Submission

By

BusinessNZ
The voice of business

to the

Local Government and Environment Select Committee

on the

Affordable Housing: Enabling Territorial Authorities Bill

February 2008

PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

AFFORDABLE HOUSING: ENABLING TERRITORIAL AUTHORITIES BILL SUBMISSION BY BUSINESS NEW ZEALAND[1]

1.0 INTRODUCTION

1.1 Business NZ welcomes the opportunity to comment on the Affordable Housing: Enabling Territorial Authorities Bill ("the Bill"). The rising cost of housing and associated costs is a significant issue for household budgets. Not only does it make up a large proportion of the Consumers Price Index (CPI), it also has considerable implications for other sectors of the economy, particularly the flow-on effects associated with higher interests rates as the Reserve Bank has tightened monetary policy over the last couple of years in response to concerns over inflationary pressures from the housing sector.

1.2 The Bill enables (but does not require) territorial authorities to assess the level of affordable housing in their districts. Following its assessment, a territorial authority may, if it wishes to, develop an affordable housing policy and implement that policy. The explanatory note to the Bill alleges that affordable housing policies will promote the provision of housing affordable to low and moderate income earners and in a manner that takes account of the need for a variety of housing sizes, tenures, and costs.

1.3 Business NZ has serious concerns with the Bill and recommends that it does not proceed. While Business NZ appreciates that the Bill only enables (but does not require) territorial authorities to develop an affordable housing policy, there are likely to be unintended consequences[2] which may well reduce the number of houses available and/or increase the cost of available housing.

1.4 Also, the Bill as drafted represents a taking of property rights off land developers without compensation. The provisions in respect to what territorial authorities can do to facilitate the provision of affordable housing are truly draconian, with the explanatory statement saying that *"there is no limit to the options a territorial authority can consider…[including]…requiring the developer to pay (land or money) to the territorial authority".* The mere fact that this extreme is being contemplated is enough to harm New Zealand's reputation. If implemented, it would be blatant theft. Similarly, outlawing the use of restrictive covenants is of equal concern. While there is no obligation for territorial authorities to develop an affordable housing policy, the danger is that the Bill effectively provides no limits on what territorial authorities can do if they decide to adopt an affordable housing policy.

---

[1] Background information on Business New Zealand is attached as Appendix 1.

[2] Unintended consequences are not necessarily restricted to those mentioned in this paragraph but also include the potential for 'gaming' e.g. developers build 'affordable' housing in a particular block, it's bought up by investors who then onsell for a substantial windfall gain, thereby defeating the whole purpose of the exercise. Trying to prevent such activity is likely to be extremely difficult.

1.5 One of the fundamental principles on which a market economy (such as New Zealand) is based is that property owners (including businesses) have relative security of their property rights and have the right to use their property in the manner they choose (while respecting the same rights of other property owners).

1.6 Investors must also have confidence that any assets they purchase or improve upon will be safe from confiscation and unreasonable restrictions, or alternatively, that they will be compensated for any erosion of their property rights. If this is not the case, then there is limited incentive for anyone to undertake long-term investment.

1.7 If property developers saw themselves as being at the mercy of the territorial authority with little guarantee of long term security in their investment, they would likely have little incentive to invest in projects. Secondly, there might be little discipline for territorial authorities to fully investigate alternatives to ensuring greater affordability of housing as confiscation of developers' land and money would be an easy option.

1.8 Any basic understanding of the economic principle of supply and demand would acknowledge that artificially lowering prices leads to reduced supply and or increased costs for other householders, as developers seek to cover their costs and make a normal profit. This is borne out by overseas studies cited below.

1.9 Notwithstanding the above, there are significant issues in respect to housing costs which deserve critical consideration, as discussed below. These include, but are not limited not, the amount of land available for sub-division.[3]

RECOMMENDATIONS

Business NZ **recommends** that:

The Bill does not proceed.

[3] The 4th Annual Demographia Housing Affordability Survey: 2008 shows that NZ has one of the least affordable housing markets compared to a number of other countries surveyed. Perhaps more importantly, it stated that *"Once again, the Demographia survey leads inevitably to one clear conclusion: affordability of housing is overwhelmingly a function of just one thing, the extent to which governments place artificial restrictions on the supply of residential land."*
"New Zealand (with Australia) has the least affordable housing among all of the surveyed nations. The national Median Multiple is 6.3, more than double the Median Multiple ceiling of 3.0. New Zealand is the only surveyed nation in which all of its markets are rated "severely unaffordable." Tauranga is the least affordable, with a Median Multiple of 7.5. Auckland has a Median Multiple of 6.9."

Without prejudice to the above recommendation

Business NZ **recommends** that:

Artificial restrictions on land availability for sub-division be lifted with the intention of providing a greater supply of land available for sub-division.

Business NZ **recommends** that:

Developers be compensated for any loss of property rights (e.g. in terms of land or money required to be paid from developers) to ensure that they are no worse off after the transaction than they would otherwise be.

2.0 DISCUSSION

2.1 Concern over housing affordability and more particularly, real increases in the cost of housing have been examined on various levels.

2.2 Business NZ understands that the Commerce Select Committee has still to report back on its investigation into affordability issues, while the Reserve Bank and Treasury recommended looking into the potential for improving the responsiveness of housing supply as one possible tool which would directly affect the housing and residential market and thereby supplement the role of interest rates in managing inflation.

2.3 For its part, Business NZ released a publication in April 2007 entitled *"OCR: The Sharpest Tool in the Box? – Giving Interest Rates Some Help to Control Inflation"* While accepting that there were no silver bullets to reduce inflationary pressures, Business NZ outlined a number of options for taking some of the pressures off inflation. Of specific importance to housing costs and inflationary pressures arising from the same, Business NZ recommended (a) improving the quality of regulation, and (b) improving the responsiveness of housing supply.

2.4 In respect to improving the responsiveness of housing supply, Business NZ stated that there appeared to be a range of issues surrounding housing supply that would warrant further investigation. These include:

1. Artificially restricting the amount of land available for new housing can result in artificial price increases as households compete for the strictly limited availability of new sub-divisions;

2. Potential time delays in getting resource consents and building permits which could add to overall housing costs;

3. Issues surrounding requirements for building materials and standards which may add unnecessary costs.

2.5 All the above issues would need to be considered in-depth to determine whether provision should be made for greater flexibility, provided basic public safety standards are met.

2.6 Clearly the issue of land supply would appear on the surface to be the most logical issue to be addressed given significantly rising land development costs – principally as a result of restrictions on land supply. It is accepted, however, that there have also been significant increases in land costs irrespective of constraints on land supply. Notwithstanding this, a greater supply on land available for sub-division should reduce overall costs, particularly in the main metropolitan areas.

Table 1: Household debt

Quarter	**Household debt as % of disposable income**	**Debt servicing as a % of disposable income**
Sep 03	122	9.2
Dec 03	125	9.3
Mar 04	127	9.6
Jun 04	130	9.8
Sep 04	131	10.2
Dec 04	134	10.6
Mar 05	137	10.9
Jun 05	140	11.3
Sep 05	143	11.5
Dec 05	146	11.9
Mar 06	148	12.2
Jun 06	150	12.4
Sep 06	152	12.6
Dec 06	155	12.9
Mar 07	158	13.3
Jun 07	160	13.7
Sep 07	162	14.1

2.7 Household debt levels are currently sitting at 162 per cent of disposable income and debt servicing costs are 14.1 per cent of disposable income largely as a result of previous hikes in interest rates by the Reserve Bank flowing through to most households as fixed rate mortgages come up for renewal. Household debt levels and servicing costs seem to keep edging up without respite. While increasing debt levels have not been a particular problem per se (given relatively low interest rates until recently) this has changed as the impact of recent hikes in the OCR have now hit most households.

2.8 The housing market has cooled significantly over the last few months with both the number of houses being sold and average number of days taken to sell increasing.

2.9 Notwithstanding the now widely accepted slowdown in the increase of housing prices, the ability of many people to afford houses has declined given the double digit growth in housing prices for a number of years. As can be seen below, for the last six years, average house prices have increased on an annualised basis of between 10 and 25 percent. While household income growth has also been relatively strong over this period, particularly given what economists would refer to as "full employment", growth in household income has obviously not kept pace with an, until recently, rampant housing market.

Figure 10: Housing Prices

2.10 The problem of reducing housing costs and making houses more affordable is best met through ensuring that that are no artificial barriers in terms of the supply of housing stock. Currently, as stated above, housing costs are artificially inflated through effective controls on land supply. Such restrictions need to be removed as far as possible, with controls over land use only applied where there are strong public health or safety issues involved.

2.11 The proposals outlined in the Bill are likely to be counterproductive and even further restrict housing supply, thus leading to higher overall prices than otherwise would be the case. Restricting or requiring developers to supply certain areas of "low-cost" housing is likely to result in higher costs on other sections of the community as developers try and recoup losses. The alternative, if they cannot effectively recoup losses, will be a tendency to provide even less housing than currently is the case with overall inflationary pressures rising in the housing sector and affordability of housing becoming even more of an issue than it is now. Overseas studies bear this out, some of which are briefly mentioned below.

Overseas evidence on "affordable housing" initiatives

2.12 A number of overseas (US) studies show the adverse effects with proposals to require developers to provide for low-cost ("affordable") housing.

2.13 Papers from economists provide persuasive evidence that forcing developers to provide 'affordable housing' as part of their resource consents actually reduces the supply of housing and increases prices.

2.14 In their 2004 paper, **Housing Supply and Affordability: Do Affordable Housing Mandates Work?**, Benjamin Powell and Edward Stringham concluded that *"by restricting the supply of new homes and driving up the price of both newly constructed market-rate homes and the existing stock of homes, inclusionary zoning (forcing developers to provide below market-priced homes) makes housing less affordable."*[4]

2.15 The paper stated that *"…Economics 101 tells us that price controls like those imposed by inclusionary zoning will likely lead to less housing not more, and may well reduce the amount of affordable housing available in the communities that need it most. As developers have often pointed out, if they are required to sell some houses at prices below market rates, they will have to make up the difference by raising the prices of other homes in the development. And if that does not work, they can simply shift development to other communities where there are not inclusionary zoning mandates. Either way you get higher prices or less housing."*

[4] Reason Public Policy Institute, "Housing Supply and Affordability: Do Affordable Housing Mandates Work?", by Benjamin Powell and Edward Stringham (April 2004).

2.16 The paper considered that the main reason why inclusionary zoning has failed to create more affordable housing is that price controls do not get to the root cause of the affordable housing problem given that supply has not kept up with demand due to artificial restrictions. While US based, the paper cited a study that found that 90 percent of the difference between physical construction costs and the market price of new homes can be attributed to land use regulation.

2.17 Three economists, in an Independent Policy Report "Below-Market Housing Mandates as Takings: Measuring their Impact"[5] concluded that: *"Over a ten-year period, cities that imposed a below-market housing mandate on average ended up with 10 percent fewer homes and 20 percent higher prices. These results are highly significant. The assertion by the court in **Home Builders Association v. Napa** that "the ordinance will necessarily increase the supply of affordable housing is simply untrue."*

2.18 "Below-market housing mandates are simply a type of price control, and nearly every economist agrees that price controls on housing lead to a decrease in quantity and quality of housing available. Because these price controls apply to a percentage of new housing, and builders must comply with them if they want to build market-rate housing, price controls also will affect the supply of market-rate housing. Because price controls act as a tax on new housing, we would expect a supply shift leading to less output and higher prices for all remaining units."

2.19 "….The costs of below-market housing mandates are a taking no different in substance from an outright taking under eminent domain.[6] Below-market housing mandates…should rightly be considered a taking, in terms of economics, below-market housing mandates only differ from an outright taking in degree – there is not a "total taking" but a partial taking and clearly a diminution of value without any compensation. The amount of harm imposed by below-market housing mandates should inform their status under the law."

---

[5] The Independent Institute, "Below-Market Housing Mandates as Takings: Measuring their Impact" by Tom Means, Edward Stringham, and Edward Lopez (November 2007).

[6] A *taking* is an action by a government depriving a person of private property without the payment of reasonable compensation. A government can do this in several ways including:
(a) physically occupying it and preventing others to enter upon it;
(b) exercising the power of eminent domain (see below); and
(c) regulating its use to such a degree that it no longer has any economically available use (a regulatory taking).

Eminent domain (which exits in common law legal systems), is the inherent power of the state to seize a citizen's private property, or rights in property, without the owners consent. The property is taken either for government use or by delegation to third parties who will devote it to "public use". The most common uses of property taken by eminent domain are public utilities, highways, and railroads. Many countries and states require that the government body offer to purchase the property before resorting to the use of eminent domain.

2.20 Before even contemplating proceeding with this Bill, the Government needs to clearly analyse and demonstrate why the above international studies (which involve applying simple economic principles of supply and demand to the housing market) will somehow not apply in the case of housing market in New Zealand.

Business NZ **recommends** that:

the Bill does not proceed.

Without prejudice to the above recommendation

Business NZ **recommends** that:

Artificial restrictions on land availability for sub-division be lifted with the intention of providing a greater supply of land available for sub-division.

Business NZ **recommends** that:

Developers be compensated for any loss of property rights (e.g. in terms of land or money required to be paid from developers) to ensure that they are no worse off after the transaction than they would otherwise be.

APPENDIX 1

BACKGROUND INFORMATION ON BUSINESS NEW ZEALAND

Business New Zealand is New Zealand's largest business advocacy organisation.

Through its four founding member organisations – EMA Northern, EMA Central, Canterbury Employers' Chamber of Commerce and the Otago-Southland Employers' Association – and 70 affiliated trade and industry associations, Business NZ represents the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business NZ contributes to Governmental and tripartite working parties and international bodies including the International Labour Organisation, the International Organisation of Employers and the Business and Industry Advisory Council to the Organisation for Economic Cooperation and Development.