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BUILDING BETTER HOMES, TOWNS AND CITIES

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# Thinking About the Logics of Affordable New Build Delivery

## Some Preliminary Thoughts on the Structural Position of Different Types of New-Builders

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# Thinking About the Logics of Affordable New Build Delivery:

## Some Preliminary Thoughts on the Structural Position of Different Types of New-Builders

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## Introduction

New Zealand faces three conundrums in relation to its housing stock and the new builds which replenish it. The first is persistent under-supply of housing both in the aggregate and, more particularly, housing affordable to people and households on lower and middle incomes. The second, is misalignment between the new built stock typology and functionality in relation to the needs of New Zealand's population now and into the future. The third is a seemingly obstinate seam of poor quality builds, builds subject to major performance problems or uncompleted builds which have negative impacts on buyers. Anxieties around each of those problems have been expressed in the political arena, by the building industry, by community organisations, and by ordinary individuals and households.

Indeed, the Building Better Homes Towns and Cities National Science Challenge was the 'people's choice' in the public consultation on the targeting of research investment to solve New Zealand's big problems and position New Zealand for a better future. It is a choice that reflects pent-up frustration with both the seemingly intractable nature of these problems and the immediacy of them. The marginalisation of people from home ownership, over-heated house prices, to widespread unaffordability to leaky homes, to New Zealand's extraordinary rate of driveway deaths and injuries, have profound impacts on the social, psychological and financial futures of individuals and families as well as acting as a drag on national and regional economies.

No one wants these outcomes, yet we appear to have little ability to deal with them. The stream of work in this Strategic Research Area of the Building Better Homes Towns and Cities digs into the deep 'architecture' of the building industry, the relationships between housing providers and housing consumers, the pathway dependencies between actors in the complex web of transactions that deliver housing into communities and to people, and the calculative logics that generate these seeming inertias. To date the long-term outcomes of the logics, and the tools different players use to make decisions, are often not clear and we do not understand how they affect New Zealand's ability to get affordable homes in towns and cities that are productive and meet the needs of the diversity of people who live in them. Nor do we understand how the fundamental logics arising out of different structural positions, the tools different actors use to make decisions and the nature of the relationships they have with other actors might be adjusted to get better overall outcomes.

SRA – The Architecture of Decision-making, focuses on three nodes in which logics are structured and decisions made. Those are, first, critical resources holders, particularly the holders and suppliers of land and finance. The second node, critical actors, consists of two sets of actors. On the demand-side are householders who may influence but effectively are the consumers of the dwellings delivered into the housing market. The other set of critical actors are on the supply-side. They transform land and finance into homes and built environments. They include developers, housing providers (public, private and community), the construction industry and infrastructure providers. The final node on which this SRA focuses is the myriad of agents who influence the supply of land, manage financial risk, the impacts of development and the performance of dwellings on behalf of society and for the public good.

This paper focuses on the critical actors in supply. It argues that certain logics arise out of the different structural positions of those who deliver new builds into the housing stock. It suggests that suppliers of new-builds can be best understood as positioned along two dimensions:

- The quartile of value of stock and the populations to which new builds are targeted; and
- The extent to which the provider of new builds is locked into a long-term commitment to that stock and the people who live in it.

It argues that private developers and builders have no long-term commitment to the stock they build. In addition, changes in the policy framework around affordable housing over the last three decades have pushed them to focus on higher value quartiles of stock. Finally, that those two dynamics have generated a short-term, transactional approach that encourages poor performance and destabilises the industry. The paper contrasts that structural position with two other new-build suppliers – retirement villages (RVs) and community housing providers (CHPS). Finally, the paper focuses on the potential for strengthening the engagement with the building industry in ways that will not only deliver affordable housing and value for money, but also serve to stabilise the building industry itself.

### Key Actors Delivering New Builds

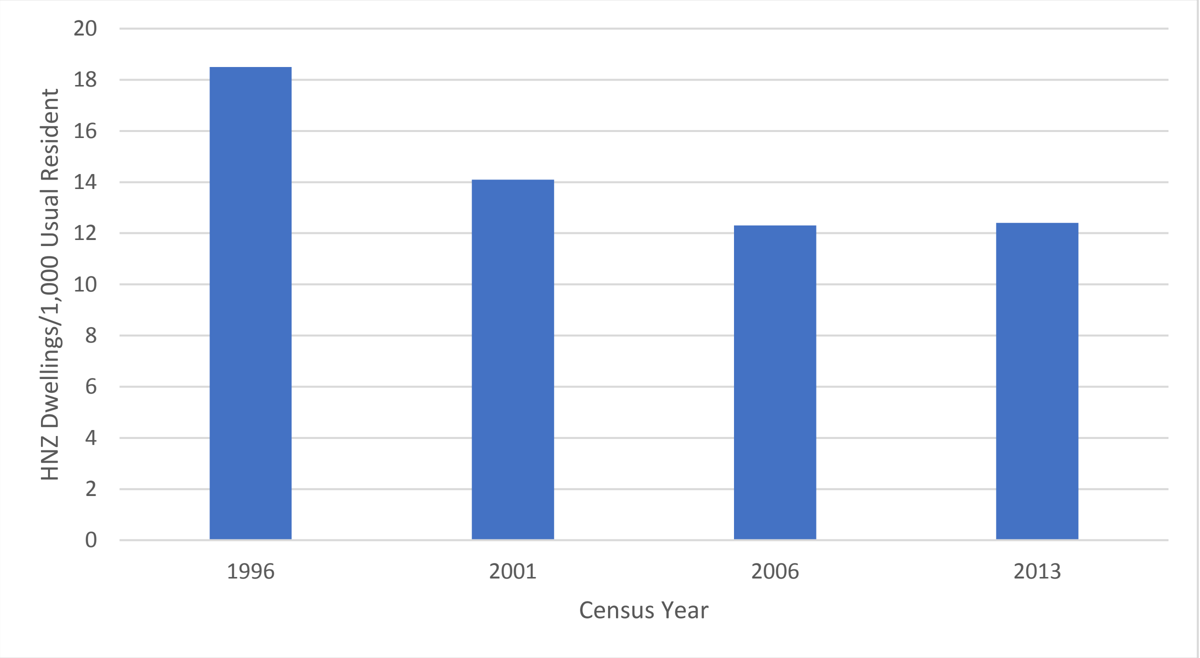
The vast majority of new builds are by developers/builders delivering to investors or owner occupiers. There are some critical characteristics associated with the production and delivery of stock by those actors:

- The build or development is typically initiated by the supplier or when commissioned from the supplier's existing set of plans or product range.
- Developer/builders have no long-term ownership or management interest in the developments they generate or the dwellings they build. Indeed, some would argue that their exposure to liabilities around 'failures', either financial or in terms of stock performance, can be minimised and avoided.
- Buyers and users of that stock may also have no long-term commitment to (or right to use in the case of tenants) the stock itself. In the context of rising house prices, dwellings may become primarily used for investment and speculative purposes rather than primarily for amenity/use value or even as a long-term asset.
- Developer/builders tend to deliver stock that they believe will have the most generalised appeal and are resistant to accreditations beyond the New Zealand Building Code (NZBC) unless significant price premiums can be attained.
- Developers/builders are sensitive to building cycles. The quantum and price of delivered stock can ebb and flow in relation to aggregate demand, matters of resource supply including labour availability, and also calculative practices centred on financial viability within the industry.[1]

[1] Those calculative practices, the impact of them on affordable housing supply, and the misunderstandings around them are being explored within this SRA. An initial commentary on calculative practices can be found in Murphy, 2017.

There are other actors, however, that supply new builds into the market. In the New Zealand context, three are important currently or in the past: central and local government, RVs, and CHPs. The building and provision of housing by central and local government has been largely curtailed and in both sectors, there have been moves to dispose of existing stock. In the case of local government, there have been contradictory signals from central government over the last three decades about the legitimacy of local government involvement in delivering housing. Councils have not been incentivised to build new stock. Nor, under current policy, are councils to access the Income Related Rent Subsidy (IRRS) for new tenants.[2] New-build in the Housing New Zealand (HNZ) stock has always been limited, but declined significantly since 1996.[3] As Figure 1 shows, the rate of HNZ stock per population saw a particularly acute fall in the mid-1990s. In short, of local and central government, RVs and CHPs, building dwellings and delivering housing is the core business of only RVs and CHPs. Both currently only have small stocks, but they are active new builders. They and developer/builders are then the focus of this paper.

**Figure 1 Rate of HNZ Dwelling Supply 1996-2013[4]**




[2] There is considerable argument around whether IRRS provides an adequate basis on which to build new stock. Some capital assistance was provided to some CHPs to supplement the IRRs to support building, first at 30 percent of build cost then 50 percent in May 2016. The Minister of Housing stated she was confident that this would incentivise CHPs to pursue building programmes (See The Nation: Lisa Owen interviews Paula Bennet, 10 September 2016). As Saville-Smith *et al.*, (2017: ii, 6-7, 13) show, that view is not universally shared by CHPS delivering new builds unless they have already well-established lines of credit *and* a significant portfolio of stock the value of which can secure borrowing. Typically, CHPs with the latter have acquired their stock through substantial government investment over the post-war period. Many CHPs report that IRRS in and of itself is not sufficient to fund borrowing and stock expansion.

[3] Olssen *et* al., 2010.

[4] HNZ, Annual Report, 1996 and Census data 1996, 2001, 2006, 2013.

For CHPs and RVs there are some critical characteristics associated with the production and delivery of stock. They:

- Have long-term ownership and management interests in the stock they build and deliver.
- Target particular segments of the housing market. In the case of RVs the market segment is older owner occupiers with significant capital wishing to downsize.[5] Among CHPs targeting tends to be disadvantaged families and individuals marginal to the rental market and home ownership.[6]
- Provide diverse tenure opportunities which are not currently typical in the housing market. Among CHPs that includes rental, shared ownership, license to occupy (LTOs), rent for buy. In RVs the dominant, although not the only, tenure is LTOs.[7]
- Are highly regulated unlike other dwelling providers involved in new builds.

For RVs long-term commitments to their stocks and their residents are locked in by the Retirement Village Act 2003 and the Code of Practice 2008. This includes a memorial struck against the land title of a retirement village. That memorial is designed to ensure that a retirement village can only be disposed of as a going concern. The occupation rights of residents cannot be unilaterally cancelled and residents have secured interests in a village that is prioritised over other liabilities such as mortgages of an owner operator.[8]

Similarly, to be registered as a CHP, irrespective of whether or not they receive the IRRS from government for one or more stock units, a CHP must be registered by the Community Housing Regulatory Authority (CHRA). Registration involves assuring CHRA that tenancy management will involve:

- *Supporting tenants experiencing financial hardship, including arrears management*
- *Referring tenants to budgeting advice services*
- *Ensuring that ending tenancies is a last resort.*

CHPS must report annually to CHRA in considerable detail about their operations and financial position to maintain their registration.[9] Charities Services also require CHPs to report on activities to sustain their registration as a charity. In addition, under the new insulation and fire alarm requirements, CHPs are required to ensure that their existing stock meets the new standards well before private landlords. Private landlords, even when their tenants receive the government funded Accommodation Supplement, are required to meet the new standards by July 2019. CHPs were required to meet those compliance standards by July 2016. While the latter requirement is ostensibly associated with receipt of the IRRS, CHPs not receiving the IRRS have already been asked to demonstrate compliance with the new insulation requirements as part of their registration monitoring process.[10]

In short, both CHPs and RVs are embedded in distinct regulatory and administrative structures that demand that they deliver to residents a high level of certainty, stock performance and security. RVs and CHPs also have some significant differences. RVs drive

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[5] Saville-Smith, James and Rehm, 2016.
[6] Saville-Smith, Fraser and Saville-Smith, 2014:7-8.
[7] Jones Lang LaSalle, 2017.
[8] Retirement Village Act, 2003, Section 22.
[9] See the performance standard guidelines for a sense of the considerable detail and complexity required of CHPs http://chra.mbie.govt.nz/assets/Uploads/performance-standards-guidelines.pdf.
[10] MBIE, 2015.

capital injections through, in some cases, shareholder investment and through capital acquired through the sale of LTOs. Few CHPs have capital inputs through the sale of shares in their stock, although shared ownership programmes do provide capital injections for some. Most are reliant on government or charitable funding for capital injections. In that sense, CHPs can be more akin to developers/builders in the sense that stock expansion is increasingly associated with a need to seek private market finance. Queenstown Lakes Community Housing Trust presents a variation from the mainstream because it receives development contributions associated with inclusionary zoning. Accessing capital through resident co-payments in the form of shared ownership has become problematic because of the Charities Service's views regarding the populations able to be assisted under the Charities Act.

### New Builds and Structural Position in the Landscape

CHPs and RVs build dwellings either through their own internalised building operations or through contracting with the building industry. What they have in common is they build dwellings because they wish to provide housing in the long-term. This differentiates them from most developers/builders. Unlike the latter, CHPs and RVs are locked into a long-term commitment to their stock and the people who live in it. One of the most important differentiators of CHPs and RVs is the value of stock they build to meet the needs of their market segments. RVs provide entry affordability to what is a comparatively wealthy population through LTOs and fund their management of service through service fees and deferred management charges. Because of that business model it is not easy to make direct comparisons between the CHPs, RVs and developer/builder new build values. Notably, however, an Auckland RV has recently sold the first LTO for more than a million dollars. Despite the problems associated with comparing stock values because of the different tenure and market arrangements, it is clear that CHPs target the lower quartiles of stock value. That directly reflects the low incomes of their residents.[11] By contrast, developer/builders have increasingly targeted their production of new-builds to upper quartiles of value.

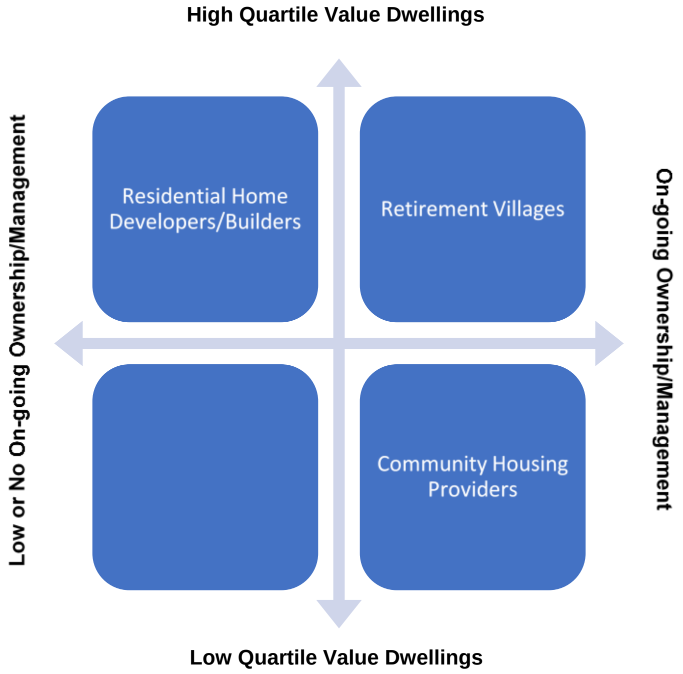
Figure 2 provides a schematic illustration of the new build landscape when these two dimensions of on-going interest in the stock and the targeted quartile of value are articulated. Some might argue that private landlords should be assigned to the lower left quartile of this schema. They, typically, however, are consumers of builds rather than procurers of builds. Property investors concerned with providing rental housing certainly buy apartments but usually off plans or speculative builds by developers/builders delivering units in body corporates[12] or, even more usually, existing and older dwellings on the market.[13] The actors of interest in this paper are those who actively procure and/or deliver new builds into the stock: developer/builders, RVs and CHPs.

[11] Saville-Smith *et al*., 2017: 7.

[12] See Darroch, 2010, for an analysis of investment in rental housing in the Auckland context. See also Dixon and Dupuis, 2003 and Dupuis, *et al*., 2002 for analysis of the tension between use and investment in the apartment sector.

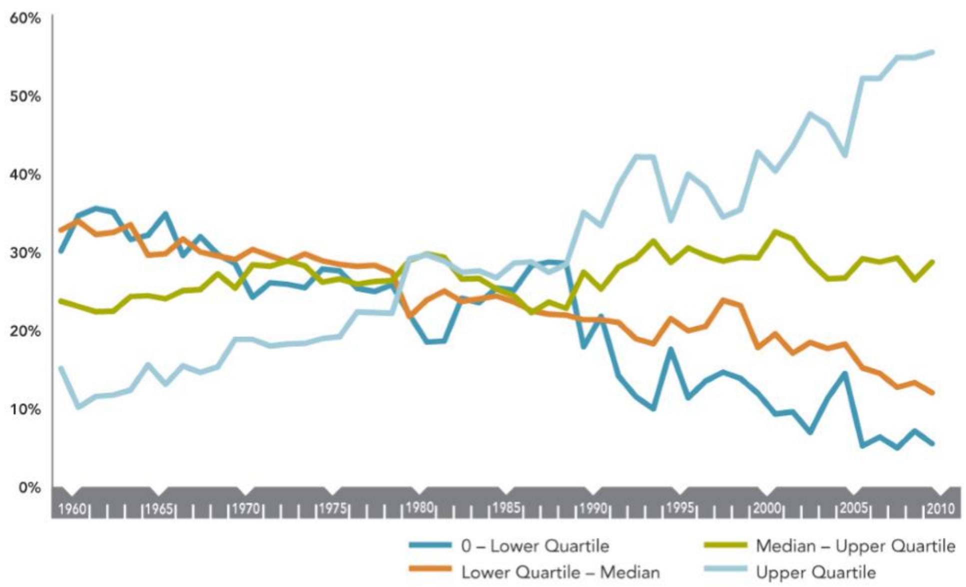
[13] Buckett, Jones and Marston, 2012; White, *et al*., 2017.

**Figure 2 Current Landscape of New Build Delivery in Key Dimensions**




The currently diametrical pattern of CHPs and developer/builders is by no means fixed. While CHPs are persistently positioned within the lower, right quarter, it can be argued that the building industry sector has in the past targeted lower quartile dwelling values (Figure 3).

**Figure 3 Proportions of New Builds Delivered by Dwelling Value Quartiles 1960-2010**




*Source:* Productivity Commission calculation using QV data

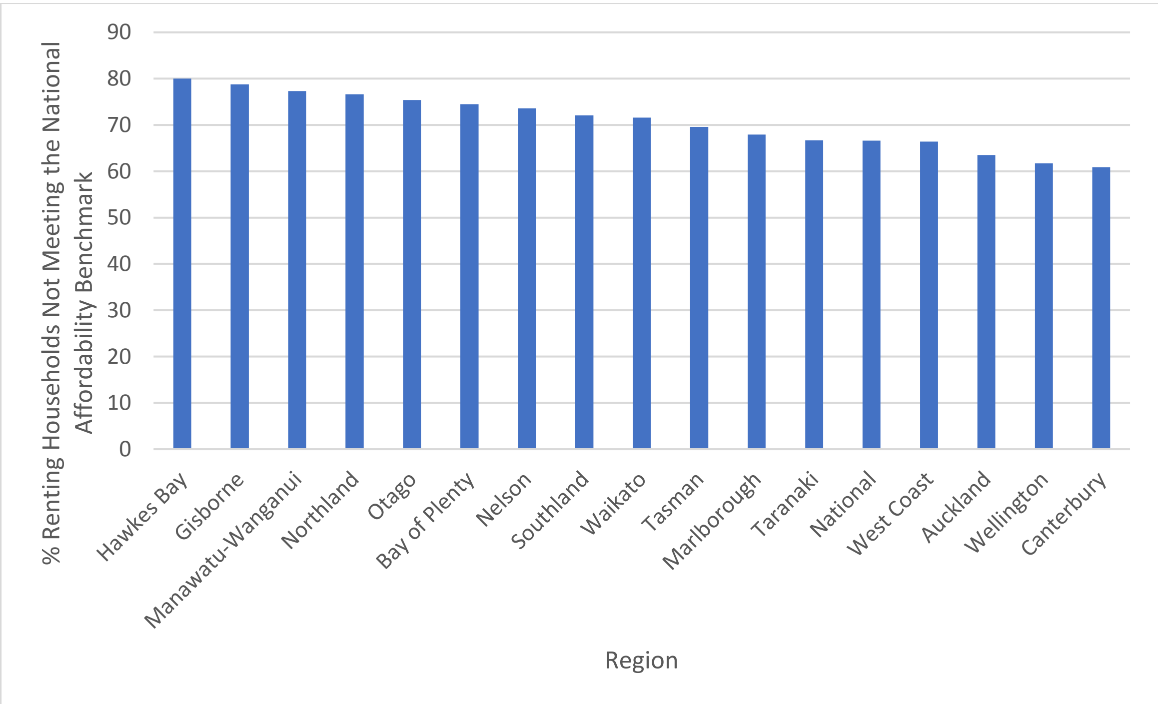
*Notes:*

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.

The 1960s saw more than 60 percent of new residential builds falling into the lower two quartiles of value. Under those circumstances, developer/builders could be best portrayed as lying predominately in the lower left quartile and RVs disappear altogether. In the 1980s, the production of new builds was, despite some fluctuation, broadly distributed evenly across the four quartiles of value. From 1990, however, the pattern of new builds showed a reversal of the distribution evident in the 1960s. Increasingly higher proportions of builds were directed to higher quartiles of value from the 1990s. By 2010, more than half of new-builds were in were in the highest quartile of value. Meanwhile, production in the lowest quartile of value had plummeted to less than 10 percent of new residential dwellings and the next lower quartile of value attracted less than 20 percent of builds.[14]

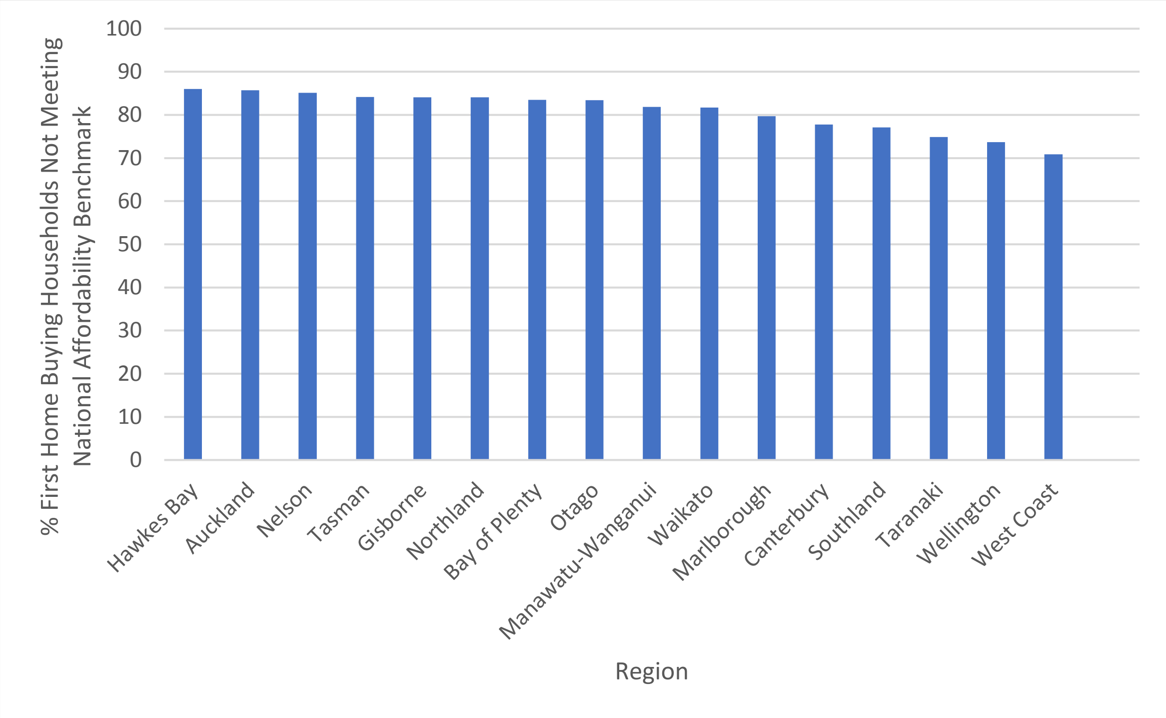
With around three-quarters of new builds in the two highest quartiles of value, the problems of aggregate under-supply have been exacerbated by under-supply for lower income home owners as well as presenting barriers to entry for first home owners. The decline in owner occupation associated with low levels of supply in the lower quartiles of value have contributed to widespread unaffordability, not only for owner occupiers but also for households in rented dwellings (Figure 4). The recently released Housing Affordability Measure (HAM) suggests that since 2007 over 80 percent of first home buyer households have consistently been unable to meet the National Affordability Benchmark. Even in areas in which population growth was limited, more than 70 percent of first home buyers were unable to meet the National Affordability Benchmark in June 2015 (Figure 5).[15]

**Figure 4 Renting Households Not Meeting the National Affordability Benchmark June 2015**




[14] Productivity Commission, 2012:6.
[15] MBIE, 2017:15.

**Figure 5 First Home Buying Households Not Meeting the National Affordability Benchmark June 2015**[16]




## Exiting Lower Quartiles of New Builds

The period around which the balance between targeting lower and higher quartiles of dwellings altered was marked by three changes:

- First, there was a significant re-working of the institutional landscape of housing assistance and capital allocation around housing which pushed developers/builders away from a focus on lower quartiles of house value.
- Second, there were new opportunities to access credit through the retail banking sector and international finance, including new forms of mortgage innovation.
- Third, and arguably associated with and subsequent to the previously noted opportunities for accessing credit, were changes in house prices supported by the promotion within the

[16] There has been some debate about the HAM since its release:

- There has been a suggestion that the data is 'old'. The HAM constitutes a significant advance in New Zealand's analytics and the reporting of 'old' data should be considered a strength. The provision of a time series, as this does, provides an opportunity to better understand trends across periods in which market, regulatory and policy settings may have changed. Whether the implication is that there would have been significant increases in affordability or decreases in affordability is unclear. In personal communication with some officials, it has been suggested that the 2016 and 2017 HAM would show a significant fall in the proportions of household unable to reach the National Affordability Benchmark. To do so, one or more of the following conditions would have to prevail: (a) a significant increase in household incomes; (b) a significant decrease in dwelling prices; and, (c) further falls in mortgage interest rates. Those conditions do not appear to have been met since 2015, but the next update of the HAM will be of interest.
- It has also been reported that the Reserve Bank suggested that the interest rates used in the model calculating affordability is too low. The issue of appropriate settings such as interest rates is always contestable. In this case, if HAM had used the setting reportedly recommended by Reserve Bank, the proportions unable to meet the National Affordability Benchmark would have been higher than those reported.

building and real estate industries increased dwelling-related consumption for instance double and triple car garages and landscaped sites.

### *Changing Institutional Landscape of Housing Investment and Government Policy*

The late 1980s and early 1990s saw significant changes in the framing and institutional landscape of housing assistance and provision. Those included, most critically, the institutional restructuring of the Housing Corporation of New Zealand (HCNZ), the sale of the government's mortgage portfolio which had accumulated since the establishment of State Advances, and the replacement of income-related mortgages for first home owners and income-related rentals for state housing tenants by an untied Accommodation Supplement.[17] The latter effectively transformed housing assistance from social investment to welfarism.

The movement from post-war social investment in housing to benefit-based welfarism was also accompanied by reductions in capital funding for new builds targeting low income households. State support for first home buying families to build deposits were also removed. The ability to capitalise universal family benefits was lost when the family benefit itself was abolished in 1991. The latter, and the loss of income-related interest rates for mortgages, affected low income and particularly sole parent families which had been served by a number of builder developers in the 1970s and 1980s. In addition, the building industry was affected by reductions in the building of council and government owned rental housing. Equally importantly, latent and unmet demand for CHP housing evident of the last decade[18] has not driven a significant supply-side response in lower quartile value housing because of difficulties in accessing capital, uncertainties around the tax status of CHPs, and uncertainties around charitable status.[19]

### *Credit, Rising Consumption and Rising House Prices*

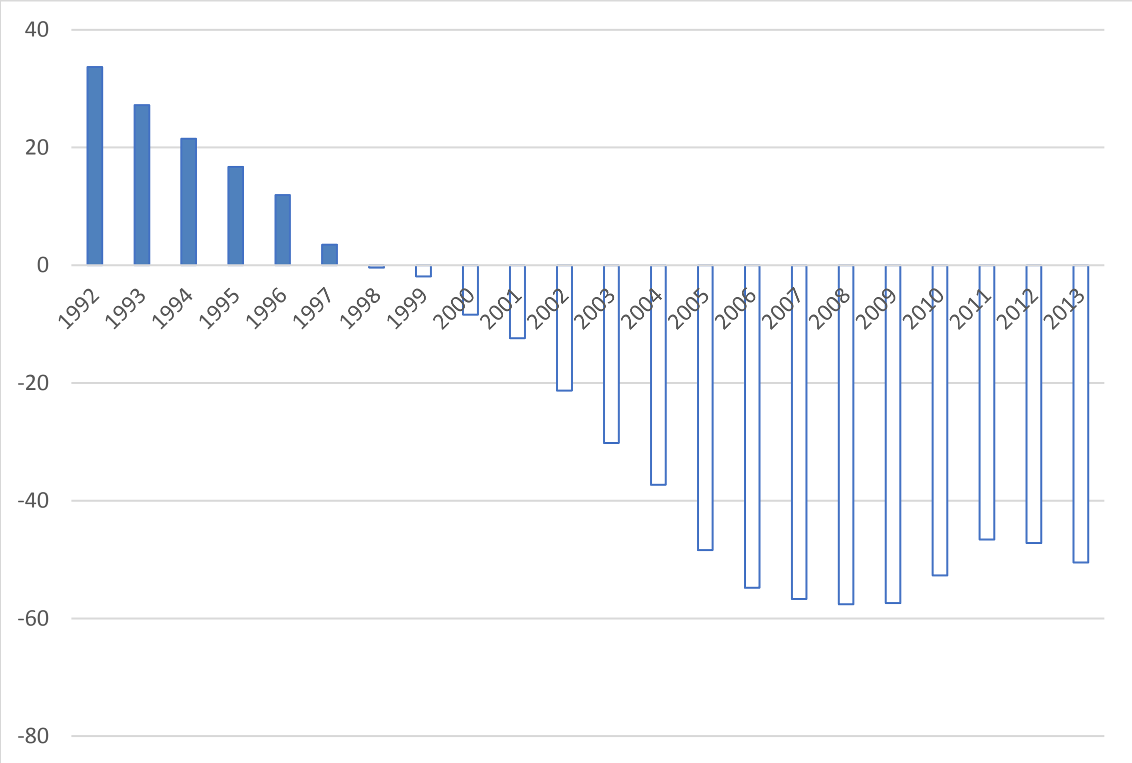
In parallel with those changes there was increased access to credit, often secured by the asset value of dwellings but not restricted to providing credit for the purchase of the dwelling itself. Changes in mortgage markets and mortgage securitisation characterised the early 1990s globally. In terms of retail banking, this had less impact for New Zealand than apparent in the United States, the United Kingdom, and even Australia.[20] It had a profound impact on the access and the conditions of access to mortgages among low income families. Their entry to home ownership was facilitated by income-related mortgage provision by the HCNZ. There were significant constraints placed on applicants regarding their indebtedness and their mortgage was tied entirely to house purchase. The global developments around mortgage securitisation underpinned and facilitated the sale of the HCNZ mortgage portfolio and eventual disestablishment and replacement by HNZ. It set the conditions for the eventual movement of the building industry away from the production of low cost, entry level housing. The global flush of liquidity also evident at the time saw considerable mortgage innovation in New Zealand. This was facilitated by New Zealand banks accessing global, wholesale money markets. Most importantly, it broke the link between domestic savings and the provision of

[17] Murphy, 2000; Murphy, 2003.
[18] Saville-Smith, Fraser and Saville-Smith, 2014: 8-9.
[19] Saville-Smith *et al*., 2017.
[20] Murphy, 2011.

credit. This was associated with flushes of liquidity and access to credit among householders who had previously been restricted in access to credit.

Increased access to credit is evident in Figure 6 which shows the percentage of nominal income available after debt 1992-2913.[21] Arguably, rising house prices evident throughout New Zealand in the mid-1990s and into the early years of the 21st century were fuelled by the de-coupling of domestic saving and expansion in the banking sector and access to new and less constrained forms of credit to households. For some households, the home became transformed into an asset underwriting credit. For other households that dynamic, combined with the exit of the building industry out of entry priced housing, was associated with exclusion from home ownership.

**Figure 6 Percentage of Household Nominal Income Available After Debt 1992-2013**




For developer/builders, those dynamics and increases in median house prices[22] combined with a reduction in actualised demand among those looking for lower quartile value housing, provide the context for developer/builders to move into higher value production. A new liquidity among householders, some of whom subsequently found themselves over-leveraged, may have acted as a pull factor in the re-focusing on higher value dwellings with developer/builders providing more amenities such as landscaping than previously provided in entry level homes. The latter may have also been driven around planning requirements in some councils for on-site hard surfacing for parking spaces and the like.

The shift in median house prices is driven primarily by the sale and purchase of existing stock. The prices of existing dwellings are important for the price of new builds. While it is

[21] Reserve Bank of New Zealand, 2017.
[22] Rehm and Murphy, 2016.

popularly believed that new build house prices are driven by a cost-plus approach by developers/builders, the practices of developers/builders suggest otherwise. Developer/builders typically make decisions around whether to acquire land and build by using residual valuation models. Rapidly increasing housing prices alter the bids that developers make for land and, under competitive bidding processes, determines the purchase price of land.[23] Thus under competitive market conditions, developer/builders focusing on high value housing developments will outbid developer/builders seeking to build low price, entry level housing. As the quantum of mortgage finance increases and house prices are bid up, developers with a 'bullish' view of house prices will secure (buy) the land and building output shifts to high value/priced housing outputs.

Under those circumstances, developer/builders are likely to redirect their attention to producing dwellings not affordable to those on lower incomes. CHPs cannot, *a priori*, redirect their attention to delivering higher cost housing, developer/builders can and do. CHPs target low income individuals and households and those marginal to the housing market. Where CHPs are involved in the production of dwellings through procurement they do so in the lower quartiles of value. CHPS have struggled to find capital funding, a problem exacerbated by recent uncertainties around charitable status. Those uncertainties impact on the tax status of CHPs but also the ability of CHPs to pursue funding from charitable funders.

Those uncertainties, as well as the diminishing capital funding directed to community housing, have affected CHPs' ability to provide a sustained procurement pipeline for the building industry. A perhaps less obvious but equally important consequence is a tendency for some CHAs to land-bank over longer than desirable periods. There are costs associated with the holding of vacant land although some councils have a policy to reduce rates for vacant land owned by charities. Some CHPs, like other developers and builders, can use land assets to underwrite the costs of construction. Notably, the latter tends to be associated with delays in using that land for construction and can itself become a barrier to development. One CHP reported when participating in recent research on the dynamics of borrowing on the retail market:

> *We are sitting on three sections. They underwrite a very small mortgage with the bank for a rental dwelling. As our banker says, they don't want to secure against the value of the rental dwelling itself. They don't want to expose themselves to the risk of having to evict vulnerable tenants if they ever had to foreclose. It would not be a good look for the bank.*[24]

### *Costs of 'Over'-Consumption*

It is well recognised that the dwellings produced as entry level homes in the lower quartiles of value in the post-war period were simple homes. Three developments have characterised New Zealand's dwellings from the late 20$^{th}$ century until now: improvements in building performance, particularly thermal performance; changes in the new-build 'package' delivered to new home owners; and, increases in dwelling size. There is limited research into the impacts of those developments on construction costs and house prices. The idea that improved performance requirements under the NZBC are a cost driver is often referred to in the context of NZBC reviews, but the costs of such items as insulation and double glazing

[23] Murphy, 2017.

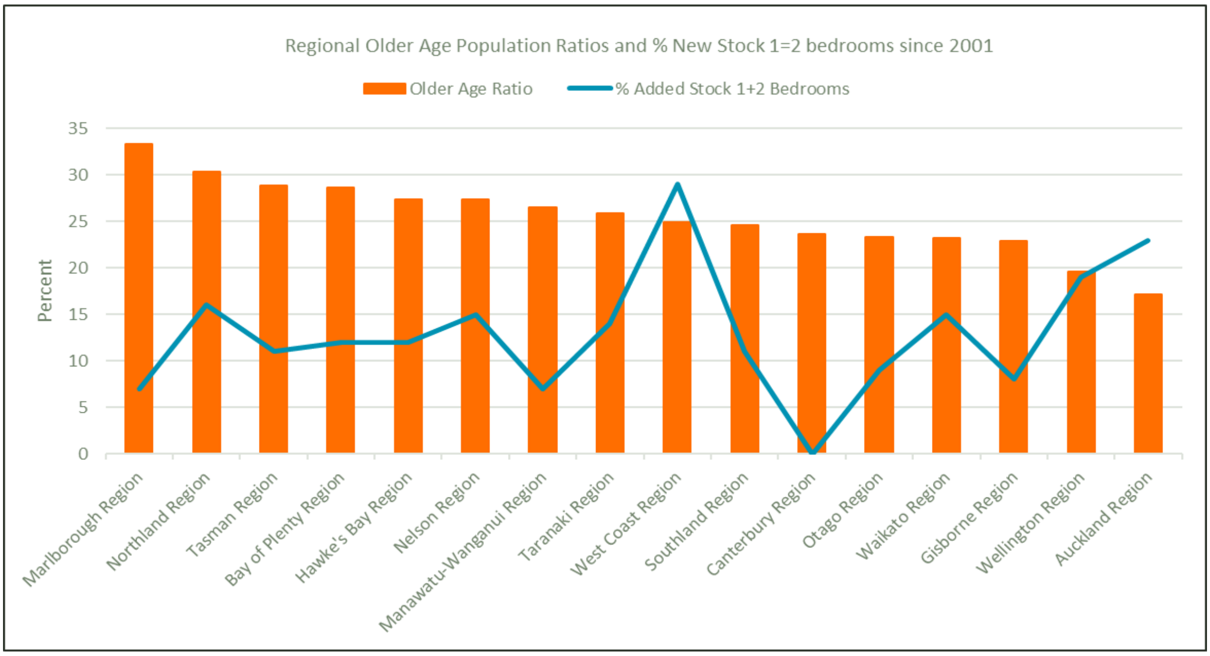
[24] Saville-Smith, *et al*., 2017.

have reduced substantially since 1978 when thermal performance requirements were first included in the NZBC. Similarly, there is evidence both in New Zealand and overseas that improved performance around accessibility and functionality through universal design or LifeMark accreditation has minimal impacts on construction costs.[25]

What has clearly changed in the last twenty years or so is the 'package' associated with a new home. Landscaping, fencing, and driveways are typically part of the package promoted by group home builders. Some of the amenities such as driveways and parking spaces have been generated out of local council requirements around subdivision. Others reflect the imposition of covenants by developers. The prevalence of covenants and their impacts either on construction costs or house prices has not been researched systematically in New Zealand, but will be under The Architecture of Decision-Making SRA. Notwithstanding, there seem to be a number of amenities delivered by developer/builders which reflect a desire to 'add-value' to the product they are delivering. It appears that the concept of the 'turn key' has gone beyond the notion of a dwelling able to be used and code compliant to, increasingly, an idea of a house requiring no further work or investment either inside or out by the owner.

The third aspect of housing consumption in new-builds relates to dwelling size. It has long been recognised that dwelling floor sizes have become increasingly de-coupled from the numbers of people living within them. Certainly, as Figure 7 shows, the production of 1 and 2 bed-room homes remains out of alignment with the ageing population which is associated with falling household size. It is notable that the production of 1- and 2- bedroom dwellings is most prevalent in Auckland, almost undoubtedly driven by a combination of student apartments and retirement villages.

**Figure 7 Older Age Population Ratios and % New Stock with 1 or 2 Bedrooms since 2001[26]**




[25] Saville-Smith, 2013.
[26] Stock analysis provided by Dr Michael Rehm, Business School, University of Auckland.

There are costs associated with larger new builds. In the past, there was a tendency for developer/builders to present bigger homes with a lower per square metre price as better value than smaller homes. It is notable that recent industry discourse through builder and developer websites has shown a significant shift around this. It is unclear what prompted this shift, although it seems likely to have been influenced by the wider public discourse on unaffordability which has manifest itself in the 'tiny home' movement. There has also been some analysis around the operating costs of larger homes, particularly in relation to energy consumption.[27] It is unclear to what extent those commentaries have infiltrated home size tastes. Recent research on downsizing, however, has found that among older movers there is an unmet demand for smaller homes in the open market. The lack of supply of smaller dwellings has prompted some older people to move into retirement villages.[28] A similar pattern of under-supply in the open market for smaller dwellings has also marked the movement into retirement villages in Australia.[29]

In summary, only CHPs have the building of dwellings in lower quartiles of value as their core business. For central government the production of stock affordable to households on low incomes is a tiny aspect of government 'business' and is on the margins of its policy settings. Councils have long had an ambivalent attitude to the retention of pensioner housing which is now complicated by the positioning of council housing outside the IRRS policy. Developer/builders have long shifted away from production in the lower quartiles of value except those that are commissioned through CHPs, a relationship which is discussed later in this paper.

### Structural Position and Delivering Good Homes

CHPs also have quite a distinct structural position in relation to the other critical dimension of new build production. That is, the extent to which the producer is locked into a long-term commitment to that stock and the people who live in it. Those producers with long-term commitments to the stock and its residents must take account of that in their decision-making calculations and practices. Producers without that long-term commitment make decisions within and for the short-term in relation to any stock unit. There are, of course, potentially moral hazards with the latter in terms of the quality and performance of the stock produced. The costs of under-delivery of quality and performance for those with short-term commitments to the stock they produce are potentially passed on to consumers. In the context of the building industry the problem of moral hazard in the production of the residential stock can be exacerbated where there are deep information asymmetries between the producers and the consumers of new-builds. The problems of moral hazard and informational asymmetries, as well as the importance of housing as both a private and public good, underpin in New Zealand, as in similar jurisdictions, the regulation of building performance and standards.

Whether the standards incorporated into the NZBC are adequate as a minimum and whether the building industry can be mobilised to deliver beyond current codes is beyond the scope of this paper. Those are issues being researched through BRANZ Levy Funding in a programme dedicated to examining the dynamics of the industry 'going beyond the code'.[30] What is of

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27 Isaacs, *et al*., 2010: 147-152; Saville-Smith and Fraser, 2006.
28 Saville-Smith, James and Murphy, 2016.
29 Judd, *et al*., 2014.
30 http://www.branz.co.nz/cms_display.php?sn=323&st=1&pg=17682.

importance in this context is the implications of a structural positioning around short-term or long-term interests in the delivery of new builds. Notably, while HNZ might be expected to have, and certainly had, long term commitments to both stock and tenants, both have been somewhat diluted in recent years. In relation to new builds, HNZ has increasingly used lease arrangements and, of course, there have been on-going attempts to transfer or sell existing stock to CHPs with fluctuating enthusiasm.[31] Similarly, HNZ has adopted a policy of tenure reviews and an explicit policy of moving tenants out of HNZ stock.[32] As such, there are only two substantial producers of new builds for whom a long-term commitment to the stock and the residents who live in them is central to their operations: CHPs and RVs. Both RVs and CHPs are regulated in ways that enforce those commitments.

Flush with capital and targeting wealthier owner occupiers, the RV sector is characterised by high levels of land acquisition and land-banking with considerable stock numbers in the pipeline.[33] Many RVs, because of those tendencies and availability of capital, can take advantage of, in some jurisdictions such as Auckland, more permissive requirements associated with integrated residential developments. Those include less onerous requirements around: maximum impervious areas; building coverage; landscaped area; outlook space; daylight; outdoor living space; front, side and rear fences and walls; and minimum dwelling size.

In contrast, for CHPs, the combination of delivering to the low incomes households, their long-term commitment and interest in their stock, and the uncertainties around capital, policy and regulation have made commitments to new builds extremely difficult. It is notable that CHPs see themselves as disadvantaged not only around planning rules but planning processes in relation to integrated developments.[34] Nevertheless, it is notable that recent research involving seventeen CHPs of varying size showed that together they built around 750 stock units in the two years 2015-2016.

The regulatory requirements imposed on CHPs, as well as their own charitable purposes, create profound incentives for CHPs to develop housing which can be delivered at affordable rents or mortgage payments for resident households. This requires careful control over construction costs or purchase prices. The logics for CHPs, however, go beyond aspects of ‘entry’ costs. The logics of CHP investment in dwelling development are shaped by two other connected but separable imperatives. The first imperative relates to the living standards of resident households. The second imperative relates to the resilience, amenity and functionality of a CHPs housing stock over the long term.

The first of those imperatives prompt CHPs to focus on locations that allow residents to access public transport and optimise walkability. This contrasts with other developers and builders who tend to pursue greenfield sites, often on settlement peripheries and under-served in relation to neighbour amenities and connectivity. The concern with resident living

[31] Housing New Zealand, 2016:3; See for current situation MSD, Social Housing Transfer Programme, http://www.socialhousing.govt.nz/.
[32] James and Saville-Smith, 2016:5-6. Tenure Security for Older Tenants: A country review of policy, programmes and regulation A Working Paper prepared for SmartGrowth and the Population Ageing Technical Advisory Group (PATAG) Western Bay of Plenty Sub-region, https://www.smartgrowthbop.org.nz/media/1657/tenure-securityoverview-final-july.pdf.
[33] Jones Lang LaSalle, 2017.
[34] Saville-Smith, *et* al., 2017.

standards and affordability is also reflected in a concern with reducing other 'day-to-day' home running costs. Good thermal performance and adopting other technologies such as solar water heating is a high priority among many CHPs and are specifically directed to reducing the costs of residents' energy consumption.

The second imperative for CHPs is to ensure the resilience of their stock. Recent research around CHP procurement practices found a constant tension for CHPs between price and durability. The specification of lower performance and quality whiteware and appliances such as toilets, taps, basins and sinks to deal with price pressures have frequently shifted rather than reduced costs:

> *Bathroom fittings were not as robust as needed – social housing needs robust fittings and equipment. It needs things done properly and well. Sturdy. It was all done to be cheap as possible and it's not always the best way … One of the greatest issues is funding decent housing – warm, suitable (Medium single region CHP).*
>
> *You do worry a bit about compromises around quality, especially if you're strapped for cash. There's a tension between wanting to get better homes and not having a lot of money… Good, well designed products but not high end. We need good, robust fixtures and fittings, but we don't need high end products to achieve that (Large single region CHP).*[35]

The imperative to reduce the costs of repairs and maintenance is to some extent shared by both CHPs and other landlords. Unlike other landlords, however, the registration requirements on CHPs imposes additional expectations on CHPs around maintenance not required from other landlords. Moreover, because CHPs are likely to retain their housing over the long term and are constrained to provide security to their residents, CHPs cannot escape the costs of repair, maintenance, replacement or remediation associated with lower specification materials, appliances, fittings or whiteware.

These considerations are perhaps less pressing for RVs. RVs acquire and retain significant capital contributions from their residents: up-front in the form of deposits, through capital gain in LTOs which are typically not shared with an exiting resident or resident's estate, and deferred management fees. These provide a sustained source of capital for repairs, refurbishment and maintenance. Capital gain on LTOs and deferred management charges are realised at every move made by residents. Moving from independent villas to serviced apartments require a sale and purchase of the independent villa LTO and the associated payment of a deferred management fee. Movement from a serviced apartment is associated with another sale and deferred management fee then subsequent purchase of the serviced apartment LTO. There is some diversity around these matters in the RV sector, but the capital flow to RVs can be substantial. Table 1 sets out three examples of LTO purchases with different turn-over rates at 2015/16 dollars. CHPs are not positioned similarly and must fund repairs, maintenance and refurbishment from rents or seek funds outside operating revenues.

[35] Saville-Smith, *et* al., 2017: 12.

**Table 1 Three Examples of Capital and RV LTO Purchase and Sale 2015/16**[36]

| Transaction | Case 1 – 6yr turnover | Case 2 – 6yr turnover | Case 3 – 10yr turnover |
|---|---|---|---|
| LTO Purchase Price | $450,000 | $300,000 | $279,000 |
| RV Resale Price | $560,000 | $250,000 | $600,000 |
| Asset Related Costs Charged by RV | $155,300 | $138,586 | 0 |
| Retained Wealth by Exiting Resident/Estate | $294,700 | $161,414 | $200,000 |
| Capital Gain Retained by RV | $90,000 | 0 | $321,000 |

In short, CHPs, like RVs, are both the procurers and the consumers of their new build stock. Both are regulated in ways that mean that their thinking and decision-making needs to be long-term and they are exposed to long-term liabilities. The implications of the latter can be particularly challenging for CHPs because they target low wealth, low income households. CHPs and RVs differ, then, from both private landlords (who tend to purchase from the existing stock in any case) and developer/builders. Within the life-cycle of a dwelling, developer/builders have only a short-term involvement and liability. Moreover, there are a variety of ways in which those liabilities that do exist beyond the completion of a build can be avoided, including not completing builds at all.

It is the logic arising out of this aspect of the structural position of developer/builders that is one element of and helps us to understand a persistent seam of design, material and construction problems. The most dramatic of those problems to date has been around weather tightness and what is commonly referred to as 'leaky building syndrome'. The latter is apparent in stand-alone dwellings and multi-units built from the mid-1980s and, particularly, in the the following three decades. While popularly associated with monolithic panel and plaster finished monolithic cladding, it is by no means limited to those dwellings. Leaky buildings are characterised by inappropriate entry and retention of water into the building and its components. The damage done from pervasive water ingress and retention was exacerbated where untreated timber framing was used. Rot and decay have been accompanied by other negative consequences. Residents have complained of damp, cold and mould associated illnesses.

The costs of remediation, both public and private, are known to be high. The value of affected buildings have been compromised and certain residential dwelling styles have become stigmatised even where there is no evidence of leaking. Rehm has found a pronounced decline in the value of dwellings likely to be stigmatised as leaky homes (Table 2). The full costs of leaky building syndrome are unknown, in part because the prevalence of the syndrome is not well understood. Moreover, there is some evidence that even where remediation has been undertaken, New Zealand, like some overseas jurisdictions, is likely to suffer from a 'second generation' of building failures.[37]

[36] Saville-Smith, Smith, Murphy, Rehm, and James, 2016.
[37] James, Rehm and Saville-Smith, 2016.

**Table 2 Median Real Capital Gains (1997-2013) Non-Monolithic Clad and Monolithic Clad Dwellings**[38]

| Dwelling Typology | Key Characteristics and Measures | Auckland | | Wellington | |
|---|---|---|---|---|---|
| | | *N* | Median Real Capital Gain | *N* | Median Real Capital Gain |
| Standalone Homes | Monolithic-clad | 72 | 209,904 | 43 | 104,413 |
| | Non-monolithic | 1,481 | 235,279 | 769 | 134,602 |
| | Difference in gain | | -25,375 | | -30,189 |
| | % Difference | | -12% | | -29% |
| Apartments & Units | Monolithic-clad | 33 | 130,235 | 21 | 57,401 |
| | Non-monolithic | 883 | 145,202 | 343 | 72,065 |
| | Difference in gain | | -14,967 | | -14,664 |
| | Difference | | -11% | | -26% |

The experience of leaky building syndrome represents one symptom of a more widespread issue with the production of residential new builds. According to Parke and Warren, the construction industry in New Zealand across both residential and non-residential sectors saw an improvement in its key performance indicators between 2006 and 2012.[39] Notwithstanding, the industry was marked by low client expectations and a tolerance of both cost increases and defects requiring remediation. This is consistent with findings arising specifically from research into the residential building industry. The BRANZ 2015 new owners' satisfaction survey found that only 8 percent of new build owners expected no defects in the completed product. Even so, 32 percent reported that the level of defects were greater than they had expected and 84 percent of the 708 survey participants called their developer/builder back to remedy defects.[40]

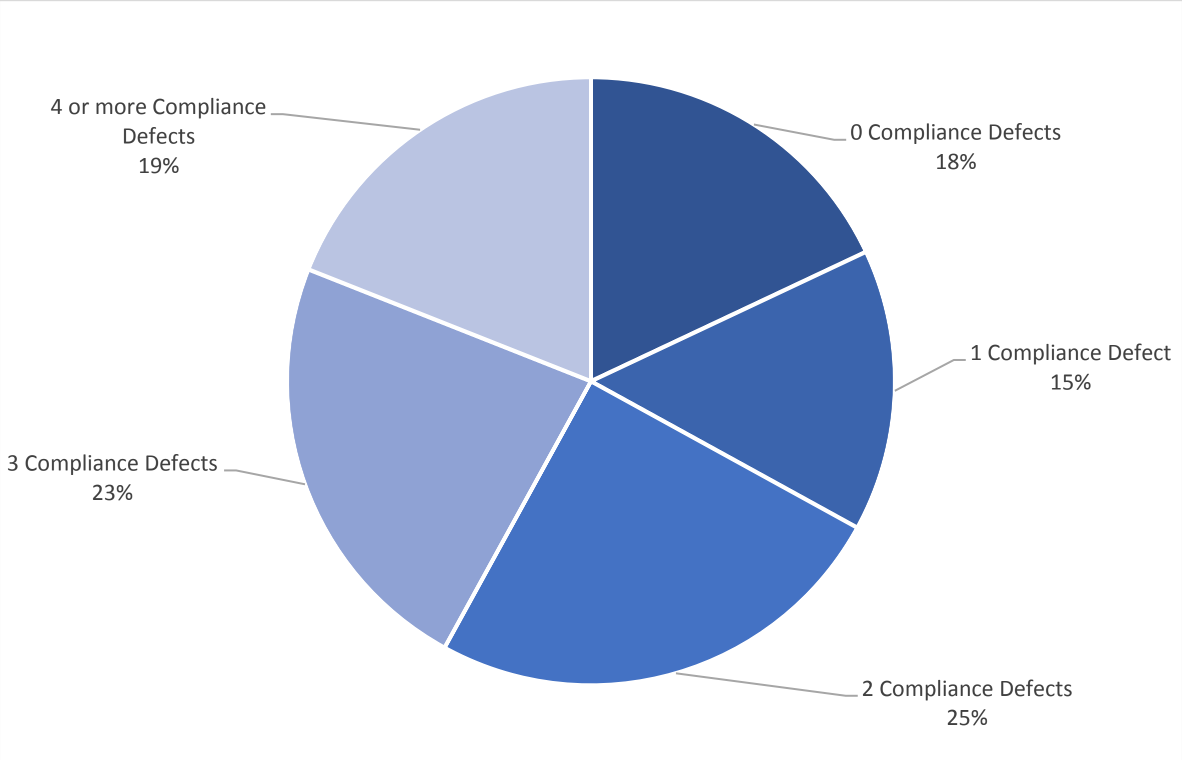
The tendency for clients of the building industry to have low expectations is perhaps reinforced most clearly when comparing new homeowners' sense of satisfaction with new builds and independent assessment of new build dwellings. The 2015 survey participants showed average satisfaction scores lower than those in 2011, 2012 and 2013. Nevertheless, only around 16 percent report satisfaction as less than the mid-point along a five-point scale from low to high satisfaction. That proportion is consistent with the 17 percent of owners of a new build who were critical of their builder. It is significantly less, however, than the proportion of residential new builds that exhibit quality defects or, more seriously because it indicates the regulatory system is not universally protecting the owners of new builds from compliance defects.[41]

Research into 225 new homes prior to lining, and before final inspection, found only a very small minority (8 percent) were without quality defects. Almost two thirds (65 percent) had three or more quality defects with 31 percent exhibiting six or more quality defects. There were also high proportions of non-compliance with code. Over 60 percent of dwellings did not fully meet the insulation standards required under NZS 4246:2006. Over 60 percent had non-compliant window reveal fixing and over half had loose wall underlay. Proportions of

[38] Rehm 2009; James, Rehm and Saville-Smith, 2016.
[39] Parke and Warren, 2013.
[40] Curtis, 2016.
[41] Curtis, 2016: 6.

non-compliance between 30 percent and 40 percent were found for head flashings, cut-outs in framing, fixing edge distances and seals around vanities and showers. Almost a fifth of these new homes (18 percent) had no compliance defects at all. A slightly higher proportion had four or more compliance defects (Figure 8).[42]

**Figure 8 Compliance Defects in New Residential Builds (n=225)**




The driver for developer/builders to produce good homes clearly arises out of an internalised desire to do so rather than their structural position. The evidence suggests that despite usual assumptions, while reputation may be a psychological concern for a builder or developer, in material terms, its impacts are limited. The 2015 homeowners survey showed that while owners reported that quality and reputation were key criteria for the selection of a builder, owners of franchise builders typically were influenced by their own observation of a show home, advertising or quotes. Independent builders were more likely to be selected because of family or friend recommendations. Neither franchise nor independent builders showed high levels of repeat business although that was more evident among independent builders than franchise developer/builders.[43]

In short, the structural position of developer/builders has some particular characteristics which, despite a commitment to service and quality, behaviours and decision-making are shaped by low levels of repeat business for most clients. Developer/builders operate in a sector in which pipelines of work are uncertain and margins are coupled to existing house prices rather than productivity. The logics of developer/builders are inherently shaped by the short-term and the transactional. Unlike for RVs and CHPs, for developer/builders the monitoring and regulatory controls on industry entrance, exit and accountabilities are

[42] Page, 2015: 84-85.
[43] Curtis, 2016: 13

relatively light. As the building industry acknowledges, the ability of some developer/builders to avoid taking accountability has a destabilising impact on both the industry and its customers. Evidence of non-compliance with regulatory standards is twinned with clumsy, expensive and often ineffective mechanisms to hold developer/builders to account.

There are a number of practices within the building industry which while not seen as desirable within it are also accepted as common. In the context of New Zealand's experience of leaky homes three of those practices became very evident, but they have been by no means restricted to avoiding claims related to leaky buildings:

- The use of project specific companies. This typically involves the establishment of a company structure for a development project with a range of shareholders and directors who close the company at the end of a project's completion.
- Phoenixing. That is, the movement of assets from one company to another, often, but not always, leaving the original company in liquidation.
- Voluntary liquidation, receivership or bankruptcy, sometimes, but not always associated with industry exit.

Those practices can be used, separately or in conjunction, as avoidance strategies for both long-term and short-term liabilities. The short-term liabilities are typically in relation to paying for materials, sub-contractors, service providers and employees. The long-term liabilities relate to avoiding the consequences of failed building performance (including non-completion of homes) and the costs of repairs and remediation.

The establishment and then retirement of a project-specific company, phoenixing and bankruptcy are all legitimate mechanisms. The purposeful use of those mechanisms to avoid liabilities is illegal. Illegality is sometimes difficult to prove. Moreover, there are barriers to prosecution. The first is the problem of proof of illegal practice. The second is the degree of materiality if illegality is to be prosecuted. The Companies Office demands that a prosecution is in the public interest, a decision to be informed by a list of factors in the Companies Office guidelines:

> a. *The seriousness of the offending;*
> b. *The extent to which the offending involves the abuse of the corporate structure, such as the use of phoenix companies;*
> c. *Whether the offending poses a reputational threat to the New Zealand corporate registration system*
> d. *There are grounds for believing the offending is likely to be continued or repeated;*
> e. *The offending is prevalent;*
> f. *The offending was premeditated;*
> g. *The extent and level of financial or other loss or harm caused by the offending;*
> h. *Whether the offender has a previous history of offending;*
> *The defendant was in a position of authority or trust and the offending is an abuse of that position.*[44]

[44] Companies Office, 2017.

In addition, there are complexities and deficiencies in the framing of insolvency and corporate structures. There have been arguments that the law around phoenix companies has a history of being poorly drafted and is impractical and, despite some revision since 2008, remains complex.[45] Similarly, some members of the building industry argue that processes around receivership, liquidation and bankruptcy as well as the courts are used to protect 'rogue' players within the industry.

In 2015, the president of Civil Contractors New Zealand claimed:

> *The smart developers and their smart lawyers can use the court system to delay payment and the longer they delay payment, the more time they have to take any funds that that development company holds, and squirrel it away to some other legal entity somewhere else… That becomes the problem because then it gets to a final payment and they just simply put their hands up in the air and say we don't have any money... And then they wind the company up and start again.*[46]

The adequacy of current insolvency laws and practices became the focus of a government review in 2015. Notwithstanding, receivership, liquidation and bankruptcy are common strategies used by developers and builders to avoid liability. In response to a reported 160 building companies in Canterbury becoming insolvent in the previous year, with 60 of those companies owing creditors around $40 million, the president of the Registered Master Builders Association for Canterbury, Ivan Stanicich, commented:

> *The law is an arse… and it lets people protect their interests by shutting the doors when it's tough.*[47]

Reports on building company and developer failures are replete with similar comments about the complexities around recovering debts. The 2013 collapse of the Mainzeal construction company, which was heavily involved in residential apartment building, has generated still unresolved litigation around assets and related party debt.[48] There are examples in which directors have been involved in previous liquidations and even made bankrupt. In January 2017, an Auckland home building company ceased trading affecting over thirty dwellings. With creditor claims estimated at around $2 million, it has been reported that the sole director had previously been banned as a director for a period of three years.[49] The sole director explained the collapse as caused by:

> *theft combined with the continuing increase in building costs which could not be passed on to clients because of fixed-price contracts, resulted in the company's downfall.*

[45] Keeper, 2007; Keeper 2008; MacKenzie, 2008; Finnigan, P., 2017.
[46] Baker, 2015.
[47] Truebridge and Stylianou, 2016. Canterbury's 'bloody problem': Hundreds of building-related firms failing
[48] Hamish Fletcher, Cranston Homes goes into liquidation owing creditors $1.5m, *New Zealand Herald*, 30 May 2017, http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11866237.
[49]Building firm collapse leaves homeowners at a loss of $1.7m, *RNZ*, 2 May 2017, http://www.radionz.co.nz/news/national/329919/building-firm-collapse-leaves-homeowners-at-a-loss-of-$1-point-7m.

Notably, the director also commented that he started this current company to generate "employment and ran fine margins to help homeowners let down by other building companies." He described his company as being:

> *genuinely the good guys and we got screwed.*[50]

Similarly, the explanation by a longstanding developer/builder for his expulsion from the Registered Master Builders Association in 2016, an expulsion followed by insolvency in May 2017, is instructive. In addition to indicating that avoiding rather than addressing poor performance claims and remediation was a usual pathway in the building industry, the company is described as delivering "a very high standard of product" despite a mass of leaky home claims:[51]

> *Rather than run away like a lot of other builders and ignore them and leave customers in the lurch, we've dealt with over $4 million worth of leaky building claims. It's cost us in the millions, it's cost us a lot of money which we could have walked away from.*

Regulatory agents have expressed concern that some liquidators appear to be actively hostile to recognising and pursuing payments to creditors within the building industry as well as to householders who have paid deposits for houses.[52] Whether this reflects problems around insolvency law, or the dominant position of financiers and banks as secured creditors, or, as a has been claimed, problems around the under-regulation of insolvency practitioners,[53] is unclear. What is clear is that these practices 'work' because developers and builders typically do not have long-term ownership interests in the stock they build and there are a variety of ways in which they can protect themselves from liabilities associated with performance.

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[50] Akoori, 2017.

[51] *NZ Herald*, 2017.

[52] Baker, 2015.

[53] Notably a bill to regulate Insolvency Practitioners was introduced to Parliament in April 2010 and went to its second reading in 2013. It has been in committee since. An Insolvency Working Group was established in 2015 which recommended:

- *Introducing a licensing system for insolvency practitioners*
- *Making various other changes to legislative settings that impact on insolvency practitioners such as:*
    - *Modifications to insolvency practitioner disqualifications*
    - *Additions and clarifications to insolvency practitioners' responsibilities, roles and duties*
    - *Changes relating to reporting requirements*
- *Making improvement to the law relating to voluntary liquidations such as:*
    - *assigning a publicly searchable unique identification number to existing and future directors*
    - *requiring the consent of the petitioning creditor for the voluntary appointment of liquidators or administrators;*
    - *providing the ability for the liquidator to void, with limited exceptions, the transfer of a company's assets once the liquidation order is made.*

### Logics, Structural Position and Getting Good, Affordable Homes Built

This paper has focused on two aspects of New Zealand's current dilemma around both the performance of New Zealand's housing stock and its alignment with housing need. It suggests that understanding the structural position of those who produce new builds is critical to understanding the apparently persistent problems of misaligned supply and deficiencies in the quality, performance and functionality of new builds.

The key conclusions are these:

- Developer/builders have repositioned themselves over the last thirty years out of delivering dwellings in the lower quartiles of value because of significant reductions in the demand from:
  - organisations commissioning new builds for vulnerable low incomes households in the local and central government and the community sector; and
  - low income households, due to the abolition of first home owner, interest-related mortgage provision and the abolition of opportunities to capitalise what was until 1991 a universal family benefit.
- There has been a reduction in the actors who combine an interest in producing new builds, a long-term commitment to that stock and the residents who live in it. CHPs and RVs are currently positioned at that nexus. Both are regulated to sustain that combination. RVs are currently flush with capital but CHPs are largely starved of capital. Unlike RVs, CHPs have been subject to considerable policy and regulatory uncertainty. CHPs, unlike RVs, target households most marginal to the housing market and currently left untargeted by the building industry.
- The regulatory framework directed to ensuring residential build quality and performance struggles to be effective in an environment in which:
  - the structural position of developer/builders encourages a short-term, transactional approach;
  - heated house pricing decouples price from performance;
  - margins are uncertain and demand is cyclical; and
  - other statutory mechanisms can be used to facilitate avoidance of liabilities and accountabilities.

Those conclusions suggest a number of ways forward. We need:

i. A better understanding of the way in which the broad regulatory framework can help to stabilise the building sector as a whole rather than protect problematic behaviours by some actors within it. This implies recognising that the performance of new builds is not simply reliant on the Building Act and its associated performance requirements or issues of skill and innovation. It implies taking an active and broader approach to adjusting the regulatory framework specifically to achieve improving the supply of affordable, well-performing homes.
ii. More consideration needs to be given to the way in which investment into lower quartile value new builds can be encouraged and attract the building industry back into that space.
iii. More support needs to be given to the building industry and CHPs to leverage off what has been shown by the CHP procurement research to be a strong platform for productive and mutually beneficial collaborations into the future.

Finally, this paper suggests that acknowledging the transactional, short-term logic of developer/builders helps us to understand limited adoption of innovations in high performance and increased functionality in new build design and build even where there is consumer demand. It helps us, too, to understand some of the difficulties around exercising consumer sovereignty in the housing market and associated problems of build quality. It also explains why, for instance, the adoption of beyond the code building such as LifeMark accreditation in new builds has been overwhelmingly associated with CHPs and retirement villages. As a consequence, it suggests that we need to find ways in which innovation for building better homes, towns and cities can generate those short-term transactional benefits for key actors while supporting positive long-term outcomes.

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