

25 September 2018

Hon Grant Robertson
Minister of Finance
Private Bag 18 888
Parliament Buildings
Wellington 6160

Hon Phil Twyford
Minister of Housing & Urban Development
Private Bag 18 888
Parliament Buildings
Wellington 6160

Hon Nanaia Mahuta
Minister of Local Government
Private Bag 18 888
Parliament Buildings
Wellington 6160

Who's
putting local
issues on
the national
agenda?

**We are.
LGNZ.**
Te Kāhui Kaunihera o Aotearoa.

Dear Ministers,

Request for independent residential construction costs inquiry

I am writing on behalf of Local Government New Zealand ("LGNZ") to ask the Government to take a further action to address New Zealand's housing affordability issue. We wrote to the previous Government on this matter in June 2015 and now wish to raise our concerns with you. I have attached the letter that was sent as it outlines in detail the case for an inquiry.

In our view, addressing the unjustifiably high residential construction costs is essential and should take place alongside the initiatives you already have underway, including the Urban Growth Agenda, Kiwibuild, and reviewing the regulation of building products and assurance systems.

The Productivity Commission, Commerce Commission and MBIE uncovered evidence of competition and regulatory barriers to expansion and innovation in the residential construction sector, which are contributing to higher costs. In LGNZ's view, there has been no detailed investigation into the matters raised and the identified issues have not been addressed. We consider this to be a gap in the policy responses to the issue of housing unaffordability.

We therefore ask the Government to consider commissioning a special taskforce to conduct more detailed analysis into the market, and we will be advocating publicly for this. The attached letter explains why we believe this action is required.

We appreciate that legislation is in train to provide the commerce Commission with powers to conduct market reviews but even with speedy passage of the legislation we expect that it will be some time before the Commerce Commission might choose to pick this issue up. The housing affordability issue is too important to wait that long.

We would welcome an opportunity to discuss this matter with you.

Kind regards,

A handwritten signature in purple ink, appearing to read 'Malcolm Alexander'. The signature is fluid and cursive, with the first name 'Malcolm' written in a larger, more prominent script than the last name 'Alexander'.

Malcolm Alexander
Chief Executive
Local Government New Zealand

Who's
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**We are.
LGNZ.**

24 June 2015

Hon Paul Goldsmith
Minister of Commerce
Private Bag 18888
Parliament Buildings
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Hon Paula Bennett
Minister of Local Government
Private Bag 18888
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Hon Bill English
Deputy Prime Minister
Private Bag 18888
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Hon Nick Smith
Minister of Building and Housing
Private Bag 18888
Parliament Buildings
Wellington 6160

Dear Ministers

Request for independent residential construction costs inquiry

I am writing on behalf of Local Government New Zealand (“LGNZ”) to ask the Government to take a further action to address New Zealand's housing affordability issue.

Initiatives such as the Productivity Commission's Inquiry “Using Land for Housing”, RMA reform, Housing Accords and special housing areas, and improving local authority processes to make land available for building are important, but we are concerned these are not enough.

In particular, it is our view that the Government must take a harder and closer look at New Zealand's unjustifiably high residential construction costs. The Productivity Commission, Commerce Commission and MBIE have recently uncovered evidence of competition and regulatory barriers to expansion and innovation in the residential construction sector, which are contributing to higher costs.

However, there has been no detailed investigation into these matters and the identified issues have not been addressed. For a Government committed to competition and productive markets, and given what is at stake for New Zealand's welfare, this looks to be a gap in the policy responses to the issue of housing unaffordability.

We therefore ask the Government to consider commissioning a special taskforce to conduct more detailed analysis into the market, and we will be advocating publicly for this.

The following explains why we believe this action is required.

The need to promote competition

LGNZ is aware that improving housing affordability is a key policy focus for the National-led Government and acknowledges the important part that our members have to play in improving outcomes. LGNZ members are committed to taking steps to support the Government's objectives to improve housing supply and to make the Government's specific initiatives successful.

However, as noted by the Productivity Commission in its 2012 report into Residential Housing: "a coherent and determined push across multiple policy areas is required in order to meaningfully improve housing affordability."¹

LGNZ is concerned that the coherence of the Government's response to this issue is being compromised through the failure to properly consider a critical factor in housing affordability: the economic and regulatory barriers to expansion of firms seeking to drive competition in the residential construction sector itself.

Competition is vitally important to markets properly functioning to keep costs down and deliver innovative new approaches. We fully support Minister Goldsmith's stated objective upon taking responsibility for the Commerce and Consumer Affairs portfolio:²

Looking ahead, I want to ensure we maintain a predictable, trusted and productive commercial environment where competition can thrive and consumers have confidence and choice.

This aligns with the Commerce Commission's statement on its dedicated construction website that:³

These rules [of competition] help ensure that businesses and consumers benefit from effective competition, which **drives more innovation, lower prices, greater choice or better quality.**

However, as outlined below, the Commerce Commission does not appear to have the resources or the tools it requires to identify the economic and legal barriers to expansion of firms seeking to drive competition in that sector. This includes considering any barriers arising from the setting of certain standards in the building industry that may adversely impact on that market's overall competitiveness.

Previous investigations into competition

We think that previous investigations into the competitive dynamics of the residential construction sector have been limited and ineffective. What is most concerning is that the investigations have identified material issues, but there has been no effective follow-up to address them.

The New Zealand Commerce Commission

In 2010, the Commerce Commission asked Research New Zealand to conduct a small number of qualitative interviews with firms in the non-residential construction sector.

Although a good initiative, the investigation was flawed:

- (a) **It neglected the residential construction sector:** The investigation focused exclusively on the non-residential construction sector, despite analogous investigations (such as a 2009 investigation in the UK) focusing on the construction sector as a whole;
- (b) **The investigation was limited in scope:** It was only concerned with the procurement of building jobs (and therefore with the practices of cover pricing and bid rigging), rather than other competition factors that could increase the cost of building materials and finished houses;

¹ Productivity Commission, *Housing affordability inquiry - Final Report*, March 2012, at iii.

² Media Statement, 29 October 2014.

³ <http://construction.comcom.govt.nz/competition-law/competition-checklist/> (emphasis added).

- (c) **The sample size very small:** Only 12 commercial businesses were interviewed;⁴
- (d) **The sample was not representative:** Small companies, and very large companies, were excluded from the investigation; and
- (e) **The Commerce Commission was powerless to take action:** Unlike an investigation in the UK,⁵ the Commerce Commission received information from Research New Zealand in an aggregated and anonymous form, on the basis that the research could not be used for the purposes of an investigation.

Even so, this limited investigation was enough to persuade the Commerce Commission of the low levels of education regarding competition laws in the construction sector, and of the likelihood that firms were, and had in the past been, practicing cover pricing.

The Commerce Commission's response to these issues was, however, ineffective. It launched an education campaign that suffered from many of the same flaws as did its investigation:

- (a) **The sample size was too small:** To measure the effectiveness of its education campaign, the Commerce Commission interviewed only 30 medium to large sized firms (out of a possible 93);
- (b) **The programme did not last long enough:** The Commerce Commission monitored the construction industry for two years, after which it moved on to a different industry (health);
- (c) **The programme was not effective:** Over the two years of the education campaign the Commerce Commission reported a minimal increase in awareness of competition laws (47% up from 30% in 2011),⁶ and did not prosecute a single breach of the Commerce Act in the construction sector.

The Commerce Commission's investigation and subsequent education campaign therefore cannot be considered to have adequately uncovered, let alone taken sufficient steps to prevent conduct in the non-residential construction sector, and it did not even reach to the residential construction sector at all.

Since its 2010 investigation, the Commerce Commission has also approved a reduction in the number of competitors in a number of building supply markets; including bricks,⁷ steel framing,⁸ pipes and pipe systems,⁹ and sand (used to make concrete).¹⁰

In several of these decisions, the Commerce Commission relied on the possibility of imports from countries such as Australia and China to constrain the newly-merged entities. However, as noted by the Productivity Commission in its Report on Residential Housing (2012):¹¹

Although the New Zealand market is generally open to imported substitutes from other countries which can produce materials on a more economic scale, the size and isolation

⁴ <http://www.comcom.govt.nz/business-competition/anti-competitive-practices/construction-sector/construction-sector-research-questions-and-answers/> at [9].

⁵ The investigation in the UK prosecuted 103 companies for nearly 200 breaches of competition law.

⁶ New Zealand Commerce Commission *Annual Report 2011/12* at 9.

⁷ CSR Building Products (NZ) Limited / Brickworks Building Products (NZ) Pty Limited [2012] NZCC 30.

⁸ USG Corporation / Boral Limited [2014] NZCC 4.

⁹ Fletcher Building Australia (Pty) Limited / Crane Group Limited [2011] NZCC 719; Interpipe Holdings Limited / Fletcher Concrete and Infrastructure Limited [2011] NZCC 720.

¹⁰ Tomarata Sand Limited / Coastal Resources Limited [2010] NZCC 696.

¹¹ Productivity Commission, *Housing affordability inquiry - Final Report*, March 2012, at 176.

of New Zealand's market presents a number of practical barriers, making this less likely to occur.

While some of these barriers, such as regulatory hurdles, can be minimised (as indeed the Government has done through lowered tariffs and temporary suspension of anti-dumping duties for residential construction materials), other barriers (such as the country's small size and geographic isolation) cannot. This fact has led many industry participants, including Auckland Council,¹² to express concern as to the state of competition in the market for the supply of building materials.

Most recently, the Commerce Commission has also concluded a long running investigation into the plasterboard market. In the Investigation Closure Report, released 22 December 2014, the Commerce Commission concluded that no breach of competition laws had occurred.

The Ministry of Business, Innovation and Employment

On 6 November 2013, the Ministry of Business, Innovation and Employment ("MBIE") released an options paper presenting a suite of potential solutions to various barriers to competitive and productive outcomes in the residential construction sector (the "Options Paper"). This was in response to the Productivity Commission's Report on Residential Housing.

While the Options Paper focused predominantly on the regulatory framework and import barriers (such as tariffs and anti-dumping laws), it did discuss certain aspects of competitiveness in the residential construction sector.

This discussion, however, was limited. MBIE relied exclusively on submissions from the industry. Some submissions complained of anticompetitive behaviour; some denied it. In the absence of any direct investigation, MBIE was not in a position to accurately gauge the prevalence of barriers to expansion in the market.

As a result, while MBIE did discuss the theoretical harm that could be caused to consumers by practices such as cover pricing, predatory pricing and oppressive rebate structures, MBIE's ultimate conclusions as to the state of competition were ambivalent:¹³

It is important to note that it is not entirely clear that the described behaviours occur, or if they do, to what extent. Despite the concerns raised by a number of submitters, no detailed evidence of the kinds of conduct at issue has been presented to us. This may be, in part, due to the commercial sensitivity regarding many aspects of these practices.

Later, at p 34, MBIE noted:

There is no definitive evidence for the existence of the types of rebate structures described to us. However, if they are in place in a way that is contingent on "tipping points" as described above, then they are **likely to be limiting access to distribution channels for some manufacturers**. It is unclear if there is a net harm to consumers, but the lack of transparency in relation to these arrangements means that **consumers are less likely to see any benefits that might be accruing further up the supply chain**.

MBIE then put forward various options, such as more government intervention (requiring disclosure of financial or other benefits, and developing government tendering practices), less government intervention (promoting industry self-regulation), and better education of the industry (itself a

¹² Productivity Commission, *Housing affordability inquiry - Final Report*, March 2012, at 177.

¹³ Ministry of Business, Innovation and Employment, *Residential Construction Sector Market Study: Options Paper*, 6 November 2013 at 32.

concerning suggestion given the Commerce Commission's recently concluded campaign that purported to achieve just that).

The nature of MBIE's conclusions is reflective of the fact that, unless a detailed investigation into the competitive dynamics of the market has been performed, it is impossible to discern a policy that will improve that market.

This was noted by MBIE itself:¹⁴

Given the difficulties in establishing the exact nature of possible competition issues in the sector, a cautious approach should be taken to policy interventions.

Conclusion

Over the course of their investigations, both the Productivity Commission and MBIE received a number of submissions from industry participants alleging a lack of competition, and a general lack of awareness of competition law, in the residential construction sector.

Despite these submissions, no proper investigation into the economic and legal barriers to competitive outcomes in the residential construction sector has been performed. The Commerce Commission's investigation in 2010 did not focus on the residential construction sector and was limited in scope. Nor did the Commerce Commission find any breach of its laws in the recently concluded plasterboard investigation. The MBIE Options Paper identified theoretical issues with the industry. The Productivity Commission report did not focus on competition within the market at all.

A detailed and in-depth investigation into economic and legal barriers to competition in the residential construction sector is an essential factor of any "coherent and determined push across multiple policy areas" demanded by an issue as complex as the state of residential housing.

Although the Commerce Commission is the expert competition regulator, we are not convinced that it has the power or the tools to conduct the analysis required. This is not a criticism. It simply reflects that (as illustrated by the plasterboard investigation) it is entirely possible that relevant actors are complying with the law and yet structural influences that require a policy approach to their resolution have not been adequately identified and addressed.

We would welcome an opportunity to discuss this matter with you.

Kind Regards



Lawrence Yule
President
Local Government New Zealand

¹⁴ Ministry of Business, Innovation and Employment, *Residential Construction Sector Market Study: Options Paper*, 6 November 2013 at 38.



Office of Hon Dr Nick Smith

MP for Nelson
Minister for the Environment
Minister for Building and Housing

23 JUL 2015

Mr Lawrence Yule
Local Government New Zealand
PO Box 1214
Wellington 6140

Dear Mr Yule

Thank you for your letter dated 24 June 2015 regarding residential construction costs and housing affordability.

As you note in your letter, housing affordability is a key policy focus for the Government and there are a wide range of initiatives underway. We welcome LGNZ engagement on this issue.

We do note that in the study by the Productivity Commission into housing affordability it is more the costs of the section, rather than the built home, that has significantly increased over the past two decades and that the largest proportionate increase in costs was in development contributions. That is why RMA reform, improved land release and urban redevelopment policies and development charges have been the priority issues to address. We believe there are also gains to be made in improving competition and productivity in the residential construction sector and welcome LGNZ interest in this work stream.

We agree with LGNZ that legal and economic barriers are likely to be more important in holding back competition and productivity of the residential construction sector than anti-competitive conduct. The market study found a range of barriers that, on their own, may not have a large impact on competition and productivity. However, their presence across a number of levels of the construction supply chain pointed to a cumulative impact that could be more significant. Specifically, the market study's findings were as follows:

- The regulatory building control system is not operating in a way that supports competition and productivity gain in the sector.
- Remaining tariffs and anti-dumping duties prevent importers from competing with domestic manufacturers on an equal footing.
- Industry-good research is vulnerable to undue influence from conflicts of interest.
- Strategic arrangements in the upstream supply chain may be acting as a barrier to competition.
- Consumers have not been active, informed and confident market participants.
- The sector's history of path dependent development is not supportive of innovating and productivity gain.

Since the release of the options paper you mention in your letter, the Government has overseen a comprehensive work programme to address the barriers to improving competition and productivity of the residential construction sector. The actions that the Government is taking include:

- improving the operation of the regulatory building control system by:
 - reviewing recent building innovations to ascertain which of these should be provided for in the Acceptable Solutions
 - reviewing the framework for maintaining Acceptable Solutions
 - revamping MBIE guidance on the product assurance framework
 - considering modifications to the way in which the joint and several liability rule functions in the building sector;
- suspending temporarily the impact of tariffs and anti-dumping duties on competition from imports by:
 - introducing a temporary tariff concessions scheme and suspending the imposition of anti-dumping duties on key residential construction materials
 - the approval by Cabinet, in principle, to introduce a bounded public interest test for the anti-dumping and countervailing duties regime and to consult with stakeholders on the automatic termination of anti-dumping and countervailing duties after they have been in place for a specified period (e.g. five years);
- considering improvements to the governance and structure of the Building Research Association of New Zealand (BRANZ) and other levy-funded research organisations, their oversight by government and levy payers, and the potential separation of funding and research functions;
- increased visibility of the Commerce Commission in the sector, both through its enforcement and advocacy roles (discussed below);
- leading the sector towards more transparent pricing strategies by utilising government procurement of building materials as the source of best practice examples;
- empowering consumers to become more confident, active and informed market participants by passing the Building (Residential Consumer Rights and Remedies) Regulations 2014.

We do not consider that a further general inquiry into the residential construction sector is necessary given the findings of the market study and the action that has been taken. However, we do acknowledge that our role is not complete and will continue to monitor and modify the regime through other mechanisms, such as a review of Section 36 of the Commerce Act.

However, in some areas, such as the regulatory building control system, we consider that a stronger and more collaborative focus is warranted. Local government is likely to be a key participant in this.

We would like to invite LGNZ to meet with MBIE to establish a working group to establish a shared view of the roles of MBIE and building consent authorities on building control system issues. We suggest this could focus in particular on the following issues:

- performance vs specific product specification (generic vs named product);
- the role of Acceptable Solutions versus alternative solutions; and
- CodeMark and the product verification framework.

We have asked officials to contact LGNZ to discuss the establishment of such a group.

Your letter also discusses some aspects of the Commerce Commission's work in the construction sector. We would like to briefly address these matters.

Advocacy and enforcement by the Commerce Commission

LGNZ expresses concerns about limited action taken by the Commerce Commission in the residential construction market.

Given the Commission's focus on anti-competitive conduct, rather than the broader regulatory and institutional barriers to competition (which we discuss above), we are comfortable with the Commission's approach.

Your letter discusses the Commission's commercial construction survey. It is important to distinguish between work that the Commission undertakes to support its advocacy and education efforts, and investigations that it undertakes in respect of allegations of anti-competitive behaviour by particular firms.

The Commission's research assessed the sector's awareness of price fixing laws and established the potential issues in terms of competition or anti-competitive conduct, in order to guide the development of an education programme.

We are informed that the Commission survey was targeted at commercial construction because overseas experience showed that cartel activity was commonly experienced in the commercial arena, especially around bid-rigging and anti-competitive agreements in tendering by commercial firms.

The Commission has maintained its focus on education of both the residential and commercial construction sectors in the past 12 months. This has included the launch of a construction website and a series of seminars and workshops with the construction sector. It has also used its education campaign to promote its leniency policy and encourage whistleblowers to contact the Commission with information on potential anticompetitive conduct.

Last year the Commission successfully prosecuted Carter Holt Harvey for price fixing in the Auckland commercial timber market. The Commission's investigation into the plasterboard market, which LGNZ mentions, was extensive. While Winstone has a

large share of the plasterboard market in New Zealand, the evidence did not demonstrate that it was behaving in an anti-competitive manner in breach of the Commerce Act. The investigation was in response to allegations that Winstone has entered into exclusive contracts with merchants.

The Commission found that Winstone's supply contracts with merchants (excluding Placemakers, which is also a subsidiary of Fletcher Building) did not contain contractual provisions that required merchants to purchase all their plasterboard from Winstone. Nor were the rebates Winstone paid anti-competitive. As a consequence competing plaster board manufacturers did have avenues to get product to market. Construction investigations into anti-competitive conduct and Fair Trading Act issues remain a priority for the Commission.

Your letter also discusses the Commission's approvals of mergers and acquisitions in the construction sector. We are confident that the Commission applies robust criteria to clearances and authorisations. The Commission conducts ex-post reviews of many of its clearance and authorisation decisions, which has included a review of its bricks decision. These help it to evaluate and continue to improve its decision-making on these matters.

Conclusion

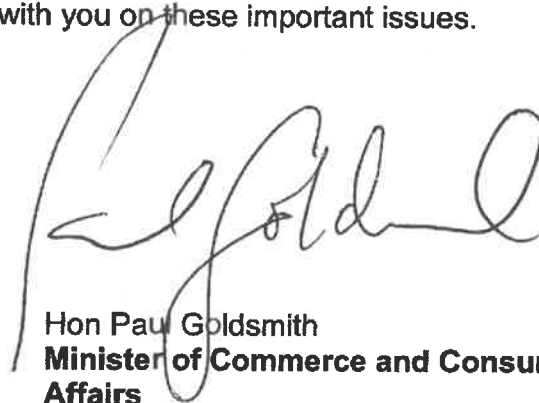
In summary, we are comfortable with the focus and activities of the Commerce Commission on anti-competitive behaviour in the construction sector, and with the outcomes of the Residential Construction Sector Market Study. However, we acknowledge there is still more work to do and are committed to progressing the Government's work programme in this area.

We look forward to further engagement with you on these important issues.

Sincerely



Hon Dr Nick Smith
Minister for Building and Housing



Hon Paul Goldsmith
Minister of Commerce and Consumer Affairs

cc Hon Bill English, Deputy Prime Minister
Hon Paula Bennett, Minister of Local Government