NEW ZEALAND
PRODUCTIVITY COMMISSION
Te Kōmihana Whai Hua o Aotearoa

Housing affordability inquiry

Summary version of report

March 2012

The Productivity Commission aims to provide insightful, well-informed and accessible advice that leads to the best possible improvement in the wellbeing of New Zealanders.

Housing Affordability

Summary version of final report – March 2012

The New Zealand Productivity Commission

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What this 'Summary version' is

This 'summary version' provides the key points, findings and recommendations from the Commission's housing affordability inquiry final report. It is designed to give you a quick route into the key insights from our examination of housing affordability in New Zealand.

The final report itself follows the release of an earlier draft report and issues paper; consideration of submissions on both papers; a large number of meetings with interested parties; and the Commission undertaking its own research and analysis of issues central to housing affordability.

For more information about the final report please visit our website www.productivity.govt.nz or call us on 04 903 5150.

Format of the summary version

Key points

- The key points box at the start of each chapter is a summary of the main considerations and findings on each topic.

F **Findings** are shown in numbered order at the end of each chapter.

R **Recommendations** are shown in numbered order at the end of each chapter.

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Overview

Why is this inquiry important?

The Government has asked the Commission to evaluate the factors influencing the affordability of housing in New Zealand (both rental and owner-occupied) and to examine potential opportunities to increase affordability.

The context of this inquiry is the recognition that stability of the home environment is important for social cohesion and family stability. There is a concern that real (inflation-adjusted) house prices in New Zealand are markedly higher than they were a decade ago and that this has been associated with general declines in housing affordability and home ownership rates. These declines have contributed to increased demand for rental accommodation and additional pressure on the social housing sector.

The aim of this report is to suggest policy improvements that could enhance the performance of the housing market and the effectiveness with which it meets the needs of New Zealanders. This would be important at any time, but is particularly so in the aftermath of a house price boom between 2001 and 2007 that was unprecedented in recent history and one of the longest and steepest since data began (Figure 0.1). Real house prices almost doubled over this period, which equates to an average increase of 12% per year. The boom has started to unwind but house prices remain above long-term levels.

Figure 0.1 House prices, real and nominal

Source: Quotable Value and Statistics New Zealand

Notes:

1. Real house prices are measured as the ratio of actual house prices to the CPI.

Although unprecedented in history, New Zealand's recent house price boom occurred more or less at the same time as rapid house price expansions in a majority of OECD countries. Indeed, co-movements in real house prices have been unusually strong internationally over the 2000s, suggesting a significant role for global factors in propagating this period of real house appreciation (Box 1).

Box 1 **Box 1** What drove the surge in New Zealand house prices in the 2000s?

The sharp rise in house prices in New Zealand during the 2000s reflected a number of cumulative demand-side factors against a degree of stickiness in housing supply. Internationally, a range of influences came together to encourage a strong increase in credit growth, much of which increased effective demand for housing in a number of OECD countries:

- In conjunction with loose monetary policy in the United States, high savings from some Asian and oil exporting countries worked to lower interest rates in global credit markets.

- A move from an 'originate' strategy to 'distribute' strategy (securitisation) reduced the quality of the loan books in the United States without a commensurate increase in capital requirements for relatively risky loans.
- A progressive relaxation of credit standards in originating banks also led to a reduction in the quality of banks' mortgage portfolios.

Although these global factors increased credit availability in New Zealand, the impact on the mortgage market was less pronounced than in the United States. In particular, securitisation was nowhere near as prevalent as in the United States and there was not the same disassociation between lenders and borrowers. Intermediation continued to be the dominant model in New Zealand, implying little incentive for banks to expand loan volumes without paying adequate regard to risk.

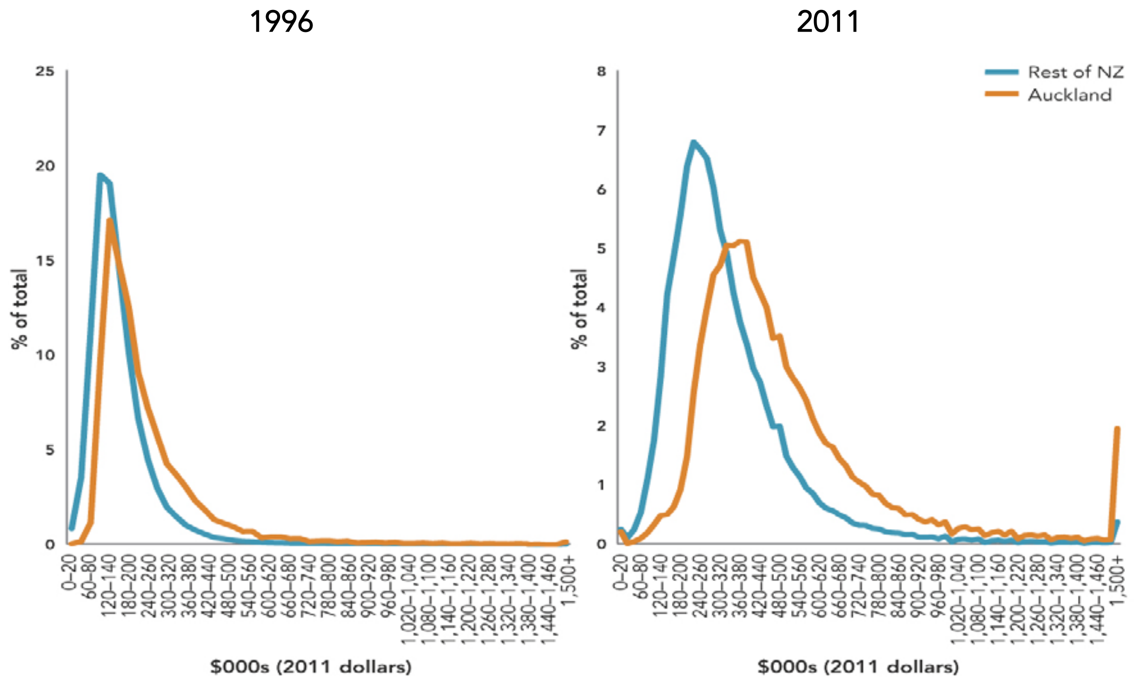
On top of these global developments, a number of New Zealand-specific factors also worked to increase housing demand:

- Strong natural population growth over the last 30 years.
- Net migration flows turned from losses of around 10 000 people per year in 1999-2001 to strongly positive, peaking at over 40 000 people in 2003.
- Partly reflecting a higher terms of trade, real GDP per capita increased by around 14% between December 2000 and June 2007. Rising household incomes increased effective demand for house ownership and for 'trading-up' to a larger, higher quality or better-located house.
- Interest rates were relatively low in 2002 and 2003 when the OCR ranged around 5%.[1] This partly reflected subdued inflationary pressure due in part to the falling price of a wide variety of imported goods as low-cost Asian manufacturing increased in scale and scope (Bollard and Smith, 2005). Lower interest rates also saw an adjustment in loan servicing capacity occur.
- The New Zealand exchange rate was relatively low up to 2003 but began to increase thereafter as interest rates increased. A lower exchange rate may have increased the attractiveness of New Zealand residential property to overseas buyers.
- As a result of house price inflation and financial market innovation, households felt wealthier and found it easier to 'borrow on the house' in the form of increased withdrawal of housing equity (Figure 2.5). The released funds were used for housing purposes (upgrading existing homes, 'trading up' to better ones and purchasing investment properties) that further fuelled the housing boom and also for spending on consumer goods and services.

The house price boom was more widely dispersed across the country than previous house price expansions. However, there were important exceptions to this trend – in the Queenstown Lakes District and metropolitan areas in Auckland and Wellington, houses were among the most expensive in the country in the early 2000s, but these regions still experienced strong real house price appreciations over the boom. In Auckland – home to around one third of New Zealand's population and 31% and 41% of its housing stock by number and value respectively – this continued a well-established trend of strong real house price increases relative to the rest of the country. As a consequence, the distribution of house prices in Auckland is now markedly different to that in the rest of New Zealand, particularly at the lower end of the Auckland housing market. For example, between 1995 and 2011, the gap between lower-quartile house prices in Auckland vis-à-vis the rest of the country increased by over 260% in real terms. The analogous figures for median and upper-quartile house prices are 230% and 150% respectively (Figure 0.2).

[1] The OCR troughed at 4.75% at the beginning of 2002, but rates were under 6.00% from May 2001 to July 2004.

Figure 0.2 Distribution of house prices in Auckland and the rest of New Zealand



Source: Productivity Commission calculation based on QV data

Notes:

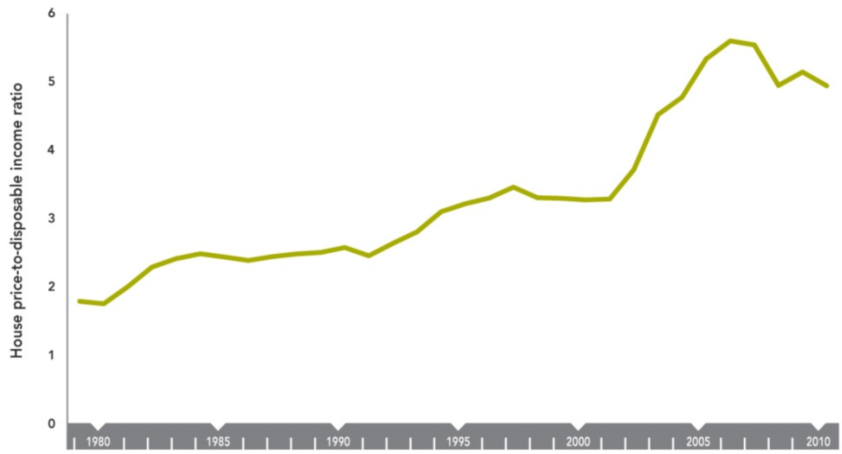
1. House price distributions are shown in constant (2011) dollars (deflated by the CPI).

What has happened to housing affordability?

House buyers

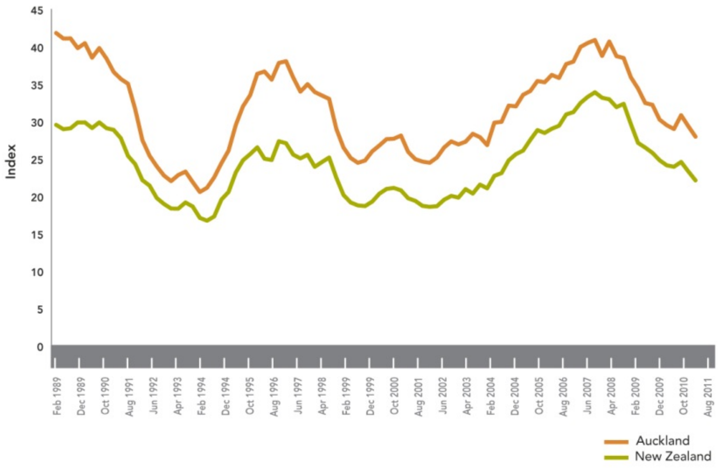
Ten years after the surge in house prices began, national measures of house price-to-disposable income ratios remain elevated and would require sharp falls in house prices to return to long-term averages (Figure 0.3). Affordability measures that include financing costs are currently closer to longer-term averages, owing to interest rates that are low compared with earlier times (Figure 0.4). This is often over-looked.

Figure 0.3 House price to disposable income ratio



Source: Productivity Commission calculations using Reserve Bank of New Zealand data.

Figure 0.4 Massey home affordability index



Source: Massey University Real Estate Analysis Unit.

Notes:

1. A low index indicates improved affordability.

These aggregate measures do not necessarily indicate what is happening to affordability for different types of households. Disaggregated measures indicate that:

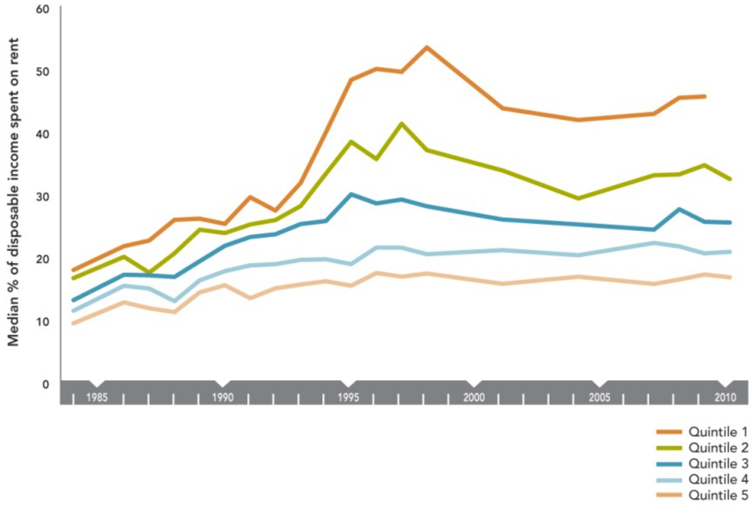
- Affordability pressures are particularly evident in Auckland, reflecting that city's higher house prices.
- Housing affordability is lowest among those who are younger, single, have lower income and wealth, or belong to an ethnic group other than New Zealand European.
- During the last house price boom, housing affordability became a constraint for some middle-income groups, whereas it had previously mainly been an issue for those on lower incomes. It is not yet clear if this is a cyclical phenomenon or a structural trend.

Renters

During the house price boom, rents increased at around the same rate as generalised inflation. Across territorial authorities, rents grew in a relatively tight range of 2.3% per year (in Dunedin City) to 8.2% per year (in Buller District). In all cases, rent increases were significantly less than real house price inflation and the ratio of house prices to rents increased markedly, a departure from the long-term broadly stable relationship.

This apparently benign aggregate situation disguises a more difficult position for renters on lower incomes. In particular, people in the lowest two income quintiles spend a much higher proportion of their income on rent than people on higher incomes (Figure 0.5). Even though the situation appears to have improved since the late 1990s, those in the two lower income quintiles still spend, on average, more than 30% of their disposable income on rent, after allowing for government assistance.

Figure 0.5 Median rent-to-household disposable income by disposable income quintile



Source: Productivity Commission and Treasury calculations using Statistics New Zealand Household Economic Survey (HES) data.

Notes:

1. HES was not conducted in 1999, 2000, 2002, 2003, 2005 and 2006. Data for these years was interpolated.
2. Income quintiles are based on the entire HES sample.
3. The 2010 quintile 1 figure is excluded because there is some uncertainty about its reliability (Perry, 2011).

When house prices increase, households that have to spend a large proportion of their income on rents will find it hard to save for a deposit for a house. Between 2001 and 2006, as rising house prices pushed the affordability constraint further up the income distribution, the number of 'intermediate renters' – households with at least one person in employment who cannot afford to buy a dwelling at the lower quartile price assuming standard bank lending criteria – increased by over 150% to 187,400 households or 58% of all private renters. Driven in part by declining interest rates, the share of intermediate renters is estimated to have declined since 2006. One in three renters – and a large proportion of intermediate renters – lives in Auckland.

What are the key features of the housing landscape?

Many features of the housing landscape influence housing affordability, which implies that opportunities for improving housing outcomes are likely to be found in many places. A number of factors are small though cumulatively important, other factors are more significant. As a backdrop to the Commission's suggestions for improving housing affordability, the report outlines key features of the landscape that influence the demand for housing, the supply of housing and the institutional framework within which it operates.

Housing is a house/land package

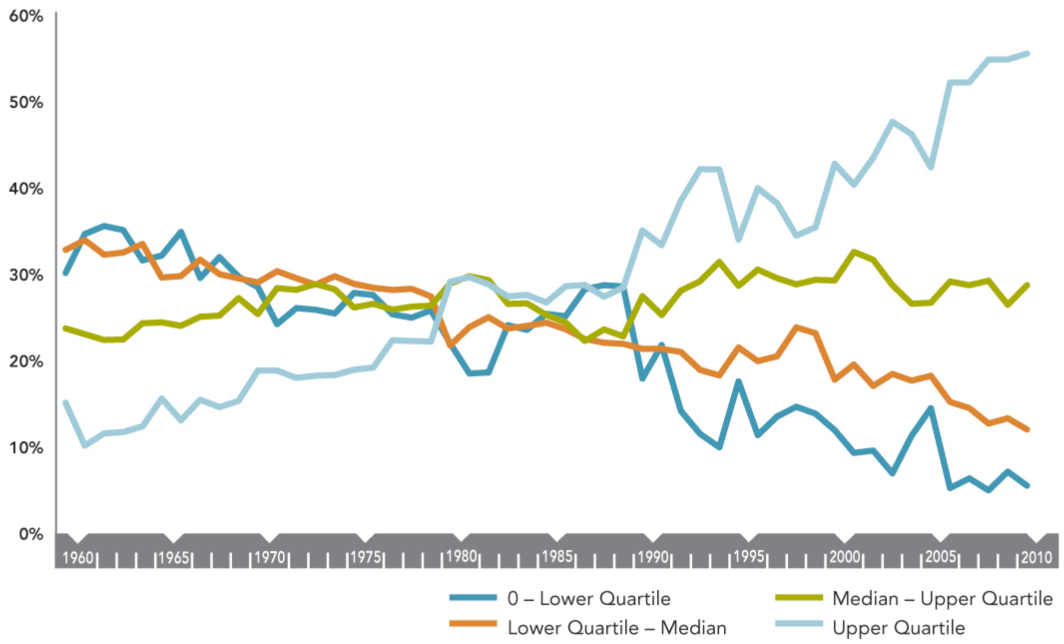
Housing is a house/land package, as land has to be developed and serviced with infrastructure before it is usable for housing. This inquiry therefore examines the determinants of the cost of land, of the infrastructure needed to service that land, of building materials, and of the costs of assembling those materials to build a house.

Section prices have grown more quickly than house prices over the last 20 years, indicating that appreciating land prices have been a key driver of house price inflation in New Zealand. This suggests a shortage of residential land in places where people want to live. Land price pressures have been particularly acute in Auckland, where section prices now account for around 60% of the cost of a new dwelling, compared with 40% in the rest of New Zealand.

Although much of New Zealand's land area is unsuitable for residential development, the country's low population density is such that the potential supply of raw land is relatively abundant. While pressure on land prices in the biggest and fastest growing centres is expected, the movements in recent years seem excessive. This implies that policy and planning practices may be constraining the supply of residential land. For example, strong land price pressures in Auckland raise questions about the impact of policies aimed at increasing density – such as the Metropolitan Urban Limit (MUL) and other planning restrictions – on housing affordability. A major challenge ahead is to improve land release and planning approval processes so that affordability considerations are integrated fully into spatial planning.

A distinctive feature of residential investment in New Zealand, which may be linked to rising land prices, is that new supply has tended to come in the form of large and relatively expensive houses or, to a lesser extent, apartments that are targeted at the top end of the market (Figure 0.6). As such, the majority of new dwellings are currently not targeted at the affordable end of the market, adding to the difficulties faced by intermediate renters seeking to buy a 'starter' home.

Figure 0.6 New housing investment, value distribution



Source: Productivity Commission calculation using QV data

Notes:

1. For each year, the data show the share of new houses that are valued within each quartile of the value distribution for the existing housing stock.

Underlying demand has been strong and is projected to continue increasing

Responsive land release and planning processes are likely to be particularly important given projections that underlying demand for housing will be strong, driven by household formation, which depends, in part, on population growth and factors that determine household size. New Zealand's natural population growth has been strong, while migration flows have been highly variable and often focused on Auckland. Population growth has been unequally distributed across the country, largely as a result of internal migration patterns and the regional preferences of international migrants.

Demographic changes – such as population ageing, cultural and ethnic diversification and a radical transformation in family structures – have also been a feature of recent years and have tended to segment housing markets. Changes in New Zealand's ethnic structure have increased average household size in some areas while the ageing population structure has tended to reduce it elsewhere. The net effect has been an overall fall in average household size and an associated increase in household formation.

Looking to the future, net household formation in New Zealand is expected to continue to increase as the population continues to grow and households become yet smaller. While the extent to which this underlying demand for housing becomes effective depends on whether households have the capacity to pay for housing, demographic projections suggest a need for home construction volumes to increase.

The housing market is segmented

Housing growth will not, however, be uniform across the country. There are stark regional differences between housing markets. Statistics New Zealand's projections suggest that Auckland will have the largest increase, accounting for 60% of New Zealand's population growth and for almost half the number of new households, followed by Wellington and Canterbury. Auckland is also expected to have the highest growth rate in household formation.

One consequence of this segmentation is that adjustments to changing housing needs and preferences will create market and price pressures that are likely to differ across New Zealand. While a complex web of demographic influences are at work in New Zealand, the outcome overall is that household formation is concentrated in and near Auckland and is likely to remain so for the next few decades. For that reason, the challenge of providing adequate housing is largely an Auckland one. A small number of regional centres will also face challenges, albeit to a lesser degree.

The rental market is important

The stability of rents while house prices were rising over the 2000s boom allowed the rental market to act as a 'safety valve' in the face of rising house prices. As house prices increased rapidly, the rental market expanded to accommodate an increasing number of households that favoured renting over home ownership, given its relative affordability compared to home ownership.

This exacerbated a trend that had been under way for some time (Figure 0.7). Home ownership peaked in the late 1980s/early 1990s, when around 75% of private dwellings were owned by their occupants. Since then, ownership levels have dropped to around 65% – which is about average for the group of OECD countries for which data is available. Currently, around 408 000 households are estimated to live in private residential rental accommodation. The decrease in home ownership since the end of the 1990s has been particularly marked in Auckland, where around 40% of households now rent (Figure 0.8).

Figure 0.7 Tenure choice in New Zealand

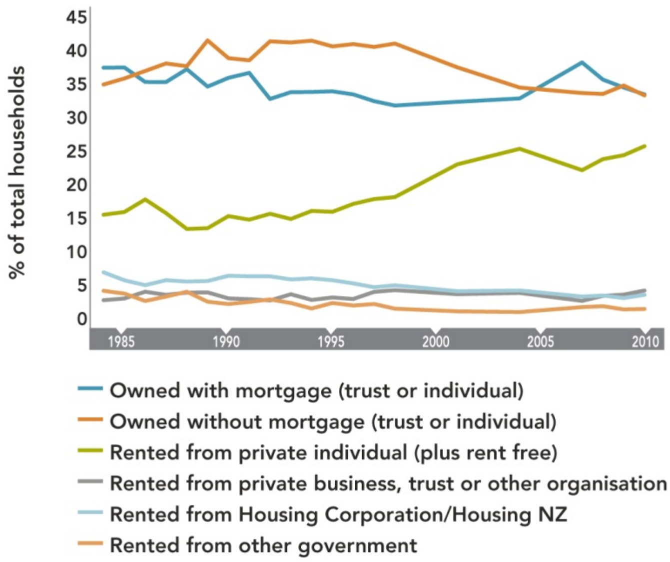
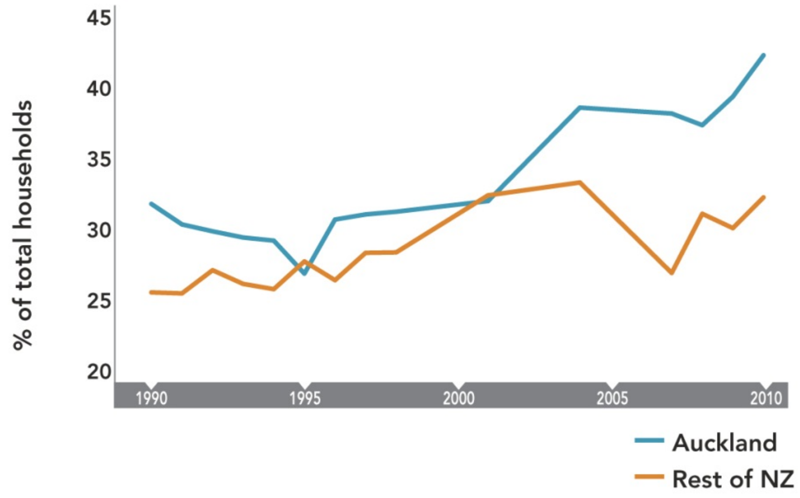


Figure 0.8 Regional profile of tenure type



Source: HES, OECD, NZ Census

Investment in the rental market

Most investors in New Zealand's rental market are relatively small scale. Landlords have been prepared to accept low yields on their rental properties, in part because of expected capital gains in housing and lack of confidence in other investment markets. Although estimates vary, the net cash yield on rental properties over the 2000s house price boom is estimated to be well below 4%. In contrast, capital gains have been relatively strong until recently and New Zealand home owners have, on average over the 2000s, enjoyed superior returns compared to investing in the share market.

However, since the end of the 2000s boom, capital gains on rental properties have diminished significantly. Although difficult to judge, demand pressure may already be working to increase rents in the bigger cities, with recent data indicating that rental households on middle incomes are spending an increasing share of disposable income on rent.

Outside of student accommodation and retirement villages, large-scale landlords have a very limited presence in the New Zealand market. A low cash yield is likely to be one reason why institutions have been reluctant to enter the rental property market. In effect, they have been crowded out by small scale private investors. The large scale of investment required to assemble a suitably diverse portfolio of rental properties in different locations with different demographic exposures is also often cited as a barrier to institutional investment in the sector. Challenges around capturing any construction scale economies in the sector may also be inhibiting large-scale involvements. Reflecting these barriers, the share of people living in rental properties owned by private businesses, trusts or other organisations has remained low at under 5%, indicative of a very low level of institutional involvement in the sector.

The residential building industry is fragmented with low productivity growth

In a typical year, the residential building industry builds about 24,000 new homes and renovates about 32,000 homes. The industry is essentially a fragmented 'cottage industry' dominated by very small independent builders constructing bespoke homes. Sole traders (with no employees) are the most common firm size and businesses employing more than 20 employees constitute only 9% of total sector employment. Most builders construct one house at a time: in the year to May 2010, 4,604 firms built just one house during the year. In contrast, only 30 firms built more than 30 homes, while just 5 firms built more than 100 houses. As noted earlier, most new homes are being built for the upper end of the market.

Productivity growth is below that of other New Zealand industries and below that of building industries in other countries. Submissions also pointed to problems such as projects exceeding budget and agreed timeframes, non-compliant or defective work, and reliance on lower quality materials which have a shorter life-span and require higher levels of maintenance.

The building materials industry is concentrated but still small scale

Manufacture and distribution of building materials is relatively concentrated in New Zealand, which has prompted claims that the market suffers from a lack of competition. The firms concerned nevertheless appear unable to reach the scale necessary to match international product prices.

Materials account for around half of all residential construction costs. Material costs for a standard home (excluding those installed by sub-contractors) increased by 19% in real terms between 2002 and 2011. However, around one third of this increase is due to changes in the nature of materials used (for example, the introduction of double glazing to meet revised thermal efficiency guidelines in the Building Code) rather than the cost of specific materials. As such, real price increases for individual materials appear to have been relatively modest. Nevertheless, the cost of building materials in New Zealand is significantly higher than in Australia, and is one reason for the higher cost of building construction in this country, with adverse implications for housing affordability.

Councils perform key roles in the housing market

Councils have a major influence on all stages of house construction, as they are responsible for urban planning, including the release of land for development and zoning decisions; providing or arranging for the provision of infrastructure to land that is to be developed; issuing building consents that are required before buildings are demolished, removed, constructed or altered; and ensuring compliance with the Building Code.

The construction and land development sectors are more responsive to changes in housing demand in some parts of the country compared to others. There is also some evidence that, in areas of the country where housing supply is more responsive, an increase in housing demand results in relatively more houses and smaller increases in real house prices, with beneficial implications for housing affordability. Although difficult to show conclusively, differences in supply responsiveness at the territorial authority level may, in part, reflect the efficiency with which local councils implement and enforce regulations governing the land development and building sectors.

Where has the Commission found opportunities to improve affordability?

The Commission has reviewed these features of the housing landscape in order to identify opportunities to improve the housing sector's capacity to meet consumers' preferences for housing that is safe, comfortable and affordable. While housing is largely a private market, the way in which the market operates is heavily influenced by its regulatory and institutional framework. Hence the Commission has focused on ways to improve this framework. While many of the Commission's proposals apply nationally, there is a particular focus on Auckland, given that the challenge of providing adequate housing for a rapidly growing population is largely one for Auckland, although a small number of regional centres will also struggle. The Commission has also concentrated on ways to increase affordability for those on lower incomes, where the biggest social issues are found.

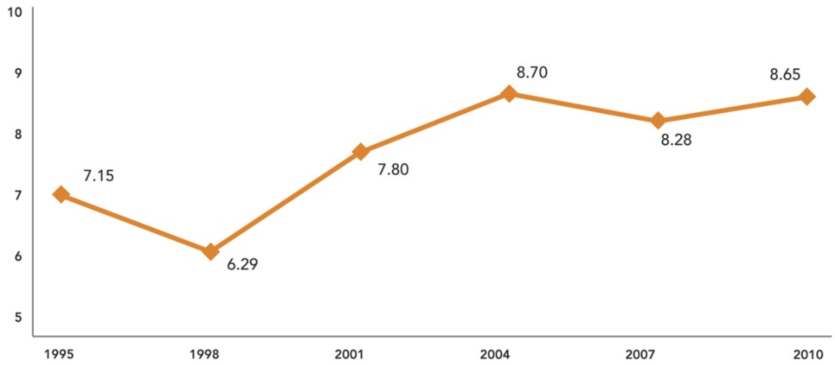
Planning

Urban planning requires consideration of a wide range of objectives, including environmental management and economic development goals. Planning practices have not adapted to be able to adequately manage and balance these multiple objectives.

The prevailing approach to urban planning in New Zealand reduces housing affordability in our faster growing cities. The widespread planning preference for increasing residential density, while at the same time imposing restrictions such as minimum lot size and height restrictions, and limiting greenfield development, places upward pressure on house prices across the board. Constraints on the release of new residential land create scarcity, limit housing choice, and increase house prices. These impacts may be disproportionately felt in particular areas. In Auckland the MUL is a binding constraint on the supply of land for urban growth and has increased section prices within the city. This is indicated by the large differential between land prices 2 kilometres inside and 2 kilometres outside the MUL (Figure 0.9), which suggests that

Auckland Council's proposed compact city approach, based on containment of the city, undermines the aspiration of affordable housing. An immediate release of land for residential development would ease supply constraints and reduce the pressure on prices. This could be achieved by a combination of bringing significant tracts of greenfield *and* brownfield land to the market. Auckland Council should show in its final Auckland Plan how it has considered and reconciled affordable housing with its other priorities. Christchurch Council should also increase the supply of land and councils in other high-growth centres should explore the options for doing so.

Figure 0.9 The price multiple of land 2km within the Auckland MUL to land 2km outside the MUL



Source: Productivity Commission modelling

More generally, a shift in philosophy may be called for, based perhaps on zoning areas from which development is to be *excluded* and then allowing market forces to determine appropriate land uses on the balance (subject to complying with environmental standards), with councils using their infrastructure planning as a means to signal where development will take place and under what time-frame.

In New Zealand, the slow pace at which land for housing is planned, zoned, and released contributes to the high price of sections and thereby house prices. Long development lead times have been identified as a problem, taking between two and ten years because of regulatory complexities. Councils should review their regulatory processes with the aim of providing simplified, speedier and less costly consent processes and formalities, to expedite the supply, and reduce the cost, of housing.

However, while councils' time planning and consenting processes are part of the problem, the regulatory system itself is a factor. Inquiry participants consider that the Resource Management Act (RMA) in particular is overly complex, giving rise to unnecessary costs, duplication, delays, and uncertainty, which may deter new development. The RMA also has limited capacity to adequately consider the benefits of urban development that would lead to affordable housing.

Planning must take account of the RMA, the Local Government Act (LGA) and the Land Transport Management Act (LTMA). These statutes have different legal purposes, timeframes, processes and criteria. With multiple participants and decision-makers, there is no single mechanism for facilitating engagement, securing agreement among participants and providing information for robust decision-making. The Government should consider the case for reviewing planning-related legislation.

A consequence of local government planning policies is the spillover effects for central government. Unaffordable housing increases the requirement for state-sponsored or subsidised housing while high rentals and house prices increase the need for welfare assistance by way of the Accommodation Supplement to meet housing costs. The other manifestation of housing shortages – overcrowding and dependence on poor quality housing stock – impacts adversely on health, education and community outcomes. This stores up long-term fiscal liabilities and potentially undermines productivity and national wealth. There appears to be an absence of a balanced framework in which the impacts of local government decisions – in this case relating to urban land use – on wider government policies, programmes and objectives can be examined.

Resolving the issues surrounding the legal, institutional and decision-making frameworks in which urban planning occurs will take time. However, there are a number of measures that councils should progress that will remove impediments to the supply of housing. Specifically, a more balanced approach to urban planning is required in the interests of housing affordability. Land for housing can come from the development of brownfields sites, by infill development in existing suburbs and by making suitable greenfields sites available, ideally in a complementary manner and in a way that provides for substantial short, medium and long-term capacity.

The Commission recommends that territorial authorities:

- 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;
- investigate barriers to densification and consider more flexible approaches to achieve a balance between neighbourhood amenity and new development in existing suburbs;
- develop strategies that promote adequate competition between developers for the sale of construction-ready sections.

Paying for infrastructure development

There are two forms of infrastructure charge against new developments in New Zealand: financial and development contributions. The former focuses on the environmental effects of particular developments; the latter are intended to compensate councils for incremental capital expenditure associated with development on such facilities as reserves, networks and community infrastructure.

These charges are applied widely across New Zealand and collected $267m in 2008 (June year), amounting to 4.5% of total local government income (equivalent to 7.5% of rates income). Water supply and waste water infrastructure are funded through development contributions by more councils than other types of infrastructure, and tend to attract the highest charges.

The level of charges varies considerably between councils and between types of infrastructure, but can be significant. While some councils do not apply these charges, in other cases they can exceed $40,000 per developed section; charges of $20,000 per section are not uncommon. Overall, the increase in development charges is not enough to explain the surge in house prices in the early 2000s (for example, one survey of 10 regions suggested that development contributions made up between about 1% and 10% of median section prices, whereas prices doubled during the boom, as noted earlier), but they affect affordability and because they are charged upfront they oblige households to take on larger mortgages.

Charging for infrastructure, if implemented well, encourages efficient locational choices in the development of housing. It requires considerable skill and information, however, to design and implement charges that accurately reflect costs. The Commission has been made aware of concerns about the way in which these charges are applied in New Zealand and suggests some ideas for addressing them.

A strategy for taking advantage of the potential efficiency and equity benefits of development and financial contributions, while reducing current problems, could involve three elements.

- The development of a set of best practice development contribution guidelines that would cover when development contributions should be used, how they should be calculated, and how costs should be recovered. The principles in such guidelines should be incorporated into Schedule 13 of the Local Government Act.
- A range of measures would help councils to implement the guidelines. These include training about how to implement the guidelines and establishing a quality assurance process to help councils to implement them effectively and share the lessons from experience.
- Strengthening the incentives for good practice by increasing the scope to challenge the way in which councils set and administer development contributions. There is a range of options, with differing

degrees of costs and formality. The Commission favours improving the scope for mediation as an initial step, with the scope to challenge in the District or Environment Court a future option that could be implemented if mediation does not deliver sufficient benefits.

Greater discipline around infrastructure charging will put downward pressure on the cost of new residential development, and improve the quality of decision-making around infrastructure funding. They are, however, a small part of the governance framework within which councils operate, and would not fully address issues around how councils arrive at the overall level, composition and timing of infrastructure that they seek to fund through infrastructure charges. Effective governance of infrastructure assets is critical. Analysis of these broader issues would include matters such as:

- the appropriate role for councils in planning and providing infrastructure such as the three waters (which in some jurisdictions are not provided by councils);
- the appropriate corporate form for the entities that provide infrastructure when this remains within councils; and
- reporting and accountability arrangements.

Building regulation

Many inquiry participants raised concerns about quality, timeliness, cost and consistency in their interactions with the building control system. Regulations relating to building construction can affect the cost of building or renovating a house in six main ways.

- Imposing standards that buildings must meet with respect, for example, to durability and safety, which exceed levels that consumers would otherwise choose.
- There are costs to administer regulation, some of which are passed on to homebuyers.
- Inconsistent or slow enforcement of regulatory requirements can delay project completion or otherwise increase project costs.
- Regulation can affect the incentives to innovate with new materials or processes.
- Regulation can influence how risks are shared between different parties – home owners, architects and engineers, builders and subcontractors, material suppliers and regulators.
- The structure of the building consenting and inspection service can influence costs. Small building consent authorities (BCAs) may suffer from diseconomies of scale or be unable to take advantage of efficiency-enhancing technology, adding to the costs of administering building regulations.

The Commission cannot be sure that the benefits justify the costs generated by the building control framework:

- There is evidence that the regulatory framework, and its interaction with legal rules, impedes innovation in the building industry and efficiency in the building consents process.
- There are strong incentives for BCAs to be risk averse, and this can add to building costs.
- There is a widespread perception in the building industry that the building consent process takes too much time, and requires too much documentation and too many building inspections, all adding to the cost of building.
- There are opportunities to drive greater consistency and efficiency in the building regulatory system through shared use of technology and consolidation of building consent functions.
- Little is known about the quality of New Zealand housing. The information gap compromises efforts to assess whether building outcomes are improving, due to the efforts of the building industry and its interactions with the regulatory framework.

The Government intends to change the industry's regulatory arrangements, in part to alter the allocation of risks in the building sector. Overall, it is difficult to predict whether the costs the reforms will impose on industry participants will be justified. The Department of Building and Housing (DBH) should report on its evaluation of the reforms five years after introduction.

The Commission has eight suggestions for additional reforms.

- To encourage housing standards to be set at a level that maximises their net benefits, the Treasury Regulatory Quality Team should review the quality and robustness of the DBH's use of Regulatory Impact Statements for changes to the Building Code.
- To reduce delay costs with issuing building consents, DBH should publish, for each BCA, the total time taken between receiving applications and finally granting consents, and the number of times each BCA has used the provision to 'stop the clock' when it seeks more information. DBH should audit the 'stop the clock' information from a sample of BCAs.
- Territorial authorities should find ways to expedite the building consent process and improve communication between building practitioners and BCAs.
- The joint and several liability rule that applies in the building industry is likely to make BCAs more risk averse, because it potentially exposes them to the full costs of remediating defective building. The Law Commission should consider in its review of joint and several liability **the interaction between liability rules and the structure of industries and industry practices, and** the impact of joint and several liability incentives faced by regulators.
- To reduce the costs faced by builders seeking approval for an innovation as an 'alternative solution', DBH should provide more support to assist designers and BCAs about what is required for an alternative solution to comply with the Building Code. DBH should also investigate pathways through which alternative solutions can evolve into mainstream practice.
- There has been low uptake of the 'Multi-proof Building Consent' – a scheme introduced in 2010 to produce time and cost savings for volume builders by removing the need for the same or similar building designs to be repeatedly assessed for compliance by individual BCAs. DBH should identify the barriers to using this form of consent, and suggest ways to overcome them.
- DBH should report on the ways in which the building control system can improve the diffusion of knowledge and information in the building sector, including rapid dissemination of information about defects in materials, designs or building methods.
- Urgency should be given to DBH's programme to lift the performance of BCAs and promote greater consistency and efficiency in the building regulatory system.

The building industry

There is scope to improve the productivity of the residential building sector and so reduce construction costs. Key barriers to productivity growth are the industry's small scale, low levels of innovation, skill issues and the 'bespoke' nature of our homes. Little can be done about market characteristics which reflect consumer preferences and the small size of the New Zealand market. As such, the Commission advocates a multi-faceted approach which includes greater innovation and measures to raise skills levels.

First, the small size of most firms prevents them from taking advantage of scale economies that could lower their costs. Some barriers to expansion, such as the small size of some regional markets and consumers' preferences for bespoke designs, are inherent in the New Zealand market. Little evidence has been presented to the inquiry about regulatory impediments to the growth of firms, although the Commission's proposals for freeing up land supply and the consent process may enable new housing developments on a greater scale.

Second, the industry is fragmented vertically and relies on an increasing number of different sub-trades. Sub-contracting, or outsourcing services is common. Houses are often built using a staged step-by-step approach, with individual trades working sequentially in isolation from each other. This can result in time delays and associated holding expenses caused by sub-contractors not being on site when required, as well as the need for re-work. Improved management skills and practice, together with greater uptake and implementation of collaborative working principles, could help increase the efficiency of building processes and improve industry productivity.

Third, industry procurement practices exacerbate the disconnection between main contractors and sub-contractors. The establishment of best practice guidelines, appropriate to the New Zealand context, would be beneficial. The Building and Construction Sector Productivity Partnership is an appropriate organisation to undertake this work.

Fourth, inquiry participants raised a number of issues relating to low skill levels in the industry. The Building and Construction Sector Productivity Partnership has developed a skills strategy document for the industry that matches closely the issues raised by inquiry participants in this inquiry. Addressing these skills issues will play an important role in lifting industry productivity, along with the phased implementation of occupational licensing – the Licensed Building Practitioner (LBP) scheme – covering designers, builders, site supervisors and trades-people such as carpenters, roofers, plasterers and bricklayers.

Taxation

Taxation affects the attractiveness of investing in housing and its affordability, although the impacts are difficult to quantify and depend on factors such as tax design and key features of housing markets. In New Zealand, as in many countries, whether housing is 'tax-favoured' was debated during the recent upswing in the housing market. Although there have been several reviews of the taxation of housing, significant questions remain unanswered. These include, for example, whether capital gains, and the benefit derived by owner-occupiers from living in their own home, should be included as taxable income.

The current taxation of housing is not ideal:

- The tax system favours investment in owner-occupied housing to the extent that these houses are financed by owner-equity, although property taxes (rates) levied by territorial governments and the shift from income taxes to GST act to level up the playing field. Also, to the extent that owner-occupied housing is financed by debt, that debt is taxed heavily, given that tax is applied to the full amount of nominal, not just real, interest in the hands of savers.
- Investment properties are subject to GST and local government taxes and returns to equity are taxed. However, the ability of the investor to claim a nominal deduction for borrowing costs, which exceeds real borrowing costs, is a potential tax subsidy.
- Capital gains on housing generally fall outside the tax net. These gains were substantial during the recent boom, but it is difficult to predict how large they will be in the future.
- House price inflation and leveraging up of rental investments in the early 2000s created opportunities for rental investors to achieve positive economic returns, including capital gains, whilst reporting tax losses. It is likely that there will have been some downward pressure on rental income as a result of the expanding supply of rental properties and landlords seeing less need to maximise rental income, given the perceived capital gains and 'tax breaks'. In effect, investors may have traded away some portion of those gains by accepting lower rents. It is also possible that, over the longer run, the capital gains and 'tax breaks' may come in below what was being anticipated (particularly now that depreciation deductions have been eliminated). If that proves to be the case, the economics of the rental market ahead could look quite different from in the 2000s, resulting in both less investment and higher rents than in the last decade.

Notwithstanding these features of current tax arrangements, there is not a pressing case for changing the taxation of housing in isolation. Suggestions for reform need to strike a balance between taking the existing tax system as it is and considering how the taxation of housing can be best made to fit within that, and a more 'first principles' approach. For example, the current income tax system is a 'nominal' system – it taxes 'nominal' rather than a measure of 'real' (inflation-adjusted) income. Yet a key issue in relation to the taxation of housing concerns interactions amongst inflation, house prices (capital gains), and interest rates. This issue cannot be addressed in the context of housing alone, since it also, unavoidably, involves aspects of the taxation of personal interest income, business interest expense, and capital gains/losses across all asset classes.

Addressing particular anomalies in isolation from a broad review of the tax system would further complicate the system and could have unintended effects on housing markets and housing affordability.

The private rental market

During the recent house price boom, the private rental market expanded rapidly, and the number of intermediate renters, who might have expected to have transitioned into home ownership, has doubled. While lower income renting households (the two lowest quintiles) spend on average more than 30% of their income on housing, and have done so for a long time, rental affordability has become an issue further up the income distribution – in the $50k-$70K income range – particularly in Auckland.

Importantly, any increase in rents would be felt most acutely in Auckland, where 42% of households rent (including those who rent state houses), as opposed to 32% for the rest of New Zealand.

The Accommodation Supplement – weekly payments administered by the Ministry of Social Development – helps people to pay their accommodation costs. The total annual cost of this programme is just under $1.2 billion. While this programme reduces the pressure on low income households, the bottom 20% of households still pay more than 40% of their disposable income on rent.

There is evidence that housing quality issues such as dampness, poor sanitation and thermal inefficiency are more prominent in rental housing, and inquiry participants raised concerns about the short duration of tenancy agreements. People who enter retirement while renting may face financial hardship.

There are no obvious policy options that would significantly improve outcomes in rental markets.

- Setting minimum standards for rental accommodation, or requiring disclosure about the quality of rental accommodation, could impose large costs. There is a stronger case for voluntary disclosure, although this is more likely to be taken up by landlords at the upper end of the market.
- Increasing the Accommodation Supplement would involve a significant cost and the extent to which the Accommodation Supplement works its way into rental prices is unclear.
- Assistance programmes designed to help facilitate the transition to home ownership have generally proved ineffective. Better targeting of these programms may improve their effectiveness.

With policy options such as these unlikely to have a significant effect on outcomes, a more viable strategy is to:

- focus on the options intended to improve the affordability of housing across the board, which would make it easier for renters to become homeowners while also mitigating the pressures for rent increases;
- have a targeted social housing programme to assist those in the greatest need.

Social housing

Government owns 69,000 state houses with a total value of about $15 billion. Most are rented to tenants who pay a subsidised rent which is capped at a certain proportion of their income (income-related rent). The difference between market rents and income- related rents (the income-related rent subsidy) was $564 million in 2010/11. Additionally, Government invests significant amounts in maintaining, upgrading and managing state houses. HNZC returned a $71 million dividend to the Crown in 2010/11.

State housing is not always matched to those individuals or areas where there is the greatest need, and the stock is old and needs upgrading. HNZC's role has been refocused to providing accommodation "for those who need it for the duration of that need".

The community housing sector, made up of non-government, not-for-profit organisations, is being called upon to deliver an increased supply of affordable housing. The Housing Shareholders Advisory Group suggested that the sector provide "opportunity for those who are ready to move on [from state housing]". The Government has funded community housing providers through a range of mechanisms since 2003 with $35.35 million budgeted for the 2011/12 year. Currently, community housing comprises 1.2% of the total housing stock in New Zealand.

This emphasis on moving people through state houses (managing 'throughput') undervalues the stability needed for sustainable improvements in social outcomes. The current reform programme is based on making the best use of limited government capital. It presumes that people and families can be reallocated amongst the housing stock relatively flexibly. However, social housing is best thought of as a contribution to a complex set of social needs that typically occur in clusters. The current approach to reform is not always in harmony with the desires of communities for stability and continuity, which are often essential for addressing the needs of families requiring social assistance. It may disturb the social relationships that underpin families and local communities in areas of high state housing concentrations and undermine the social objectives of providing state housing (especially where families have multiple needs besides housing).

A stronger focus on community might deliver better social outcomes. Transferring housing stock to the community housing sector might better align incentives to balance the interests of current and future residents. Community housing organisations in other countries have shown that they can deliver better outcomes to tenants than governments, council housing departments, or private landlords. They can offer a complete 'wrap around' package of support that extends beyond the provision of housing into other needs of the client households. In many countries this has been achieved through the large-scale transfer of council or state housing to housing associations.

This increased role for the community sector needs to be supported by the measures outlined elsewhere in this report that would increase the supply of more affordable housing, and reduce the risk that those who are reviewed out of state housing have to accept inadequate housing alternatives, or are placed in a situation that leaves them vulnerable.

Both the throughput model underpinning the reforms and greater focus on community development are only viable if the community sector is capable of expanding. It has limited financial capacity, and the current funding package appears insufficient for it to expand as is needed. If the community sector is not funded properly for this transition, there is a risk that trust between it and its clients will break down, undermining service delivery.

The Social Housing Unit (SHU) has been established as a semi-autonomous body operating within DBH as an interim measure to fund the expansion of social housing providers for 2011/12 while other options for the final institutional arrangement are considered. Although the formal objectives of the SHU are clear, its structure as a semi-autonomous body leaves room for unclear priorities, mixed purposes and misaligned accountabilities. Some inquiry participants observed that there were mixed messages or tension about the role and priorities of the SHU. To be effective, the SHU will need clear accountabilities, and a clear mandate. The Commission considers there is potential for greater effectiveness and efficiency through closer integration with other social policy agencies and services.

Some inquiry participants suggested that the Accommodation Supplement (AS) could be better used to fund the community housing sector. The Commission has found that the way the accommodation supplement abates hinders the ability of community housing organisations to improve housing affordability for their clients. For example, a $48 reduction in rent per week for a family moving into community housing might leave the family only $14 per week better off. Regardless of the need to fund community housing organisations further, the Accommodation Supplement needs to be adjusted so that rent reductions in community housing create meaningful financial benefits to their clients.

Māori housing

For many Māori communities, housing is valued more for keeping whānau connected to land, tradition, tūpuna, and their whanaunga, than as a financial investment. It is "about building communities, rather than building houses." This is not to say that Māori are never interested in housing for financial reasons. Housing solutions for Māori will sometimes need to be different, particularly in areas of traditional settlement.

Māori housing aspirations face challenges related to lower household incomes. Māori as a group experience disproportionately poorer housing situations compared with the rest of the population. Compared with other New Zealanders, Māori are:

- more likely to be on state housing waiting lists (31.3% of applicants in 2010, compared to being approximately 13.9% of New Zealand's population);
- more likely to live in housing that is in poor condition;
- less likely to own their own house (43.3% of Māori were owner-occupiers in 2006, compared to 69.7% of Europeans);
- more likely to be in lower income brackets.

Māori are heavily overrepresented amongst those with the lowest financial knowledge, and heavily underrepresented amongst those with the highest financial knowledge. Financial literacy education was emphasised to the Commission as an important part of any solution to Māori housing needs, especially if a community development approach is taken.

Māori in general have a strong preference to have their whānau network living nearby. Māori tend to place a greater reliance than European cultures on extended whānau for support. Isolation from these networks can place pressure on whānau, and make them more vulnerable to social ills associated with poverty. This also means that assumptions about people trading up from entry level homes in 'undesirable' areas once they can afford to do not hold so readily for at least some urban Māori.

Māori inquiry participants identified that the social and cultural resources they have could enable them to overcome the other barriers they faced to affordable housing solutions. They had solutions to their housing difficulties that they could pursue. The social and cultural resources that whānau and communities can bring to bear are essential for resolving the housing and other social issues they face.

This is a realistic approach, and there is a real need to make policies and decisions about how public resources will be used and delivered that are better integrated with the realities and aspirations of the people and the communities they are intended to benefit. Providing funding and some autonomy to Māori organisations that have accountability to their local communities means those who are best placed and best motivated to find housing solutions are better empowered to do so. In turn, this aligns with Māori aspirations to have more control over their own futures and the way government influences them. It also aligns closely with the developing Whānau Ora approach.

Whānau Ora is the government response best placed to address Māori housing aspirations, through helping whānau plan and coordinating local public services. The Commission received a range of views about Whānau Ora as a vehicle for progressing the housing aspirations of Māori: some sceptical, some supportive. Chapter 13 identifies the role it could play, and what it would have to do to be successful.

Current government funding assistance through the SHU focuses on building new social housing. The focus on building new houses and organisations that will provide 'scale' takes a very narrow view of Māori housing needs, particularly for rural Māori. For example, there is a significant need to address the quality of the existing housing stock in areas where there are many rural Māori communities. The Pūtea Taiwhenua (rural fund) should be used to provide seed funding to organisations, using a microfinance lending approach, to address the quality of the rural housing stock.

The challenges of building homes on Māori land are well documented. Difficulties in using land as security for finance, zoning restrictions, getting agreement from shareholders in land blocks, poorly coordinated or communicated government responses, all feature prominently. Most of these challenges are not insurmountable. To resolve these issues, three groups of people and institutions would need to take action:

- public services at the local level – local authorities, Māori Land Court district offices, local Te Puni Kōkiri offices, and in some cases national organisations like the SHU and Kiwibank;
- whānau and shareholders in Māori land; and
- private finance institutions.

There has been no lasting and effective response to housing on Māori land because the three groups or institutions (local public services, whānau, and finance providers) would all need to take action, and each has plausible reasons to leave it to someone else to move first.

Whānau Ora is best placed to lead a lasting response to the challenges of building homes on Māori land. At an operational level, Whānau Ora can address Māori housing aspirations through helping whānau plan and through coordinating local public services:

- A team of Māori housing expert advisors, housed in a national agency like Te Puni Kōkiri or the proposed Whānau Ora commissioning agency, should be made available to Māori landowners with aspirations to build housing on their whenua.
- Whānau Ora facilitators should be trained to educate whānau about the options for management structures for their Māori land, and to play a role in developing plans for the use of Māori land for housing (where this is what the whānau wants).

As well, Te Puni Kōkiri, working with the Māori Land Court and private finance institutes, should develop options to adapt existing lending policies and precedents for private finance institutes to lend for building homes on Māori land. Private finance may become more readily available if accurate advice about the risks of lending on Māori land (and appropriate ways to manage those risks) was more readily available.

To start the conversation, the Commission has reviewed three models to see whether they could provide the necessary security for banks to lend: trust guarantees, a financial options system, and mutual insurance schemes. Under the right circumstances, each of these shows some promise. As well, the Commission has reviewed two models of housing where there is an element of common ownership. These are licences to occupy (as used by retirement villages) and unit titles, under the Unit Titles Act 2010. Each of these models could form robust ways to manage housing on Māori land.

Concluding comments

The entry costs of home ownership increased over the course of the 2000s house price boom for some groups in society. This has had an important impact on the journey of some households up the housing ladder, particularly those living in Auckland.

It is difficult to predict the likely balance between the fundamental drivers of demand, the supply responsiveness of the land development and construction sectors, and the associated house price and tenure dynamics. One plausible scenario is that in the absence of improvements in land delivery and the performance of the construction sector, land prices and the costs of new houses continue to increase; with rapid household formation, especially in the upper North Island, outstripping the construction of new houses.

In this scenario, the size of the rental market would increase further as the proportion of families owning their own homes continues to decline, particularly in Auckland. Compromises in housing provision would become more pressing, especially with respect to overcrowding for low-income households, as the available housing stock is utilised more intensively. Indicative of missing rungs on the housing ladder, intermediate renters would find it ever more difficult to make the transition into home ownership. In addition, a growing shortage of both private rental and affordable housing would expose the Government to increasing fiscal risk in the form of an escalating Accommodation Supplement and growing state house rental subsidies. This risk would grow significantly if rents move back into line with still elevated house prices, ending the recent and historically unusual period of disconnect and increasing the level of financial distress for many low-income renters.

An alternative scenario is that the housing market continues to be subdued. To date, New Zealand's house price correction post the Global Financial Crisis has been modest in international comparison. Given the prospect of a volatile global economy with considerable recessionary risks, there may be more price falls to come. In this scenario, supply constraints in the construction and land development sectors bite to a lesser extent and real house prices continue to fall. The market would settle at lower house prices and the affordability issue would recede. However, the continuing pressure from increasing numbers of households seeking accommodation is likely to moderate future reductions in house prices, even in the setting of a weak economy.

Although the future direction of the New Zealand housing market is difficult to predict, the policy recommendations outlined in this report are not contingent on a particular outlook. These recommendations converge around three themes for improving housing affordability, removing impediments to home ownership, and providing appropriate rental accommodation.

- An increase in the supply of land for housing, and a less constrained approach to urban planning more generally, in the interest of improving housing affordability.
- Pursuing opportunities to achieve scale and reduce costs in land development and building and construction.
- A regulatory framework that facilitates and encourages cost-reducing and quality-enhancing innovation, and where the benefits of regulation are achieved at least cost.

These three themes are mutually dependent. Getting the necessary scale economies in land development and home construction will not happen unless there are sufficient amounts of land released in the right areas and at the right price. At the same time, planning and building regulation needs to work in a way that facilitate rather than impedes development and construction. It is only when these three core elements work together in a self-reinforcing way that we are likely achieve any real impact on housing affordability.

The policy improvements outlined in this report are aimed at improving the performance of the housing market and the effectiveness with which it provides housing for New Zealanders. The ultimate objective is a housing market capable of meeting changing demands for housing in a cost-effective and affordable way over the long term and well beyond the length of a typical house price cycle.

1 The housing affordability inquiry

Key points

- The Government has asked the Commission to evaluate the factors influencing the affordability of housing and identify potential opportunities to improve affordability and reduce impediments to home ownership.
- Housing plays a central role in individual and community health, family stability and social wellbeing, in the operation of the labour market, productivity and development. As such, the issue of housing affordability is at the core of the Commission's mandate.
- Sitting behind the level of house prices is a complex set of supply and demand forces that ultimately determine the level of affordability in the housing market.
  - At its simplest, housing affordability is a function of income, house prices and the day-to-day costs of home ownership, or rents and income in the case of rental affordability. Change in any of these factors has a direct impact on affordability.
- Housing affordability needs to be understood and examined from a holistic perspective. Therefore:
  - Housing affordability, even at entry level ('starter homes'), cannot be understood without considering how the entire housing market works.
  - Affordability is relative: the experience of affordability is very different between existing home owners, first home buyers, rental tenants, and across different localities and household types. Different segments have quite different housing needs and ability to pay.
  - There are multiple impacts on housing costs that suggest that issues around land, construction, labour, and capital and their regulation contribute individually and jointly to affordability problems – resolving one in a way which compounds another may not enhance affordability.
  - It is desirable that the housing market work in such a way as to maximise the options available for quality housing for all New Zealanders regardless of income or tenure choice. This means a housing market that has both depth and diversity.
  - Affordability is influenced by the costs of accessibility – to work, schools, friends and family, recreation and entertainment.

2 The New Zealand housing market

Key points

- Reflecting a confluence of global and domestic drivers, New Zealand experienced a house price boom over the 2000s that was widely dispersed across the country. Although unprecedented in recent history, this boom was not out of line with the experience of a number of other OECD countries.
- Over the course of the 2000s boom, house price increases tended to be stronger in areas with relatively low house prices initially. However, despite houses being among the most expensive in the country, the Auckland market continued a well-established trend of relatively strong house price increases. This 'divergence' in Auckland house prices compared to the rest of the country was especially pronounced at the lower end of the Auckland housing market.
- The responsiveness of housing supply in New Zealand is around average in international comparison, but about half as effective as in a number of better-performing OECD countries. As such, demand increases are estimated to lead to proportionately larger increases in house prices than in new house construction.
- Supply responsiveness varies across the country, with implications for house price dynamics in regional housing markets. This may be related to the efficiency with which local councils implement and enforce regulations governing the land development and construction sectors.
- Land prices are a large and increasing share of the price of dwellings – particularly in Auckland, where the Metropolitan Urban Limit has constrained land development and put upward pressure on land prices. Available evidence suggests that construction costs have increased and are high in international comparison. This highlights land release and other regulatory hurdles, along with a poor performance in the construction sector, as impediments to a more effective supply response.
- Reflecting a number of factors including high land prices, most new housing supply is directed at the top end of the market, with very little new supply aimed at affordable housing.
- The available evidence suggests that the quality of the New Zealand housing stock is poor, particularly for rental dwellings.
- Over the 2000s boom, rents increased by significantly less than house prices, allowing the rental market to act as a 'safety valve'. This exacerbated a tenure shift away from owner-occupied dwellings to rental. Indicative of missing rungs on the housing ladder, the share of 'intermediate renters' – who have at least one member in paid employment but still can't afford to buy a house – increased markedly, particularly in Auckland.
- Barriers to the efficient functioning of the housing market have a negative effect on affordability that accumulates over the decades and goes well beyond the impact of house price cycles, including the house price boom over the 2000s. By the same token, even if supply responsiveness can be significantly improved, the New Zealand housing market will still experience house price cycles to some extent, with attendant implications for affordability.

3 Macro-economic factors

Key points

- The housing market affects, and is influenced by, developments in the wider economy. This interdependence has the potential to amplify significantly economic disturbances that originate both within and outside of the housing market.
- The housing market boom in the 2000s was not unique to New Zealand. Other OECD countries had a similar experience, pointing to a confluence of global influences as having been at play. These included the emergence of global economic and financial imbalances and innovations in financial policy frameworks (both monetary and prudential) that turned out to be destabilising.
- New Zealand-specific factors were also at work, some of which amplified the housing boom and others that helped to soften the subsequent 'bust'.
    - Housing dominates households' asset portfolios in New Zealand. At the start of the boom in the early 2000s, immigration increased sharply at the same time as the policy interest rate was comparatively low.
    - At the end of the boom, New Zealand experienced a softer correction relative to some other countries, because home loan defaults have been comparatively rare and because the economy has been helped by external influences such as the resilience of Asian economies.
- Housing markets that show large variations in prices can complicate macroeconomic and financial market management. Differences in housing supply regimes help to explain differences in cyclical house price movements. Hence finding ways to improve the supply responsiveness of the housing market can facilitate management of the macro-economy.

4 Housing affordability: distribution and trends

Key points

- House price increases have significantly reduced housing affordability over the past decade but, in recent years, this has been at least partially offset by lower mortgage interest rates.
- Housing affordability differs across New Zealand, with dwellings in Auckland typically the least affordable.
- Most indicators suggest that housing affordability has improved in recent years relative to the peak of the 2000s house price boom. However, house price-to-income ratios remain elevated and would require sharp falls in house prices to return to long-term averages. Affordability measures that include financing costs are currently around their longer term averages.
- Housing affordability is lowest among those who are younger, single, have lower income and wealth, live in Auckland, or belong to an ethnic group other than New Zealand European. Notably, during the last house price boom housing affordability became a constraint for some middle-income groups, whereas it had previously mainly been an issue for those on lower incomes.
- Over the last decade, rents have increased far less rapidly than house prices and the share of income that households spend on rent has fallen in most years since 1996. This apparently benign aggregate situation, however, disguises a more difficult situation for those on lower incomes who often spend over a third of their income on rent payments.
- The most recent data suggest that upward pressures on rents are beginning to emerge.
- The pockets of extreme unaffordability highlighted in the chapter suggest that there may be structural issues with some aspects of the housing market. These are examined in detail in subsequent chapters.

5 Population and demographic change

Key points

- Over the last 30 years New Zealand has experienced: population growth well above the OECD mean; volatile immigration; an ageing population; cultural and ethnic diversification; and a radical transformation of family structure. All these changes have driven a large increase in underlying demand for housing.
- Since 1971, population growth has resulted in roughly 450,000 new households and the decrease in average household size has created an additional 350,000. Between 2001 and 2006, an average of 22,000 additional households were formed each year.
- Demand pressures have differed markedly by region. This is driven by cross-regional differences in external and internal net migration and age, family and ethnic structures. Auckland has accounted for roughly 40% of New Zealand's net household formation over the last 10 years.
- As well as influencing underlying demand for dwellings, population growth and demographic changes have also influenced tenure choice, with some groups in New Zealand more likely to rent than own their homes.
- Looking to the future, in nearly all parts of the country the average household size is likely to continue falling, implying increased housing demand. New Zealand's population is also likely to continue growing strongly. Much of this growth will occur in the Auckland region, putting pressure on the regional housing market. For example, the Department of Building and Housing currently projects a shortfall of 90,500 dwellings in Auckland alone over the next 20 years (although a surplus is projected in other regions).
- The impact of underlying demand on house prices ultimately depends on the responsiveness of housing supply in the context of other demand drivers, such as income growth.

6 The role of taxation

Key points

- Taxation affects the attractiveness of investing in housing and its affordability, although the impacts are difficult to quantify and depend on factors such as tax design and key features of housing markets.
- There has been a long standing presumption of a tax bias in favour of equity invested in owner-occupied housing. This bias has been reduced by increases in the GST rate since it was introduced in 1986, and the accompanying shift in the tax base away from income taxes and towards consumption tax, together with the application of territorial government rates.
- The deductibility, and assessability, of the inflation component of interest is a tax distortion. The former favours borrowing to invest in real assets, including for investment in rental properties, and the latter encourages investment in these kinds of asset over financial assets. However, this is a general flaw in the income tax system and would be best addressed as such, rather than specifically in the context of housing.
- Whether to tax capital gains from housing should be considered in a broader context. Taxation should be approached in a principled way across the economy – an ad hoc regime for housing alone would risk significant costs and distortions.
- The government should monitor the impact of the removal of depreciation allowances on commercial properties – which includes rental housing – to check that the absence of depreciation deductions, particularly if there were a falling market, does not result in resources being diverted away from the rental sector just as depreciation deductions in a rising market drew resources into the sector.
- Overall, the Commission does not see a case for changing the taxation of housing. Current arrangements are not ideal, but addressing particular anomalies in isolation from a broad review of the tax system would further complicate the system and could have unintended effects on housing markets and affordability.

Findings

F6.1 There has been a long-standing presumption of a tax bias in favour of equity invested in owner-occupied housing. This bias has been reduced by increases in the GST rate since it was introduced in 1986, and the accompanying shift in the tax base away from income taxes and towards consumption tax, together with the application of territorial government rates.

F6.2 The impacts of a capital gains tax on housing affordability is unclear and would depend on how the tax was designed, on how operational issues were resolved, and on key features of housing markets.

F6.3 There are significant practical challenges in implementing capital gains taxes and international experience suggests that implementation typically falls short of the in-principle 'ideal'.

F6.4

A decision on whether to adopt a capital gains tax on housing should be based on a coherent set of principles that have general application, not just to housing. This matter needs to be considered from an economy-wide perspective and runs beyond the scope of this inquiry into housing affordability.

F6.5

- The elimination of depreciation allowances for houses (and other buildings) can be seen as a pragmatic balancing of a number of considerations in the light of a particular set of circumstances – the housing market boom of the early 2000s. Its aptness in the future, in different circumstances, should be monitored; ideally in the context of establishing an approach that is durable across a range of different circumstances.
- The full deductibility of interest expense for business borrowers (and assessability for savers), including of that component that is not 'real', is a tax distortion that favours borrowing to invest in real assets, including for investment in rental dwellings. However, it is a general flaw in the income tax system that would be best addressed as such, rather than specifically in the context of housing.
- Ring-fencing losses on residential rental investments from other taxable income is not called for.

F6.6

GST is an efficient tax in that it does not distort rates of return on saving and investment, is broad-based, and has low compliance and administrative burdens. The existing GST treatment of housing, which applies equally to rental and owner-occupied housing, is appropriate.

Territorial rates, which also apply equally to rental and owner-occupied housing, are an efficient form of tax.

F6.7

With respect to housing affordability:

- GST is front-loaded into the acquisition price of a house, which can raise the hurdle to first-home ownership, offset at least in part by the availability of KiwiSaver assistance for first-home buyers.
- Rates can cause strains for those who are 'housing rich but income poor'. The (government funded) rates rebate scheme, and rates postponement arrangements offered by local authorities, are available to ease these strains. There may be a growing need for these, particularly the latter, uptake of which has been low, as the community ages.

Recommendations

R6.1

That the Government monitor the impact of the removal of the depreciation allowance on commercial properties, including rental properties, for evidence that expenditures relevant to the proper upkeep and safety of buildings are being sustained.

7 Urban planning and housing affordability

Key points

- The prevailing principles and practice of urban planning have a negative influence on housing affordability in our faster-growing cities. Through their plans, councils may impede residential development by constraining the amount of land they allow for the construction of new housing.
- The widespread planning preference for increasing residential densities and limiting greenfield development to achieve this places upward pressure on house prices across the board. In Auckland the MUL is a constraint on the supply of land for urban growth and has worked to increase section prices within Auckland city.
- Increased availability of residential land for development would help address affordability. This could be achieved by bringing significant tracts of both greenfield and brownfield land to the market in Auckland and Christchurch, and exploring the options for doing so in other high-growth centres.
- More generally, the Commission recommends that Territorial Authorities:
  - take a less constrained approach to the identification, consenting, release, and development of land for housing in the inner city, suburbs, and city fringe;
  - adopt a strategy that allows for both intensification within existing urban boundaries and orderly expansion beyond them;
  - reduce barriers to densification and consider more flexible approaches to achieve a balance between neighbourhood amenity and new development in existing suburbs;
  - develop strategies that promote adequate competition between developers for the sale of construction-ready sections;
  - ensure alignment between policy objectives, planning rules and consenting processes.
- There is scope for councils, developers, land owners and builders to collaborate in bringing affordable housing to market, by ensuring the alignment of land release in suitable locations, the provision of infrastructure, and market demand.
- The slow pace at which land for housing is planned, zoned, and released contributes to the high price of sections and thereby house prices. Significant transaction costs, including delays, and high compliance costs are reflected in prices and increased risk, which may deter development.
- Planning must take account of the Local Government Act, the Resource Management Act and the Land Transport Management Act. These statutes have different legal purposes, timeframes, processes and criteria. With multiple participants and decision-makers, there is no single mechanism for facilitating engagement, securing agreement among participants and providing information for robust decision-making. There also appears to be an absence of a framework in which the impacts of local government decisions on wider government policies, programmes and objectives can be examined.

Findings

F7.1

- An adequate supply of land matters for housing affordability.
- Both greenfields and brownfields land will be needed, and greater density is to be encouraged.
- There is a trend towards greater decentralisation of employment, so it cannot be assumed that most travel will occur between city fringes and the CBD.
- Pricing that reflects resource costs will enable people to make trade-offs – for example between distance to work and transport costs, according to their budget and their preferences.

F7.2

- The literature points to Smart Growth policies having a significant adverse impact on housing affordability.
- Councils adopting Smart Growth policies need to consider the impact of such policies on housing affordability in their planning and decision-making.

F7.3

- The Metropolitan Urban Limit appears to have constrained the supply of sections in Auckland and this is reflected in escalating housing prices generally.
- Councils can take alternative approaches to binding urban limits, signalling where development will not be allowed, and using their infrastructure planning to signal where development will take place.

F7.4

- The objectives of council plans for densification may not be reflected on the ground – developers can experience difficulty in getting infill and medium-density housing underway because of the various planning rules and restrictions that apply to subdivision, land use and building.
- These restrictions are likely to add to short-term costs, frustrate the objective of increasing density, and create long-term rigidities in urban design and development.

F7.5

- The slow pace at which land for housing is planned, zoned and released contributes to the high price of sections and thereby house prices.
- Differences in supply responsiveness at the TA level may reflect the efficiency with which local councils implement and enforce regulations, the complex issues to be dealt with, and varying capacity to deal with them.

F7.6 Promoting greater affordability of land and houses and providing for diverse demand can be addressed by:

- An active approach to the identification, consenting, release, and development of land for housing in the inner city, suburbs, and city edge.
- Adopting a strategy that allows for both intensification within existing urban boundaries and orderly expansion beyond them to promote efficient urban development, offer a range of lifestyles, and avoid imposing unreasonable and costly constraints on individual segments within the housing market by recognising the benefits of advancing multiple forms of development.
- Identifying substantial areas of brownfield and greenfield land for development, (acknowledging that greenfield development also provides an opportunity to achieve medium-density development) and provision for more efficient use of existing suburban areas through infill where practical.
- Promoting competition between developers for the sale of construction-ready sections.

Recommendations

R7.1 Increasing land supply for new housing should include moderate-density development of brownfield sites *and* development of greenfield sites close to existing centres, local employment, and services.

R7.2 Auckland Council should show in its final Auckland Plan how it has considered and reconciled affordable housing alongside its other priorities.

R7.3 Councils interested in densification need to ensure that their local planning rules do not run counter to this objective. Councils should adopt more flexible approaches to achieve a balance between neighbourhood amenity and new development in existing suburbs.

R7.4 Councils review regulatory processes with the aim of providing simplified, speedier and less costly consenting processes and formalities.

R7.5 Government consider the case for a review of planning-related legislation to reduce the costs, complexity and uncertainty associated with the interaction of planning processes under the Local Government Act, the Resource Management Act and the Land Transport Management Act.

R7.6 Bring significant tracts of greenfield and brownfield land to the market in Auckland – identify and assemble land that could be quickly released and made ready for development, signal land with future potential for urban development, and make a commitment to major offsite infrastructure capacity.

R7.7

Auckland Council should look to collaborative models for the process of identifying, assembling and releasing large-scale tracts of land.

R7.8

Territorial authorities:

- 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.
- Ensure alignment between policy objectives, planning rules and consent processing.

8 Paying for infrastructure development

Key points

- In principle, the case for development contributions is strong. Linking the payment made for some types of additional infrastructure to the benefits received helps to ensure that investment reflects its opportunity cost and that locational decisions are efficient. Linking benefits and payments is also likely to be equitable.
- Development and financial contributions are applied widely in New Zealand to recover some infrastructure costs. The level of charges varies considerably, but can be significant. They are not large enough to explain the surge in house prices in the early 2000s, but have affected affordability.
- Designing and implementing charges for infrastructure that accurately reflect incremental costs is difficult, and there is concern about the way these charges – particularly development contributions – are applied. These concerns relate to their efficiency, impacts on housing affordability, whether they should be levied up-front or over time, the transparency of the processes through which they are determined, and the capabilities of councils to set charges.
- Given the benefits of properly structured development contributions, a strategy is required that helps local government to improve continuously the way it implements these charges and strengthens its incentives to do so.
- The Government should update the Best Practice Guidelines to Development Contributions written in 2003 and enhance training in their implementation.
  - The process for developing the guidelines should be based on broad consultation, and cover matters such as when the contributions should be applied, how they should be calculated and how costs should be recovered.
- Conformity with the guidelines would be encouraged by:
  - making it a legal requirement that councils have regard to the guidelines and with broad principles that would be legislated;
  - better reporting by councils of how they are complying with them;
  - external assessment of performance to encourage continuous improvement.
- Increasing the scope for mediating disputes about development contributions would further strengthen incentives for good outcomes. The Department of Building and Housing should monitor how well this is working and whether there is a need to facilitate access to legal appeals.

Findings

F8.1	It is difficult to draw a general conclusion about how much development contributions increase housing prices and reduce affordability: they vary considerably across New Zealand and the extent to which they are passed on probably also varies, although they are likely to be largely passed on to households in the long run.

F8.2

A well designed strategy could take advantage of the potential efficiency and equity benefits of development and financial contributions, while reducing current problems with them.

F8.3

Development contributions are particularly suited to recovering the incremental costs of major economic infrastructure assets, such as trunk water, sewerage and drainage, and major roads. Confining developer contributions to such critical infrastructure would simplify the charging regime for infrastructure arising from development.

Recommendations

R8.1

- The Department of Internal Affairs facilitate a consultative process for updating the Best Practice Guidelines to Development Contributions and developing a set of high-level principles for development contributions, taking account of the experience of both councils and the industry.
- The Best Practice Guidelines include a proposal that councils consider a set of threshold questions to help them to determine whether to apply development or financial contributions to particular infrastructure assets.
- The Local Government Act 2011 be amended to include a statutory obligation on councils to have regard to the Best Practice Guidelines.
- Principles for applying developer charges be included in Schedule 13 of the Local Government Act 2011.

R8.2

The Department of Internal Affairs initiate a training programme to enable councils to enhance their skills in implementing the proposed Best Practice Guidelines for Development Contributions.

R8.3

As part of the consultative process for updating the Best Practice Guidelines to Development Contributions, the Department of Internal Affairs:

- identify information that councils would need to provide in regular reports to demonstrate performance against the Guidelines;
- develop a process for assessing this performance; identifying problems and how to address them; disseminating this information to councils; and, where necessary, using lessons learnt to inform changes to the best practice guidelines.

R8.4

- The Government include in the LGA a dispute resolution process equivalent to the one in s 8AA of the Resource Management Act 1991.
- The Department of Building and Housing monitor the use of these appeals and within, say, three years, provide advice to the Government about whether there is a need to increase the scope for legal challenge of development contributions.

9 Building regulations and affordability

Key points

- The regulatory framework can affect the cost of building or renovating a house by imposing standards that exceed what well-informed consumers would otherwise choose. It is important that the regulatory process identify the costs, risks and benefits of adopting changes to building standards to ensure effective and efficient outcomes.
- The costs arising from slow and uncertain administration of building regulations and inspection services can be substantial and are largely passed on to home buyers. They deserve greater attention from building regulatory authorities.
- Many inquiry participants raised concerns about quality, timeliness, cost and consistency in their interactions with the building control system. Relationships between building practitioners and building consent authorities were poor in some areas. These tensions are likely to impede the effectiveness of the regulatory system.
- Local authorities administering building regulation face challenges in acquiring, retaining and supporting the necessary technology, skills and judgements to perform their role to a high standard.
- Achieving greater scale and better use of available technology, to ensure faster dissemination of information, greater consistency and quality, and faster processing of residential building consenting and inspection services, is both feasible and desirable.
- The development of rapid and effective feedback mechanisms which enable emerging deficiencies in building practice to be identified, diagnosed and remedied promptly is required to improve the performance-based regulatory system.
- A lack of clear pathways by which alternative solutions can become acceptable solutions may be creating a barrier that impedes cost-reducing or quality-enhancing innovations becoming mainstream practice.
- Building Consent Authorities face strong incentives to be risk averse, especially given the liabilities they have incurred in the wake of leaky homes. Reforms are being implemented that will reallocate risk among the parties to building work. The evaluation of the reforms should focus not only on whether they are effective in addressing the problem but also on the costs imposed by the new requirements.
- There is little quantitative or qualitative information on the quality of the New Zealand housing stock. Such information would provide a source of data for policy development and monitoring purposes which is currently missing.

Findings

F9.1 This lack of statistical information on the quality of New Zealand housing compromises efforts to assess whether building outcomes are improving, as a result of the efforts of the building industry and its interactions with the regulatory framework.

Recommendations

R9.1 Treasury Regulatory Quality Team in consultation with the Department of Building and Housing review the quality and robustness of the Department's RIS process for changes to the Building Code.

R9.2

- The Department of Building and Housing publish, for each 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.

R9.3 BCAs adopt a customer-focused approach in their interaction with building practitioners. They should take practical actions that would expedite the building consent process and improve their communication with building practitioners going through the consenting process.

R9.4 The Law Commission should consider in its review of joint and several liability the interaction between liability rules and the structure of industries and industry practices, and the impact of joint and several liability on the incentives faced by regulators.

R9.5 The Department of Building and Housing report on the impact of the reforms on the allocation of risks between parties to building work, five years after their introduction.

R9.6 The Department of Building and Housing provide more support to assist designers and Building Consent Authorities to demonstrate and assess how alternative solutions comply with the Building Code.

R9.7 The Department of Building and Housing investigate mechanisms or pathways by which alternative solutions can evolve into mainstream practice.

R9.8 The Department of Building and Housing should review the MultiProof building consent process with a focus on identifying barriers to its application and uptake, and suggest ways to overcome these barriers.

R9.9 The Department of Building and Housing report on the ways in which the building control system can improve the diffusion of knowledge and information in the building sector, including rapid dissemination of information about defects in materials, designs or building methods.

R9.10 Urgency be given to the Department of Building and Housing's programme to lift the performance of BCAs and promote greater consistency and efficiency in the building regulatory system.

10 The performance of the building industry

Key points

- The performance of the building and construction industry plays an important role in the supply, quality and cost of new housing, along with the upkeep of existing rental, social and owner-occupied housing. The industry is a significant contributor to the wider economy and poor productivity can act as a drag on overall economic growth.
- Industry productivity is flat-lining, and this is reflected in growing building costs and evidence of poor building quality. During the recent housing boom building costs increased above the general rate of inflation, and residential building costs are higher than in Australia.
- Building materials are more expensive in New Zealand than they are in Australia.
  - In part, this can be explained by the small size of the New Zealand market and the small scale of major material manufacturers.
  - It is unclear whether additional competition in the materials industry would reduce the costs. The Commerce Commission has investigated concerns about the behaviour of material suppliers and has found no breaches of the Commerce Act.
- 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 which 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.
  - In part, the small and fragmented nature of the industry is a reflection of the small and expensive areas of land that are available for development.
- 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.

Findings

F10.1

- During the recent housing boom, the cost of building a standard house has increased at a greater rate than inflation.
- The cost of both building materials and building a standard house is substantially higher than in Australia.
- A trend toward larger and higher specification houses is also contributing to increased costs. Factors driving this trend include changing consumer preferences, the use of covenants, and a desire to avoid under-capitalising given high section prices.

F10.2

Industry productivity is flat-lining, and this is reflected in growing building costs and evidence of poor building quality. Evidence suggests that the productivity performance of the construction industry over the past thirty years has been poor relative to other New Zealand industries, and relative to other jurisdictions.

F10.3

The lack of scale in the New Zealand residential construction industry presents a significant barrier to productivity growth.

- Small builders are less able to generate economies of scale.
- Scale home builders can reduce construction costs through the delivery of standardised housing, but scale building firms occupy a comparatively small share of New Zealand's building market.
- A lack of available land can present a significant barrier to productivity through inhibiting the development of group home builders and scale developments.

F10.4

The fragmented nature of the residential construction industry supply chain presents a number of management difficulties which can dampen innovation and result in lower building quality and higher construction costs.

F10.5

The National Infrastructure Plan represents a good mechanism for providing, where possible, forward visibility of government investment which is reliant on the residential construction sector.

F10.6

Skills issues, particularly at the management level, require attention in order for the residential construction industry to better respond to industry cycles and to improve productivity performance. The Productivity Partnership Skills Strategy focuses on a number of skill issues, which, if addressed, would help lift industry productivity growth.

Recommendations

R10.1 Given that the Productivity Partnership has a number of relevant workstreams in progress, and has an established membership of relevant representatives, the Commission considers that it is the appropriate organisation 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 section 10.4.

11 The private rental market: affordability and outcomes

Key points

- An effective rental market is a critical component of the New Zealand housing market.
- The rental market works well for relatively well-off households who value the flexibility offered by renting.
- During the recent housing boom, the private rental market expanded rapidly, providing housing for an increasing number of households that were unable to purchase a home.
- A growing number of households that would previously have transitioned into home ownership are now unable to do so. For these households, improving housing outcomes is most likely to be achieved through a reduction in house prices.
- Despite rents increasing at only a modest rate compared to median incomes during the recent housing boom, rental affordability remains an acute issue for lower-income households. Affordability pressures for these households are a longstanding issue.
- Renters on lower incomes have few housing options. They often spend a high proportion of their income on rent and may have to settle for poor-quality or inappropriate housing. The current rental market provides limited options for those who seek secure long-term rental accommodation, and people who enter retirement while renting are more likely to face hardship.
- During the past decade, the rent-to-house-price ratio significantly diverged from its long run trend. How this will resolve is unclear but rising rents will have important ramifications for the affordability of rental housing.
- Large numbers of households in the private rental sector receive the Accommodation Supplement. Any future decline in rental affordability is likely to place additional pressure on low-income households and generate further growth in Accommodation Supplement expenditure.
- Options to improve the quality of rental accommodation and tenure security without generating increased rents, reduced rental housing supply, or increased public expenditure are limited. There are no readily identifiable responses that would effectively address quality issues in the private rental market in the short to medium term.
- In the long run, better options for long-term renters on low incomes are likely to come through the growth of the community housing sector. But in the short to medium term, this sector is unlikely to be able to meet demand, particularly in Auckland.

Findings

F11.1 Low levels of housing affordability for lower-income households in the private rental market are longstanding. If rents had increased in line with house prices over the past decade, affordability for renters would be considerably worse.

F11.2 In Auckland, there has been an increase in the proportion of renting households in the $30–70,000 income bracket spending more than 30% of their income on housing.

F11.3 There is a risk that the house price-to-rent ratio will begin to return toward the long-run norm through an increase in rents. A period where rents increase at a significantly higher rate than incomes would result in further pressure on already stressed lower-income households, and would likely result in an increase in Accommodation Supplement expenditure.

F11.4 Poor-quality rental accommodation and insecure tenure have a detrimental impact on tenants, particularly older people and families with children.

F11.5 People who are in rental accommodation by retirement age are more likely to face hardship than those who own their own home.

F11.6 Under the current market conditions the emergence of institutional investors into the private rental market is unlikely. Obtaining sufficient scale in a short period of time is a major barrier for institutional investment. In addition, institutional investors require higher on-going yields and are priced out of the market by small-scale private investors.

F11.7 Assistance programmes designed to help facilitate the transition to home ownership have generally proven ineffectual in assisting large numbers of households to purchase a first home.

Recommendations

R11.1 Department of Building and Housing review the legislation and regulations relevant to rental accommodation quality for their effectiveness, and consider options for improvement, including their implementation and enforcement, in the medium term. This review should be aligned with initiatives led by Department of Building and Housing and the Social Housing Unit to support the growth of the community sector to create suitable alternatives for those in the worst housing situations.

R11.2 Government agencies responsible for the development and implementation of home ownership assistance programmes review existing (and future) programmes against criteria based around clarity of objectives, effectively targeting recipients, flexibility and cost effectiveness.

12 Social housing

Key points

- Social housing is best thought of as a contribution to a complex set of social needs that typically occur in clusters.
- The current Social Housing Reform Programme (SHRP) is based on making the best use of limited government capital. This will generally be difficult to reconcile with the stability and continuity often essential for addressing the needs of families requiring social assistance.
- HNZC's role has been refocused to provide accommodation "for those who need it, for the duration of that need". The community housing sector is being called upon to deliver an increased supply of affordable housing. In particular, the sector is expected to provide "opportunity for those who are ready to move on [from state housing]". As a result, the social relationships that underpin families and local communities in areas of high state housing concentrations can be disturbed and that can undermine the social objectives of providing state housing.
- Because housing is often just one of the needs social housing tenants have, 'wrap around' social services are essential for sustainable improvements in the wellbeing of social housing tenants.
- Coupling redevelopment with a transfer of existing state housing stock to the community housing sector might deliver better social outcomes. Transferring ownership of some state housing stock to the community is likely to better align incentives for balancing the interests of current and future residents.
- Starting the reforms by making changes to state housing without addressing external demand pressures and building sufficient options to 'move on' generates a risk that those who are reviewed out of state housing will have to accept inadequate housing alternatives, or are placed in a situation that leaves them vulnerable. This creates a future risk for the tenant and the state.
- Although the formal objectives of the Social Housing Unit are clear, its structure as a semi-autonomous body leaves room for unclear priorities, mixed purposes and misaligned accountabilities.
    - To be effective, the SHU will need clear accountabilities, and a clear mandate.
    - There is potential for greater effectiveness and efficiency through closer integration of the SHU with social policy and services.
    - Any final institutional arrangements need to balance autonomy to enable it to innovate, with integration in broader social service provision.
- There is limited financial capacity in the community housing sector, and current funding appears insufficient to expand the community sector to meet the government's objectives. If the community sector is not funded properly for this transition, there is a risk that Community Housing Organisations (CHOs) will be seen to fail in the eyes of their clients, undermining their ability to provide services.
- Reduction in rent from market value will largely be absorbed by reductions in the Accommodation Supplement, which won't make a tenant much better off. However, if the tenant received market rent levels of Accommodation Supplement where the CHO offers a reduced rent, this would enable the CHO to materially improve the wellbeing of its tenants. Regardless of the need to fund community housing organisations further, the Accommodation Supplement needs to be adjusted so that rent reductions in community housing create meaningful financial benefits to their clients.

Findings

F12.1 The most likely result of current funding criteria is many medium-scale providers developing, rather than several large-scale providers.

F12.2 Excessive reliance on the private rental market to accommodate former HNZC tenants may undermine the improvement in wellbeing that has been achieved for those tenants through state housing.

F12.3 The community housing sector is unlikely to meet the demands and responsibilities being placed on it, based on current funding for the community housing sector and projected housing need for the client group it works with.

F12.4 A fragmented community sector with a smaller asset base may face greater difficulties in managing the risks of obsolete housing.

F12.5 The way the accommodation supplement abates hinders the ability of community housing organisations to improve housing affordability for their clients.

F12.6 Better utilisation of public housing capital is always desirable, but needs to be managed in a way that does not create fiscal risks elsewhere in the welfare, social service, and justice systems.

F12.7 Robust projections of unmet demand and future demand for social housing that will not be met through increasing or realigning the state housing portfolio are essential for an honest assessment and conversation about what needs to be done, at what pace, and with what resource.

Recommendations

R12.1 Once this funding round is completed, a comprehensive review of the SHU funding process should be undertaken to reduce the cost involved in applying.

R12.2 Provide market rent levels of Accommodation Supplement where community housing organisations provide reduced rents to their clients.

13 Māori housing

Key points

- For many Māori communities, housing is valued more for keeping whānau connected to land, tradition, tūpuna, and their whanaunga, than as a financial investment. It is "about building communities, rather than building houses." This is not to say that Māori are never interested in housing for financial reasons. Housing solutions for Māori will sometimes need to be different, particularly in areas of traditional settlement.
- Māori housing aspirations face challenges related to (on average) lower household incomes and lower financial literacy. Financial literacy education is an important part of any solution to Māori housing needs, especially if a community development approach is taken.
- Māori inquiry participants identified the social and cultural resources they have that could enable them to overcome the other barriers they faced to affordable housing solutions. The Commission is persuaded that this is a realistic approach.
- Whānau Ora is the government response best placed to address Māori housing aspirations, through helping whānau plan and in coordinating local public services. The Commission identifies the role it could play, and what it would have to do to be successful.
- Housing affordability includes ongoing maintenance costs. The Pūtea Taiwhenua (Rural Fund) should be used to provide seed funding to organisations, using a microfinance lending approach, to address the quality of the rural housing stock.
- The review of Kāinga Whenua needs to be drawn to a conclusion, soon. However, whatever the new conditions, it is unlikely to meet the needs of the many Māori in rural New Zealand who would struggle to service a mortgage, or to deliver a great volume of housing on Māori land.
- To get homes built on Māori land, public services, whānau, and finance institutions would all need to take action. In general, this doesn't happen because there are plausible reasons why another group, or someone else within the group, should act first. To address this:
  - A team of Māori housing expert advisors, housed in a national agency like Te Puni Kōkiri or the proposed Whānau Ora commissioning agency, should be made available to Māori land owners with aspirations to build housing on their whenua, to guide them through consent processes.
  - Whānau Ora facilitators should be trained to educate whānau about the options for management structures for their Māori land, and to play a role in developing plans for the use of Māori land for housing (where this is what the whānau wants).
  - Te Puni Kōkiri, working with the Māori Land Court and private finance institutions, should develop options to adapt existing lending policies and precedents for private finance institutions to lend for building homes on Māori land.
- To start the conversation, the Commission has reviewed three models to see whether they could provide the necessary security for banks to lend: trust guarantees, a financial options system, and mutual insurance schemes. Under the right circumstances, each of these shows some promise. As well, the Commission has reviewed two models of housing where there is an element of common ownership. These are licences to occupy (as used by retirement villages) and unit titles, under the Unit Titles Act 2010. Each of these models could form robust ways to manage housing on Māori land.

Findings

F13.1 Housing needs are more pronounced for many Māori, and the contribution to wellbeing housing makes is not strictly the same as for other groups. Housing solutions for Māori will sometimes need to be different, particularly in areas of traditional settlement.

F13.2 Māori are heavily over-represented amongst those with the lowest financial knowledge, and heavily under-represented amongst those with the highest financial knowledge.

F13.3 The social and cultural resources that whānau and communities can bring to bear are essential for resolving the housing and other social issues they face.

F13.4 Whānau Ora is the 'best fit' arm of government currently available for progressing Māori housing aspirations.

F13.5 The review of Kāinga Whenua needs to be drawn to a conclusion, soon. However, whatever the new conditions, it is unlikely to meet the needs of the many Māori in rural New Zealand who would struggle to service a mortgage, or to deliver a great volume of housing on Māori land.

F13.6 The model of using individual mortgages to build homes on Māori land is overextended where initial funding would ordinarily be obtained through mezzanine finance.

F13.7 To get homes built on Māori land, public services, whānau, and finance institutions would all need to take action. In general, this doesn't happen because there are plausible reasons why another group, or someone else within the group, should act first.

Recommendations

R13.1 The Pūtea Taiwhenua (Rural Fund) be used to provide seed funding to organisations for using a microfinance lending approach to address the quality of the rural housing stock.

R13.2 Where the government lends for homes on Māori land, it should manage defaults through a more cost-effective means than repossessing the houses.

R13.3 A team of Māori housing expert advisors, housed in a national agency like Te Puni Kōkiri or the proposed Whānau Ora commissioning agency, be made available to Māori land owners with aspirations to build housing on their whenua.

R13.4 Whānau Ora facilitators be trained to educate whānau about the options for management structures for their Māori land, and to play a role in developing plans for the use of Māori land for housing (where this is what the whānau wants).

R13.5 Te Puni Kōkiri, working with the Māori Land Court and private finance institutions, develop options to adapt existing lending policies and precedents for private finance institutions to lend for building homes on Māori land.

Terms of reference

The Government has asked the Productivity Commission to undertake an inquiry into housing affordability.

New Zealand Productivity Commission Inquiry into Housing Affordability

Issued by the Minister of Finance, the Minister for the Environment, the Minister of Housing, the Minister for Building and Construction, and the Minister for Regulatory Reform ('the referring Ministers').

Pursuant to sections 9 and 11 of the New Zealand Productivity Commission Act 2010, we hereby request that the New Zealand Productivity Commission ('the Commission') undertake an inquiry into housing affordability.

Context

Stability of the home environment is widely considered to be important for social cohesion and family stability. Real house prices in New Zealand are markedly higher than they were a decade ago. The rise in real house prices has been associated with general declines in housing affordability, as indicated by a number of different measures, and in the rate of home ownership. These declines have contributed to increased demand for rental accommodation and additional pressure on the social housing sector. The debt accumulation and wealth effects associated with the rise in house prices may have also exacerbated New Zealand's last economic cycle. Interest rates and exchange rates were arguably higher than they otherwise would have been during the upturn and there has been greater contraction in demand during the recession. Debt accumulation may also be a factor in ongoing economic risks.

Scope

Having regard to the context outlined above, the Commission is requested to undertake an inquiry to evaluate the factors influencing the affordability of housing (both rental and owner-occupied housing), and to examine potential opportunities to increase housing affordability. For the purposes of this evaluation the Commission should:

- Identify and analyse all components of the cost and price of housing.
- Identify mechanisms to improve the affordability of housing, with respect to both the demand and supply of housing and associated infrastructure.
- Identify any significant impediments to home ownership, and assess the feasibility and implications of reducing or removing such impediments.

Particular attention should be given, without limitation, to the following matters:

a) factors influencing the supply of land and basic infrastructure for residential construction;

b) factors influencing the cost of residential construction, including the effect of standards, specifications, approval and title requirements on the cost of new housing construction;

c) the level and growth of productivity in the land development and residential construction industries, and the effect of government regulations on productivity in these industries;

d) the efficiency of taxes, levies and charges imposed at all stages of the housing supply chain;

e) the efficiency of the tax treatment of owner-occupied and rental housing;

f) the influence of changing consumer housing preferences, willingness to pay, and financing costs on housing affordability; and

g) the operation of the overall housing market, with specific reference to the availability of a range of public and private housing types, the demand for housing, and the efficiency of use of the existing residential housing stock.

Consultation Requirements

In undertaking this review, the Commission should consult with key interest groups and affected parties.

Timeframe

The Commission must publish a draft report and/or discussion paper(s) on the inquiry for public comment, followed by a final report, which must be submitted to each of the referring Ministers by 1 February 2012.

BILL ENGLISH, MINISTER OF FINANCE
NICK SMITH, MINISTER FOR THE ENVIRONMENT
PHIL HEATLEY, MINISTER OF HOUSING
MAURICE WILLIAMSON, MINISTER FOR BUILDING AND CONSTRUCTION
RODNEY HIDE, MINISTER FOR REGULATORY REFORM

30 MARCH 2011

NEW ZEALAND
PRODUCTIVITY COMMISSION
Te Kōmihana Whai Hua o Aotearoa