

Coversheet: Healthy Home Standards – Final: 7 December 2018

Advising agencies	<i>Ministry of Housing and Urban Development</i>
Decision sought	<i>Heating, insulation, ventilation, moisture ingress and drainage, and draught-stopping standards for residential rental properties</i>
Proposing Ministers	<i>Minister of Housing and Urban Development</i>

Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

Nearly 600,000 households rent in New Zealand, representing nearly a third of New Zealand homes. Our rental homes are often cold and damp, which in turn can lead to negative health and social outcomes for tenants.

Research from the independent Building Research Association of New Zealand (BRANZ)¹, shows that many of New Zealand's rental homes are consistently in worse condition than owner-occupied houses.

New Zealand rental homes could be of poor quality for a number of reasons:²

- landlords might not invest in improvements or ongoing maintenance to the home because there is little incentive to do so, as some types of improvements benefit tenants only, particularly in a tight rental market
- landlords may not be clear or aware of their legal obligations and therefore do not comply
- tenants may not be clear or aware of landlords' obligations so do not raise issues
- tenants' short tenure and a tight rental market may mean tenants are reluctant to raise issues about the home in general, especially if they are on a low income or otherwise in a vulnerable position

Low-income, elderly, children, disabled persons, and Māori and Pacific Peoples are more likely than other groups to live in, or feel the effects of, cold and damp rental homes. As a result, these groups are at greater risk of negative social outcomes.

Proposed Approach

How will Government intervention work to bring about the desired change? How is this the best option?

The Healthy Homes Guarantee Act 2017 (HHG Act) was passed in December 2017 and enables standards to be set to create warmer, drier rental homes. The standards can be set for rental homes to be adequately heated, insulated and ventilated, protected from draughts and moisture ingress and well drained. Many New Zealand rental homes are cold, damp and mouldy because they lack some or all of these features. The standards are one of several Government initiatives addressing cold and damp homes.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

People who rent are the primary beneficiaries of this proposal.

There is strong international evidence that effective heating, insulation and ventilation can directly reduce illness, by helping maintain a minimum indoor air temperature; and can indirectly reduce illness by controlling relative humidity, lowering dampness, and inhibiting the growth of mould and fungi.

Renters and owner-occupiers alike may suffer negative health effects from living in substandard properties. However, renters are more likely to live in such properties, and are also less likely to have the financial means to change their circumstances. They lack the authority to make many changes to the property that would improve their experience e.g installing a large fixed heating device.

As the lowest quality houses are concentrated in the rental market, there is a case for focussing on the quality of rental properties. For landlords, improvements may increase the value of a property and its potential attractiveness to renters. Preventing or addressing persistent dampness and mould will also maximise the lifetime of internal wall linings and other building components and chattels, and reduce maintenance costs.

The cost benefit analysis on the healthy homes standards (CBA) identifies the monetised and non-monetised costs and benefits of the proposed standards. Non-monetised benefits include school and work attendance, mental health, subjective well-being and comfort.

Taking steps to improve the healthiness of rental properties by requiring minimum standards for heating, insulation, draught stopping, ventilation, and for moisture ingress and drainage will result in net benefits for New Zealand overall.

Where do the costs fall?

Private landlords

The cost to private landlords will depend both on the current state of their properties and on the exact standards set in regulations.

The CBA estimates that it would cost in the region of \$7,500 to \$10,000 (excluding GST) to outfit a house to comply with all the standards assuming the house was deficient in all areas covered by the standards to begin with.

Public housing

Housing New Zealand Corporation (HNZC) and Community Housing Providers (CHPs), as providers of rental properties, will face increased costs to comply with the new standards.

HNZC estimates additional costs of \$113 million to \$144 million for known interventions, over and above existing planned programmes, plus a potential additional sum of \$77 million to \$99 million for interventions that may or may not be required to meet the proposed heating standard.

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As with other landlords, these agencies will incur operating costs including additional programme and tenancy management costs to implement changed processes.

The CBA identifies both capital and operating costs for all landlords. It also identifies any increase in operating costs for tenants.

These estimates are based on a number of assumptions for the public and private housing stock. In the case of public housing, property records in most cases do not have enough detail to confirm the exact number of affected properties for each standard.

Ensuring compliance

Compliance involves a number of activities including providing guidance on what compliance means, and enforcement of the standards. This involves the means to demonstrate that the standard has been complied with (e.g. through certificates of compliance) and, in some cases, requiring compliance through Tenancy Tribunal dispute processes.

The costs of publishing and enforcing the regulations will fall on the Tenancy Services Group in the Ministry of Business, Innovation and Employment (MBIE). This includes information campaigns, advice and support to landlords and tenants, compliance monitoring, investigation and enforcement, to support the effective implementation of the HHG Act. Funding was obtained in Budget 2018 to support the implementation of the HHG Act, MBIE has been funded an additional \$15.1 million for operating (over 2018/19 to 2021/22) and \$0.5 million for capital (in 2018/19). The operating costs included funding (\$1.7 million) to support the development of a housing quality measure as a Tier 1 statistic.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?

Enabling time for the standards to be met

While securing the supply of materials (insulation, heaters etc.) to undertake improvements required by the standards is unlikely to present issues, the availability of suitably qualified installers will have implications for when compliance may be realistically expected.

This risk has been addressed through when the standards must be complied with, between when they come into effect on 1 July 2019 and at the latest by 30 June 2024. We note that delays in meeting new standards can delay the expected benefits, although it is not clear that this will have any significant effect on the overall assessment of the regulatory impact.

Tenant heating and ventilation behaviour

To achieve estimated benefits some tenant heating behaviour changes are assumed. There is a risk that the assumption that 50 percent of tenants heat their homes more, either under or over estimates the benefits of installing fixed heating. Evidence indicates behaviour changes occur when households receive new heating devices suggesting it is likely that houses will use their heating more.³⁴

A number of complementary initiatives including the winter energy payment, the electricity price review and any changes to the welfare system following the Welfare Expert Advisory Group will support behaviour changes so benefits are realised. Monitoring and evaluation will also assess behavioural changes through assessment of internal temperatures which reflect heating behaviour.

Landlord compliance

The majority of landlords (75 percent) are assumed to voluntarily comply with any required standards. To achieve compliance with the remaining 25 percent of landlords, additional

enforcement and compliance activity is required. The Government has allocated \$15.1 million over four years to support the implementation of the healthy homes standards including enforcement and compliance activity (see section 6).

Planned compliance activity includes up to 2000 risk based compliance interventions with a mix of both proactive and reactive interventions. If a greater number of complaints is received, and accepted for action, then the number of proactive compliance and enforcement interventions would need to be reduced.

This may reduce the effectiveness of the proactive work in terms of incentivising landlords to change their behaviour through the fear of being caught. To mitigate this, screening methods are used by the enforcement team to ensure reactive compliance activity is focused on cases where harm is likely to occur. This reduces non-essential reactive compliance interventions maintaining capacity for proactive interventions.

Bringing multiple properties into compliance

For landlords with an extensive portfolio of rental properties, there will be costs associated with managing the process to become compliant (e.g. installation programmes and tenant management). Allowing time for the standards to be met will enable landlords with multiple properties to manage these costs over the 5 year period within which they are to comply with the new standards.

Shifting unimproved rental stock to new owners

Some private landlords may choose to sell their unimproved rental properties. If the new owner is a landlord, then the required standards will need to be met and there is no implication for achieving the objective of warm and dry rental properties. However, if the new owner chooses to occupy the property, then they may choose to improve the property to address healthy home issues, or opt to live in the property in an unimproved condition. We do not know the extent to which such shifts may occur in practice. However, we expect that most new owners would make some improvements to their properties over time.

The Building Act provides the means by which local authorities can address unsafe and insanitary homes, and requirements for properties that are renovated.

Removing unimproved houses from housing supply

Some current rental properties that need to be improved may be completely withdrawn from the housing supply (that is, they are neither available to renters nor to new owners). Where these properties are at the very low end of the quality spectrum and are unable to be improved, then the quality of the housing stock will have been improved and the supply of houses reduced. If these properties are in concentrated locations, then the effects on (rental) housing supply in those areas may be visible.

Local or central government may become involved to address emergency, temporary or longer term housing supply issues. We do not propose any additional mitigating measures.

Passing on costs to renters

The costs of upgrading properties will be borne by landlords, who may accrue limited direct benefits. Landlords may recover these costs from tenants through rents where supply and demand conditions allow them to do so. In some supply constrained markets, low income tenants may be paying close to as much as they can for housing and therefore limit potential rent increases. In these cases landlords will have to accept a reduced return on investment, or sell. Where a significant portion of landlords sell their properties this could create a short term supply shock as the market adjusts, potentially increasing short term demand on emergency or public housing.

The costs borne by landlords will vary by the type of property:

- Owners of high quality houses that already meet the standards will incur minimal costs.
- Owners of medium quality houses that will need moderate improvements are likely to stay in the rental market. With some additional one-off costs and small increases in maintenance requirements, these properties will be able to be upgraded.
- Owners of low quality houses may need more substantial repair to meet the minimum standards. These are more likely to be sold, either to another landlord with more capital available, or to an owner occupier.

A property is more likely to be sold where the costs of retrofitting are large, or if the standards apply earlier. Any practical exemptions, developed as part of the regulation design process, may mitigate these costs for some landlords. The regulation design process should clarify for landlords the nature, effects and costs of the required upgrades. Some upgrades that reduce damage to property can be mutually beneficial.

There have been recent increases in national median rent, this could be in part due to landlords anticipating the introduction of changes when considering how to set rents.

Distributional effects

Some rental properties will be sold to owner-occupiers including both first home buyers and other owner-occupiers moving into a new property. The net effect will be a decrease in the number of rental properties. Alternatively, some rental properties may be removed from use in long term accommodation altogether, and switched into short term accommodation (e.g. AirBnB).

Sales will be more likely to occur where:

- Low quality properties will require substantial upgrades in order to meet the forthcoming standards under the Healthy Homes Guarantee Act;
- Landlords are highly leveraged, with no owned rental properties that earn positive income to use to offset costs; and
- Landlords lack the skills or motivation to comply with the new law changes.

Each sale of a rental property to a new owner-occupier removes a property from the rental market. Transferring houses from rentals to owner-occupied housing may lead to a demand for more houses to accommodate the same number of people because the average, owner occupied housing has fewer people per property than rental housing.

A reduction in rental housing particularly low quality homes are likely to disproportionately effect low income households, potentially increasing demand for public and emergency housing. This pressure is also likely to increase household crowding at the margins until supply constraints can be reduced.

Effects mitigated by the context of the pressures in the broader housing market

The effects of strong demand from immigration and higher incomes for renters will be an increase in rents, especially in areas with unresponsive supply. This should encourage more landlords to stay in, or enter the housing market as rents increase. This effect is significant, because it could totally offset some of the negative effects of the healthy homes standards and other regulatory changes that affect landlords.

In practice, it is impossible to isolate, after the fact, the different causes of rent increases. If rents do increase, as we expect, landlords may attribute these increases to the

Government's policies. However, in reality other factors will be strong demand from population growth, coupled with constrained supply that will enable landlords to increase rents.

We propose to monitor any changes in rent levels through the Bond database using the monitoring framework summarised in a later section of this RIS. We do not propose any further mitigating actions. Landlords will have their own expected pay-back periods and cost of borrowing to factor into their decisions, as well as their assessments of external market conditions.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.

No significant incompatibility with the Government's expectations has been identified.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

There is a well-established, reputable body of international evidence about the public health effects of indoor air quality and temperature, and the health benefits of providing effective heating, insulation and ventilation. There is also reputable evidence that many New Zealand homes have deficient heating, insulation and ventilation and that this deficiency cannot be addressed with portable heating devices. Much of this evidence, and deeper analysis of technical and economic information, is referenced in the CBA, which has been released publicly (accessible at <https://www.hud.govt.nz/assets/Residential-Housing/Healthy-Rental-Homes/Healthy-Homes-Standards/Cost-benefit-analysis.pdf>).

In addition to the references to the evidence used for the CBA (accessible at <https://www.hud.govt.nz/assets/Healthy-Homes/Cost-benefit-analysis.pdf>), also see

- Grimes A, et al. (2012). **Cost benefit analysis of the Warm Up New Zealand: heat smart programme** (accessible at <http://www.motu.org.nz/assets/Documents/our-work/urban-and-regional/housing/Cost-Benefit-Analysis-of-the-Warm-Up-New-Zealand-Heat-Smart-Programme.pdf>)
- Lucy Telfar Barnard, Nicholas Preval (May 2018) **Healthy Homes Guarantee Standard Cost Benefit Input Warm Up New Zealand evaluation rental sector sub-analysis: differences in health events and costs by existing insulation status** He Kainga Oranga/Housing and Health Research Programme, University of Otago, Wellington (accessible at <https://www.hud.govt.nz/assets/Healthy-Homes/Otago-University-Cost-benefit-input.pdf>)

To be completed by quality assurers:

Quality Assurance Reviewing Agency:

The Treasury Regulatory Quality Team

Quality Assurance Assessment:

The Treasury Regulatory Quality Team has reviewed the Regulatory Impact Assessment (RIA) "Healthy Home Standards" prepared by the Ministry of Housing and Urban Development and considers that that information and analysis meets the Quality Assurance criteria

Reviewer Comments and Recommendations:

The proposal has been well consulted with key stakeholders. The proposal is supported by Cost Benefit Analyses prepared by the NZIER and the Ministry of Housing and Urban Development, which is summarised in the RIA. The RIA identifies the key risks, such as the tenant and landlord behavioural assumptions underlying the analysis. The analysis is

constrained to the powers enabled under the Healthy Homes Guarantee Act, and is set out in the context of a wider number of related government initiatives

Impact Statement: Healthy Home Standards

Section 1: General information

Purpose

The Ministry of Housing and Urban Development is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

Key Limitations or Constraints on Analysis

A number of initiatives are underway to address cold and damp homes (see related government initiatives). This analysis is constrained to the powers enabled by the Healthy Homes Guarantee Act which relate specifically to the fabric of rental homes i.e. heating devices and insulation.

Assumptions regarding landlord and tenant behaviour

Landlord compliance

An MBIE survey of landlords and tenants in early 2017, suggested that at least 75 percent of landlords will voluntarily comply with the 2016 insulation requirements by the time they become mandatory. This provides a basis for the assumed level of compliance with the healthy homes standards and informs enforcement and compliance requirements for the remaining non-compliant landlords.

Tenant behaviour and benefits

The benefits and costs provided in this analysis assume changes in tenant behaviour. The heating standard assumes 50 percent of tenants heat to the target temperature. This assumption does not predict that these temperatures will be reached but show that if these temperatures were reached, what would be the balance of the cost and benefits.

Limited data and information available on rental homes

We have not been able to set out full costs and benefits of all proposed options. We commissioned a cost benefit analysis of the proposed options (CBA) that helped to identify the scale of the effects of the proposed options for the healthy home standards.

The CBA contained some gaps (for example, in the assessment of the benefits of requiring higher standards than currently required for moisture ingress and drainage, and ventilation). These gaps formed part of the rationale to consult and seek information from stakeholders on known costs and benefits of our proposals.

In addition to some limits on quantifiable benefits and costs, there is limited housing quality data available on New Zealand rental homes. These limits affect the development of the healthy homes standards. In the medium term, initiatives from central government (MBIE and Statistics New Zealand) and the independent research body, BRANZ, are working together to inspect homes in 2018 and 2019 to gain better insight of New Zealand housing conditions. The data gathered from these inspections will enhance information from the 2018 census and 2018 General Social Survey.

Industry capacity

The standards may require a significant portion of the rental housing stock to undertake retrofit work to meet the standards. Given the current skills shortages in the construction sector, there is a risk that industry capacity could limit the ability for landlords to meet their obligations. Industry capacity has been considered when setting the compliance approach to mitigate this risk.

Impact on landlords and tenants

It is difficult to predict the exact market impacts from implementing the healthy homes standards. Many factors will influence whether a landlord chooses to increase the rent of their rental property, such as the current condition of their rental property and the scale of work required to lift the rental property's quality. It is likely that landlords will increase the rent they charge a tenant to offset to some extent the costs incurred from upgrading their properties, or choose to sell their properties.

It is anticipated that the standards would likely have a moderate effect on landlords overall. NZIER noted in the CBA that it is unlikely that landlords would pass on the costs of implementing the standards in full. Many private landlords hold property in hope of capital gain, as much as for rental income, and will likely be reluctant to incur the opportunity cost of vacancy and expense of recruiting new tenants by raising rents when other properties might not be doing so.

Related government initiatives

The healthy homes standards, and the potential impacts, need to be considered in the context of a number of other government initiatives underway in the rental housing sector:

- **Residential Tenancies Act (RTA) reform:** proposals that focus on such areas as improving a tenant's security and stability of tenure, modernising the law to appropriately balance the rights and responsibilities of tenants and landlords, and implementing a more efficient and proportionate enforcement regime
- **The Residential Tenancies Amendment Bill (No 2)** is currently before Parliament and makes three groups of amendments to the RTA related to contamination of rental properties, liability for damage to rental premises caused by a tenant, and tenancies over rental premises that are unlawful for residential use.
- **The Residential Tenancies (Prohibiting Letting Fees) Amendment Bill** was introduced on 22 March 2018 and passed into law on 6 November 2018. Letting agents, or any person, are prohibited from requiring a tenant to pay a letting fee, or any other fee, in relation to a tenancy. This amendment to the RTA will help to reduce the up-front costs faced by tenants and improve fairness for tenants.
- **Tier One Statistics:** Statistics New Zealand (Stats NZ), in partnership with MBIE are developing a Tier One statistic on housing quality. As part of this work Stats NZ recently consulted on a definition of housing quality.
- **Winter Energy Payment:** introduced on 1 July 2018 to help New Zealanders receiving New Zealand Superannuation, or a Veterans' Pension and beneficiaries to heat their homes by increasing the amount of money available to them over the winter months. From 2019, the Winter Energy Payment will be paid from May to September and will provide \$450 a year for single people and \$700 a year for couples or those with dependent children.

- **“Warmer Kiwi Homes”:** a new four year government programme offering grants from 1 July 2018 to cover two-thirds of the cost of ceiling and underfloor insulation and ground moisture barriers to low income home owners. Heating grants will be added from 1 July 2019.
- **Healthy Homes Initiative (HHI):** the Ministry of Health’s HHI was established in December 2013. It identifies at-risk families and undertakes housing assessments and facilitates access to interventions to create warmer, drier homes. Interventions include insulation, curtains, bed/bedding, floor coverings, heating sources and relocation. The Ministry of Housing and Urban Development and Housing New Zealand Corporation have agreed to a comprehensive evaluation of the programme, led by the Ministry of Health.
- **Te Puni Kōkiri community-led housing repair projects:** supports community-led housing repair projects aimed at whanau-owned homes in serious disrepair or without basic utilities.

Responsible Manager (signature and date):

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Claire Leadbetter

Manager, Tenancy and Housing Quality

Housing Branch, Policy Group

Ministry of Housing and Urban Development