noted that New Zealand's Superannuation system is currently predicated on the assumption that people will own their own home by the time they reach retirement." Where has that view ever been expressed in any official policy statement on New Zealand Superannuation?

residential housing are the main factor that contributes to unduly costly housing;

- believes that the RMA would need to be amended, a national policy statement would need to be made under the RMA or the incentives facing local authorities would need to be changed if the Commission's recommended strategy, to relax constraints on the supply of land in the short-term, is to be implemented effectively;
- considers that the RMA should be thoroughly reviewed to address the cost of housing on an enduring basis; and
- generally supports the Commission's recommendations on the regulation of building but considers that their scope and significance is limited. The question of whether the benefits of extensive regulation of building outweigh related costs is vital to the inquiry and warrants further examination. A more searching examination of the obstacles to higher productivity in the building industry and the efficacy of government housing assistance would also enhance the Commission's report and subsequent policy analysis.