The Market Based Model Applied to Housing in New Zealand – *Rationale and Legacy*

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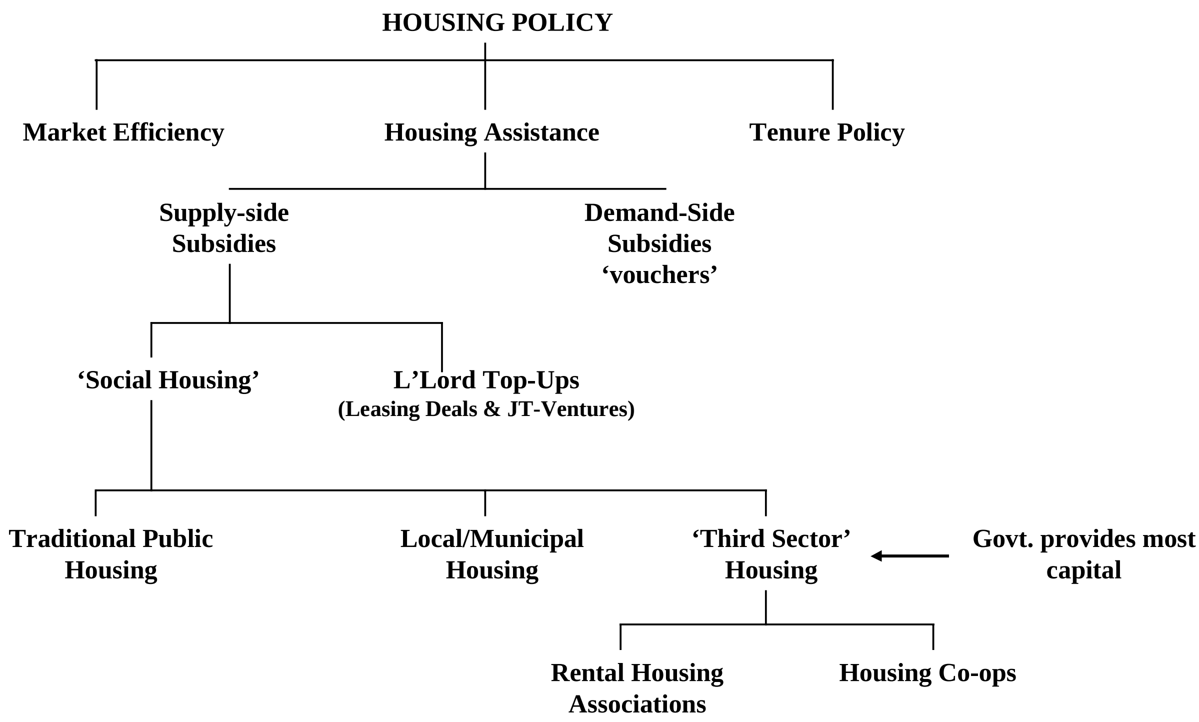
1. Introduction

In much of the developed world, the provision of housing assistance by the State has been accepted as part of the basic platform of social policy and welfare. Since the 'New Deal' and the post-WWII introduction of the welfare state, there has been explicit recognition that housing markets do not function well for the poor, for broader low income groups or for people with special needs.

The purpose behind government interventions may be grouped into three broad streams (Spiller 2001):

- Measures to improve the efficiency of housing markets, that typically relate to costs and the affordability of housing in general;
- Measures to target assistance to particular groups – housing assistance – designed to ensure payment levels, usually as a percentage of an individual's income; and
- Measures to promote particular tenures (e.g. community housing, home ownership etc).

The potential scope of housing policy interventions is summarised below:



Housing assistance and hence the public debate fall broadly into two categories.

On the supply side, the government is involved in the provision and often ownership of housing stock. This can take many forms, spanning from traditional public housing, to local government housing, through to 'third sector' intermediate organisations in the form of housing associations and co-operatives.

On the demand side, governments intervene by providing a direct income transfer with individuals then being responsible for purchasing housing direct from the market. These 'voucher-based' schemes are seen to provide greater choice and control for consumers. They allow consumers greater flexibility particularly by not tying them to fixed long term tenures, thereby supporting labour market aims and allowing access to as many options as possible.

Supply side responses tend to focus upon stability of tenure and affordability by a government subsidy of the rent payable.

These alternative approaches have been the focus of housing policy debate in most Western countries over the past two decades. The arguments on all sides relate to efficiency and effectiveness:

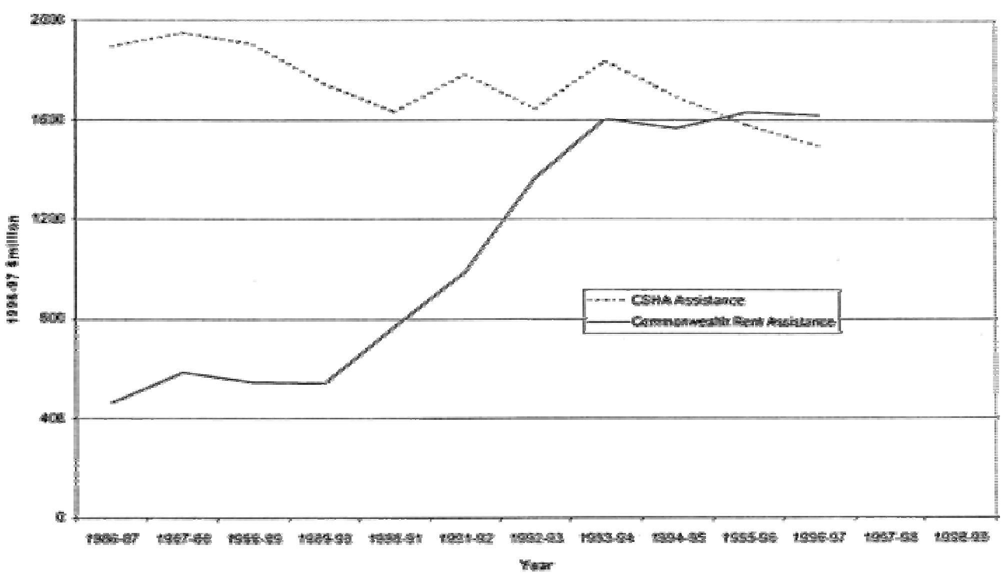
- Voucher schemes aim to provide similar levels of subsidy to individuals whether in the private market or in government sponsored schemes, thereby achieving greater equity. Moreover, voucher schemes can give assistance to a much greater number of households than the same funds channelled through public housing.
- Housing supply schemes on the other hand are said to be, over time, more effective by virtue of the number of households gaining access to the asset. This 'cumulative yield' argument requires governments to invest over long periods to build up and maintain quality stock in the right locations.

Around these issues also lie critical questions about the characteristics of the private rental market and its ability to cater for low income and special needs groups.

Over the last decade in Australia the reform of public housing policy has focussed upon the relative merits of the two models of intervention described above. A clear pattern has emerged with national resources for housing increasingly giving preference to rent assistance rather than to public housing via the Commonwealth State Housing Agreement (CSHA) – Figure 1.

Figure 1

Government Outlays on Public Housing and Rent Assistance – Australia



Reform of the CSHA has stalled on at least two occasions through governments being unable to resolve differing views at Commonwealth and State levels on implementation. Electoral cycles and the duration of the programme have not allowed a clear path forward. Similarly, at the time of writing, there appears to be no resolution in sight, notwithstanding a looming Federal election.

Against this background, events in New Zealand over the past decade or more provide an important practical example of the consequences of the approach favoured by COAG.

The New Zealand Experiment

2. Public Sector Restructuring of Governance, Management and Delivery

The housing reforms of the 1990s were shaped by two streams of analysis that can be traced to a convergence of views held by a handful of newly elected Labour Ministers in 1984 and Treasury officials.[1] They concluded, firstly, that both the structure of governance and the existing approaches to budgeting, accounting and financial management in the public sector needed overhauling. After Labour was returned with a stronger majority in 1987 they went even further in their efforts to improve the efficiency and effectiveness of public management. The State Sector Act 1988 changed the relationships and responsibilities between ministers and chief executives and their departments.

The Public Finance Act 1989 was the second piece of legislation. It changed accountabilities and requirements for managing financial matters in the public sector and made explicit the distinction between the government's purchase interests and ownership interests within a department (Scott 2001, 11-37). This established the framework for Ministerial Purchase Agreements and a new appropriation process that allocates funds to votes on the basis of output classes. The broad purpose behind the Act was refined in 1994 following the introduction of a private member's bill by 'another articulate and forceful reformer, the Hon Ruth Richardson, after her departure from her position as finance minister between 1990 and 1993' (Scott 2001, 19). The Fiscal Responsibility Act (1994) requires the reporting of the Crown's net financial position alongside the conventional measures of fiscal performance that focus on cash flows. These were the public sector reforms, that provided the enabling framework when the decision was taken by a National Government in the early 1990s to radically change housing assistance in New Zealand.

The pressure for housing reforms in the 1990s also grew out of the disillusion surrounding the record of state intervention in welfare state societies. This shift in sentiment, which was spread by those on both the Left and the Right – though for different ideological reasons – convinced many working in the public policy arena in New Zealand of the inherent superiority of markets. A strong argument was mounted for the state to get out of those activities where it ran the risk of 'crowding out' private providers, and to restrict its involvement to 'filling the gaps that the private market cannot or is unwilling to fill' (Thorns 1988, 8).

[1] Graeme Scott (2001, 25-36) provides an assessment of the extent to which the Treasury advice was grounded in ideas from the economics of institutions, accounting and management theory. 'Agency theory', the estimation of transaction costs, and the methodologies of 'value adding', accrual accounting, and output-based (v. input-based) budgeting, all played their part.

Critics of state housing argued that despite the level of public investment in housing[2], 'housing assistance programmes are fragmented, uncoordinated, inefficient and unfair' (Luxton 1991, i). For example, the Department of Social Welfare undertook three working reviews of the Accommodation Benefit in the late 1980s in an effort to iron out affordability and equity issues. Treasury wanted to see the monolithic Housing Corporation run along the lines of a State Owned Enterprise. There was also a belief that government expenditure as a share of GDP should be lower, and this meant shifting as much activity as possible off the balance sheet. It was also felt that voucher-based, income-support would open up housing choice and help to move people off dependency on state housing. These pressures for change came together in the early 1990s to help shape the housing reforms enacted as part of the Housing Restructuring Act (1992).

3. The Housing Reforms

3.1 Application of the rationale to housing

The Housing Restructuring Act (1992) comprehensively reorganised management and delivery systems, and forms of housing assistance in New Zealand. At the heart of these reforms lay a conviction that:

- state housing should operate as a business and compete with the private sector;
- there should be a clear-cut demarcation between the funding of housing assistance and the delivery mechanisms (the funder-provider split); and that
- income support as opposed to direct provision was a better way to tackle affordability issues.

3.2 Reorganisation of housing

In 1991 almost 70,000 state houses were transferred to a new State Owned Enterprise to be managed on a commercial basis (Luxton 1991, 3).

The Housing Corporation of New Zealand was left to restructure the Government's mortgage portfolio that made low cost loans available to low income homebuyers.

The policy function of the old Housing Corporation (HCNZ), along with the administration of the Residential Tenancies Act, was placed within the Ministry of Housing. In 1998, housing policy was subsequently transferred from the Ministry of Housing to a new Ministry of Social Policy with a view to co-ordinating broad social policy development[3]

In mid-1995, Community Housing Ltd (CHL) was formed as a subsidiary company of HNZ in response to gaps in the supply of housing to people with specialised needs.

3.3 The Accommodation Supplement (AS) and market-related rents for HNZ tenants

2 At the beginning of the 1990s, the old Housing Corporation's level of investment in rental and lending activities stood at around $7.6 billion.

3 Though this was never fully realised with educational and health policy remaining with their respective sectors.

On July 1 1993 a broadly based housing voucher system known as the Accommodation Supplement (AS) was introduced in conjunction with a move to a market related-rent regime for Housing New Zealand (HNZ) tenants. The introduction of market related rents for HNZ tenants, other than the 10% already paying a 'fair market rent', began in October 1991. The adjustments were to be phased in to coincide with the availability of the AS in mid-1993. Tenure neutrality and the exercise of choice with respect to renting publicly or privately, and home purchase were the key rationale.

Although conceived as a universal form of housing assistance, eligibility is restricted to low-income households with disproportionately high housing costs. The AS cuts out at 70% of rental or mortgage outgoings over the relevant threshold set for region and house size. The thresholds for beneficiaries are > 25% of the relevant benefit for those renting and > 30% of the relevant benefit for those buying.

3.4 Sales of public rental stock

With the pressure upon HNZ to operate on a commercial basis and pay dividends to the Crown-owning Ministers, the Board embarked upon a managed programme of sales, new acquisitions, and Home Leasing (from 1995) with the aim of reconfiguring the portfolio to better match demand. The policy was to divert the proceeds from sales in provincial centres to the Auckland region, and to a lesser extent to other high demand areas like Hamilton and Tauranga. Nevertheless, while 2,574 additional dwellings were acquired in these high demand areas between 1996-99, overall stock numbers fell in net terms due to the remorselessness of the sales programme from the mid-1990s onwards (Figure 2). Approximately 13,500 dwellings were sold by HNZ between 1995-99, leaving the public housing agency with 59,579 rental units by the beginning of 2001 when the pipeline effect of Home Buy[4] finally subsided.

3.5 Disposal of the mortgage portfolio

Over a period between 1992 and 1999, $2.4 billion of HCNZ prime-rate mortgages, which had been progressively adjusted upwards to prevailing market rates, were on-sold to private investment houses. By 1998/99 the writing off of Housing Corporation loans had almost ceased, apart from a few hundred suspensory loans available under a Low Deposit Rural Lending programme for housing upgrades in rural areas in the Far North and East Coast regions.

4. The Legacy of the Housing Reforms

4.1 Consequences for low-income households

4.1.1 Deterioration in affordability

Between December 1993 and December 1997 home purchase costs rose at 1.76 times the rate of the CPI, while rents increased at 2.94 times the rate of the CPI (Figure 3). Part of this increase in the housing costs index was due to the

[4] A Home Buy programme operated by HNZ between 1996-99 enabled some tenants to being purchasing their home with the aid of a suspensory loan from the Housing Corporation up to a maximum of $15,000. During the programme 1,770 HNZ dwellings were sold to sitting tenants.

changeover to market-related rents for HNZ tenants which, in turn, were progressively inflated by an overheated property market between 1993-97.

HNZ tenants were further disadvantaged because, unlike the Accommodation Benefit that it replaced, the AS only funds 70% of the gap between benefit levels and market rents. As a consequence in 1996 at the end of the phase in of the AS, only one in three HNZ tenants, and one in five private tenants had rent to income ratios below a 30% threshold. On average, the housing costs-to-income ratios for the lowest two deciles of Auckland households rose from 33-35% in 1995/96 to 55-58% in 1997/98 (Business and Economic Research Ltd, 1999).

Analysis shows that the proportion of households in the bottom quintile paying more than 30% of their disposable income on housing climbed from 17% in 1988 to 52% in 1994, before easing to 44% in 1998 (Mowbray 2001, 43-44). Furthermore, as a result of the introduction of the AS, combined with HNZ's move to market-related rents, the proportion of households in the bottom income quintile in public rental housing fell from 19% in 1992 to 10% in 1998.[5]

4.1.2 Soaring HNZ turnover rates

Since the reforms, HNZ annual allocations (excluding transfers) increased from about 9,800, representing a turnover rate of 14% in 1991, to nearly 17,000, or a turnover rate of 24% in 1996. Turnover rates peaked at 35% in August 2000 before the introduction of income-related rents. Since then they have been halved. These extraordinary turnover rates have been attributed to the disappearance of any price advantage between HNZ and similar housing in the private rental sector as well as the avoidance of rent arrears and other debt, and domestic disputes leading to the break-up of households. (It also raises a question about the importance of secure tenure when public rents are no longer affordable for beneficiaries or the working poor).

4.1.3 Overcrowding and housing-related health problems

Notwithstanding a customary preference on the part of Pacific People for living together in extended families, crippling housing costs in the mid-1990s undoubtedly led to 'doubling up' by many households. This indirectly contributed to serious overcrowding and associated health problems in areas like South Auckland. For example, additional numbers of people living in close proximity led to an increased incidence of respiratory and transmittable diseases like tuberculosis and meningococcal.

In summary, recourse to an Accommodation Supplement and market-related rents for public tenants unnecessarily imposed considerable additional hardship upon an already vulnerable segment of New Zealand's population.

4.2 Consequences for the government

4.2.1 'Blow-out' in the AS outlay

[5] This suggests that possibly poorer quality dwellings, and therefore cheaper rents, were available in the private sector; and that some of the better located HNZ stock commanded rents that only better-off tenants could afford.

Although the Accommodation Supplement was intended to be fiscally neutral, in the first year of operation (1993/94) AS payments worth $351 million were made to 251,000 recipients. By 1998/99, the number of AS recipients (332,000) had risen by about a third, while the outlay had almost trebled (Figure 4). By June 1998, additional housing assistance over and above the AS worth about $90 million was being paid to 125,000 poor households to meet chronic accommodation-related shortfalls in living expenses.

Due to the susceptibility of AS payments to economic conditions (e.g. unemployment levels; interest rates on mortgages) it is difficult to predict or contain the size of the AS outlay.

4.2.2 *Impact upon the balance sheet of the new housing organisation*

The sale of Housing Corporation mortgages forfeited any future opportunity to raise finance against the value of the portfolio.

4.2.3 *Back-log of modernisation*

Despite the selective nature of the sales programme during the second half of the 1990s, the average age of the remaining stock is 33 years and much of it is no longer suited to the needs of tenants on the current waiting list. Although HNZ received a one-off grant of $420 million in 1993/94 to augment ongoing maintenance, much of the stock still needs modernising.

Hence, a combination of divestment and unsustainable dividend payments to the Crown during the second half of the 1990s has left the restructured Housing New Zealand Corporation without adequate resources to meet the capital costs of deferred maintenance and requisite modernisation which are conservatively estimated at $1.2 billion (Deloitte Touche Tohmatsu 2000).

4.2.4 *Social purpose subjugated by commercial criteria*

Housing New Zealand cultivated an ethos consistent with its business focus as a Crown-owned enterprise. In measuring performance, for example, a criterion like the ‘weighted average cost of capital’ was consistently applied to asset management decisions. The requirement to pay annual dividends to the Crown completely transformed the operational approach of what had traditionally been a ‘not-for-profit’ housing agency. In adopting a competitive approach, HNZ shut itself off from other social housing providers, including the local government sector with it’s 15,000 rental dwellings. viz., ‘we were never kept informed or involved’.

4.2.5 *Distancing of policy advice from operations*

As a result of the separation of housing policy development and advice from the operational end of the business, in some matters policy was drafted without due regard to operational experience. Despite its placement in an environment that was supposed to enhance the co-ordination of policy, in practice housing policy was not only cut-off from the delivery agency but internally fragmented with staff at times reporting to three managers.

At the same time, there was a running down of capacity within government to properly:

- forecast future demand;

- monitor the housing environment and market dynamics; and
- advise on shifts in housing investment, tenure, and housing needs.

5. Housing Systems – a brief comparison

In light of the New Zealand experience, it is interesting to compare the system with that of parallel Australian institutions.

Table 1 provides a broad comparison of New Zealand and Australian activities of housing organisations in 1999/2000. A number of significant issues arise:

- variations in stock numbers reflect investment decisions of governments over long periods, with some states/territories now ‘catching up’ or others like South Australia, divesting stock;
- waiting lists vary considerably, presumably explained by population and labour market conditions as well as policy-induced separate approaches to access;
- corporate form is almost universally by government department, whereas New Zealand has either had a Crown-owned company or a Statutory Corporation place;
- staffing levels in New Zealand appear dramatically lower for volumes of stock managed.

This latter point appears to warrant some further investigation. The New Zealand reforms of public administration of the early 1990’s, whilst ideological in nature, imposed an important level of corporate discipline and transparency. These include:

- The annual negotiation of a Statement of Intent between the company and Shareholding Ministers on the forthcoming annual programme, including detailed performance targets. This ‘contract’ became the focus of reporting and detailed annual scrutiny by a cross-party committee of Parliament.
- Annual review by rating agencies of the company’s performance. Approximately NZ$11.2b of debt is held by bond holders in international markets. Standard and Poor’s and Moody’s each conduct a detailed annual review of performance.
- Commercial standards have been applied through taxation, company accounting and investment frameworks. This allows ‘true’ benchmarking. Applying commercial standards has also meant that large programmes of out-sourcing have been carried out.
- A heavy emphasis on risk management permeates all activities.

6. Housing New Zealand Corporation 2001

The capacity of government in New Zealand to provide reasonable levels of housing assistance has been significantly constrained by:

- the ballooning cost of the Accommodation Supplement;
- divestment and dividend payments to the Crown;
- the backlog in maintenance and the capital cost of basic modernisation;
- the sale of mortgages removing the ability to finance against the value of the portfolio; and
- debt levels being restricted by cashflows.

This contrasts sharply with the resources allocated to housing by the Crown and the balance sheet of the then Housing Corporation in the late 1980's and early 1990's.

In the medium term, therefore, the choices faced have involved:

- significant new capital from the Crown; and/or
- erosion of the balance sheet; and/or
- expansion of the range of choices/interventions and providers in the provision of low income housing.

Housing reform was a key election platform and a significant pre-election commitment of the incoming Government in 1999.

A new corporate entity – The Housing New Zealand Corporation – came into effect on 1 July 2001. It combines all housing programmes including housing policy (and policy for AS) into a single agency. The new body is, in a sense, a 'parent' with the old HCNZ remaining as a vehicle for assets. Major changes to the housing system include:

- Re-introduction of income related rents for State housing generally set at 25% of income, with the Crown compensating HNZC for the difference between market and income based rents (NZ$120m per annum);
- Introduction of a segmented waiting list (Social Allocation System);
- Increases to owned and managed stock numbers, particularly through leasing;
- Case management and intensive tenancy management being introduced;
- Commencement of five Community Renewal projects;
- Implementation of revised physical and design standards;
- Emphasis on building formal partnerships with other housing providers such as local government, community organisations, iwi-based organisations; and corporate sponsors;
- Healthy Houses;
- Investigation of home lending products;
- Informing and engaging with tenants; and
- Developing a social housing strategy

… amongst others.

Importantly HNZC retains a Board and is maintaining the commercial disciplines of the Company. It is also extensively reviewed and monitored within government by monitoring agencies. Applying commercial practice to social goals is, therefore, the essence of the revised approach.

Conclusion

Reforms in gestation focus upon problems. Almost invariably they have unintended consequences. Whether the housing outcomes of the New Zealand reforms of the early 90's were intended or not, they were disastrous for the poor and for government. Lessons for Australian housing policy are significant. Setting the balance between supply and demand side interventions is a delicate task. The fiscal cost of a heavy emphasis on vouchers is likely to be significant.

On the other hand, there is evidence to suggest additional scope for the introduction of commercial disciplines and management reform in the delivery of public housing.

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