



**Ministry of Business,
Innovation & Employment**

Residential Construction Sector Market Study

Issues Paper

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1. The Study

The Ministry of Business, Innovation and Employment (MBIE)¹ is undertaking a market study of the residential construction sector. This study is one of a package of measures announced as part of the Government's response to the New Zealand Productivity Commission's final report into housing affordability.

The purpose of this issues paper is to outline our proposed approach to the market study so that interested parties can find out how they may participate and provide information. MBIE may also directly contact key parties with expertise or experience in the New Zealand residential construction sector if MBIE considers those parties could assist with the market study.

The issues identified in this paper are intended as topics for study and do not necessarily represent the final views of MBIE or the New Zealand Government. The paper draws on a range of reports on the building sector, including the New Zealand Productivity Commission's findings. However, parties should feel free to identify other issues if they are relevant to this study.

The responses to this issues paper, along with other information gathered through targeted interviews and research, will help to inform the development of an options paper, which will set out potential policy interventions in the residential construction sector. This options paper will represent a further opportunity for interested parties to contribute to the study in advance of the final report to government.

Updates on the progress of these further steps in the study will be provided on MBIE's website: www.mbie.govt.nz.

1.1 MBIE Contacts

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¹ MBIE was formed on 1 July 2012 by merging the former Department of Building and Housing, Ministry of Economic Development, Department of Labour, and Ministry of Science and Innovation.

1.2 Making a Submission

You are invited to make a written submission on the issues raised in this paper. Submissions should be received at MBIE by 5 pm on Monday 10 June.

Your submission may respond to any or all of the issues outlined, depending on your interest. In addition, you are welcome to provide other information that you think might be relevant to this study. If possible any views outlined in the submission should be supported by evidence, such as references to independent research, facts and figures, or examples. Please also include your name, or the name of your organisation, and contact details. Alternatively, should you wish to submit anonymously, please indicate in general terms your involvement in the residential construction sector.

Submissions may be made electronically (preferred) or by post. Electronic submissions should be in Adobe Acrobat or Microsoft Word or compatible format. In addition, an electronic submission form is available at <http://www.med.govt.nz/med/about-us/consultation-on-the-residential-construction-sector>.

1.2.1 Use of information

The information provided in submissions will be used to inform our analysis and the advice given to Ministers on housing affordability, and more generally to increase MBIE's knowledge of the construction sector. We may contact submitters directly if we require clarification of any matters in the submission.

We intend to post written submissions received on the issues paper on MBIE's website at www.mbie.govt.nz. Therefore, please read the advice below regarding confidential or private information.

1.2.1.1 Confidential information

If your submission contains any confidential information, please indicate this on the front of the submission. In addition, the confidential information should be clearly marked within the text, for example, by including the confidential information in square brackets or as a separate appendix.

If you wish to provide a submission with confidential information, we prefer that you also provide a separate public version of the submission which excludes the confidential information. If provided, the public version will be posted on MBIE's website.

In any case, if MBIE receives a request under the Official Information Act 1982 for a copy of submissions, MBIE will need to make its own assessment of whether it is in the public interest to release the information received. In this event, MBIE will endeavour to consult with submitters that have provided confidential information prior to making its decision on the request.

1.2.1.2 Private information

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will be used by MBIE only in conjunction with providing its advice on housing affordability. Please clearly indicate in your submission if you do not wish your name or contact details to be posted on MBIE's website or included in any summary of submissions that MBIE may publish.

2. The Proposed Scope of the Study

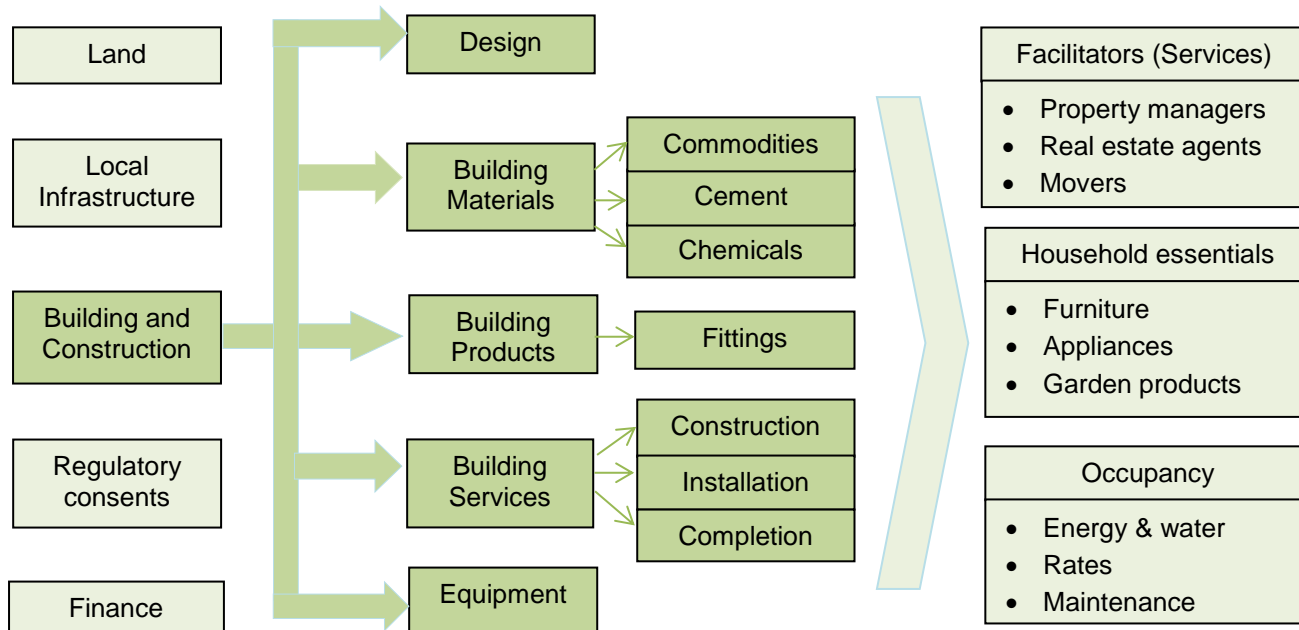
2.1 What is to be covered by this study?

The Government has asked MBIE to conduct a market level study into the residential construction sector to identify market level barriers to improved housing affordability, with particular reference to the competitiveness and productivity of the sector. The government sees improved performance in the residential construction sector as an important driver of more affordable housing. Improving the operation of the housing market overall has been identified as a government priority in the Business Growth Agenda progress report on *Building Capital Markets*.

The residential construction sector is diverse, including everything from design (including architecture, engineering, quantity surveys and project management); construction (including site works, building, roofing and concrete); installation (including plumbing, electrical, heating and ventilation) to completion services (including plastering, painting, glazing and fit out). In addition, the sector includes a supply chain of imports, domestic manufacture, and wholesale and retail distribution of building materials, products, and equipment. The overall cost of building materials in particular appears to be relatively high. Many of these goods and services are common to the construction of residential and non-residential buildings. This study will, however, focus on residential buildings only.

We have developed a high level housing input chain that defines the segments of the residential construction sector that relate to residential housing.

The housing input chain



This study is primarily focused on the markets for building materials and services, from both a supply and demand perspective. Other aspects such as design, building products and equipment could also be analysed if any significant market barriers are identified.

The residential construction sector is, however, only one element that contributes to the supply cost of housing, with other factors such as the availability of land and regulatory consenting processes also being important. These other factors are outside the scope of this study. They are being addressed by the other workstreams in the housing affordability work programme, relating to:

- Reducing land supply restrictions.
- Improving the timely provision of efficient infrastructure.
- Reducing costs and delays in regulatory processes.

2.2 What is the problem to be addressed?

The Productivity Commission made a number of findings on the performance of the residential building sector. Overall it concluded that industry productivity is low, and this is reflected in growing building costs and evidence of poor building quality. It also identified in particular a substantial difference between the price of building materials in New Zealand and Australia. Relevant key findings of the Productivity Commission are reproduced below in Appendix 1.

To the extent that the quantity and price of housing is a function of its supply costs, an improvement in industry productivity would improve housing affordability. This includes both the affordability of building new houses and the renovation and maintenance of existing ones. Consequently, we have interpreted the Government's direction as being to identify market level barriers to lowering costs in the residential construction sector. Lower costs may result from increased productivity and/or improved competition.

This study will give particular consideration to whether there are any barriers to competition within markets or unnecessary impediments to improving competitiveness and/or productivity in the sector. It will examine both structures and behaviours that might impede competition and productivity growth. However, the study will not be making assessments of whether any participants are acting in contravention of the Commerce Act 1986. Any concerns of that nature should be referred to the Commerce Commission.

The study should also be seen in the context of the Government already putting in place measures to improve housing affordability, some of which address construction costs. For example, the Government reviewed the Building Act in 2009-10, initially part of the overall programme at the time to reduce the cost of regulation. Some of these reforms are still being rolled out, including measures expected to be passed in 2013 to improve the information and power imbalance between consumers and building contractors. In addition the Government is currently looking at occupational regulation in this sector and has introduced various measures to support scale and standardisation.

We also anticipate the need to take account of other initiatives in this wider work programme such as exploring opportunities to support industry scale and productivity through the social housing programme. We also need to work constructively with the Building and Construction Sector Productivity Partnership, whose objective is to achieve a 20 percent lift in construction sector productivity by 2020.

3. Our approach

3.1 Structure, conduct, performance

The study will adopt a standard industrial organisation framework for analysing the state of competition and productivity in the New Zealand residential construction sector and its relative competitiveness with Australia. It will look to identify any structural features and conduct of participants that could impair market performance.

3.1.1 Markets to be analysed

The first stage in the analysis will be to identify particular markets for goods or services that merit detailed study. The markets may relate to a product or class of products (including labour) that are part of the supply chain for residential building. These products may be further categorised in relation to different geographical locations, particularly if high transport costs constrain the choice of products available within particular areas.

3.1.2 Market structure and barriers to entry

For each of the markets identified, we will consider the particular structure of that market. Market structure is a function of the characteristics of its participants and any barriers to potential competitors entering, or existing competitors expanding, in the market.

The market shares of existing competitors are one factor that may be considered, but market concentration is not necessarily an indicator of the level of competition in a market. Other factors that are relevant include:

- Barriers to entry and expansion (see discussion below).
- Vertical integration – where a firm operates at 2 or more functional levels of the supply chain (e.g. manufacturing and retailing building products).
- Countervailing power of buyers – where a buyer is able to influence the price and quality of goods and services acquired, as opposed to being a price taker.
- The balance between demand and production capacity (e.g. investment lumpiness might allow market power to persist without competitive entry).

It is generally regarded that barriers to entry and expansion are the most important determinant of competition and industry competitiveness. For competition purposes, barriers are any costs and risks faced by existing and potential suppliers that impede their ability to enter or expand in response to market conditions in a timely manner.

These market characteristics or entry costs, however, can also be welfare-enhancing. For example, vertical integration along the supply chain may result in economies of scale and/or scope for the firm that may be passed on to customers in lower prices. It is necessary, therefore, to consider the benefits and costs of any market features to determine their overall impact on public welfare. In doing so, it is also desirable to consider if the benefits could be achieved in a less costly way. Regulations should not unnecessarily impede competition or competitiveness of the industry.

Market barriers are generally of three types:²

3.1.2.1 Natural (or structural) barriers

Natural barriers are associated with the technology, resources or inputs required to establish and operate a business in a particular market. In general, natural barriers are matters that are outside the control of incumbents. They arise due to factors such as the size of the market, scarcity or location of resources, and constraints on technology.

Examples of natural barriers:

- Substantial economies of scale and scope in production.
- The existence of sunk costs stemming from large specialist investments in plant or equipment.
- Costs to customers of switching from one supplier to another.
- Difficulties in accessing infrastructure, technology or raw materials.
- Difficulties in accessing product distribution channels, such as specialist retail outlets.

3.1.2.2 Regulatory barriers

Regulatory barriers arise from legislation or regulations that could limit the number of market participants, or may add to the costs of starting or operating a business. However, regulations may also be designed to improve the operation of the market rather than impede it. For example, the setting of standards on services and building materials enables competition that meets the needs of buyers, particularly where it would otherwise be difficult for buyers to distinguish between the quality of materials and services supplied. In addition, although there are compliance costs from such regulation in the construction of a new house, the regulations may also result in lower costs of occupancy and maintenance over the life of the house.

Examples of regulatory barriers:

- Resource management or other planning consent requirements.
- Licensing or certification requirements for building occupations and materials.
- Regulations governing standards and quality.
- Intellectual property rights in relation to inputs, products or processes.

3.1.2.3 Strategic barriers

Strategic barriers may arise from actions taken by an incumbent business to discourage prospective entrants or existing competitors from expanding. Such actions may reflect aggressive competition and lead to lower prices or other benefits for all or particular classes of customers. However, certain forms of strategic behaviour when undertaken by a firm with substantial market power may be anticompetitive (e.g. predatory pricing).

Examples of strategic barriers:

- Investment in excess production capacity.
- Investment in advertising to raise customer loyalty, brand reputation and sunk costs.
- Raising customers' switching costs through long-term contracts or customer loyalty programs, where the customer may include a trade buyer, retail outlet or end consumer.
- Signalling that entry by a potential competitor will be responded to aggressively, such as by significant price discounting.

In addition, as the Commerce Commission outlines in its merger guidelines, the potential for imports to provide a competitive constraint requires consideration of the existence of any specific trade barriers. Trade barriers may include the level of import tariffs, other import duties, the existence of quotas or any regulatory clearances or licensing arrangements required to supply foreign goods and services within New Zealand. International transport costs and exchange rate movements may also be a relevant factor.

The ability for importers and local new entrants to access distribution channels for building products and materials is also relevant to the level of competitiveness for the supply of those products and materials. The existence of exclusive supply channels for incumbents may pose barriers to entry to these markets.

3.1.3 Market conduct and performance

Within the relevant markets, we intend to look at the way the market operates and how suppliers and buyers interact. This will include a consideration of building tendering practices and the extent of collaboration by suppliers, as well as any incentive schemes or tying arrangements that might exist within the sector.

We will consider if there is workable competition in the markets. Competition is a process of rivalry. Competition may occur on price, quality or customisation of goods or services, depending on buyers' preferences.

A workably competitive market is one where no one seller, and no group of sellers acting in concert, holds market power. Market power is the ability to act independently of competitors and to increase one's level of profits by providing less and charging more. Where there is workable competition, existing or potential competitors would keep this power in check by offering or threatening to offer effective inducements to entice customers away and expand output. A market where there is not workable competition may be characterised by excessive profits relative to costs and risks, or output and quality that are not responsive to consumer demand.

We will also consider if there are any unnecessary market impediments that impact on industry competitiveness and efficiency relative to other jurisdictions, such as Australia. We note, however, that price rises greater than the rate of inflation, or high prices relative to other jurisdictions, are not necessarily indicators of low levels of competition. These increasing (or high relative) prices could be a function of increasing (or high relative) supply costs. Supply costs may also be a function of natural, regulatory or strategic barriers that may be specific to New Zealand markets.

3.1.4 Productivity issues

The residential building industry in New Zealand appears by most indicators to be a relatively lucrative one; with good profitability per employee and high returns on the equity that is invested. There are fewer employees in the industry than at its 2008 peak, but numbers of residential builders are still high in comparison to the historic average.

However, the industry pays relatively low wages to workers with comparatively less education and training than other sectors in New Zealand. International comparisons

indicate that productivity and levels of value-add are low. Sub-contracting is common and equity investment levels are relatively low. There is also a decreasing productivity trend in comparison to past performance in the domestic industry.

The size of residential developments in New Zealand and cyclical nature of the industry may be inhibiting the ability of service providers to reap benefits of scale and scope – including standardisation and benefits that come from stability. This may help explain why the New Zealand sector does not make more use of developments observed in offshore markets such as the increasing use of pre-fabricated or modular housing.

The very small average firm size (or self-employment) that characterises much of the industry also appears to be limiting investment in education and research that might help raise productivity through innovation. In particular management capabilities and related skills have been identified as barriers to a greater level of uptake of new building processes and products.

These productivity factors may be contributing to noted price differentials or help explain industry behaviour. We will therefore consider the interface of industry productivity with competitiveness in the context of housing affordability. We are seeking an improved understanding of what is driving flat productivity in this sector relative to other New Zealand industries and relative to other jurisdictions. We will consider whether there are any policy options that might address the lack of scale and fragmentation of the New Zealand industry.

3.2 Information sources

The study will draw on a wide range of information sources, including the Productivity Commission report and other relevant research and calling for public submissions. We will also seek the views of market participants through targeted interviews and soliciting of submissions.

We will review past Commerce Commission decisions that relate to the residential building sector to see where competition issues arose and if these continue to exist. In addition, we will investigate the Australian residential construction sector, in order to better understand the seemingly unfavourable comparison drawn in the Productivity Commission report.

3.3 Possible outcomes

As mentioned, this market study has a policy focus and is not an enforcement investigation. Public enforcement is the role of the Commerce Commission. While it is too early to suggest what the outcomes of this study will be, the types of measures that might be considered include recommendations for:

- Changes to government regulations or rules to reduce barriers or impediments to competition or industry competitiveness.
- Changes to government procurement practices.
- Measures that improve transparency and consumer information, or make consumer switching easier.
- Other measures that improve industry competitiveness or productivity.

4. Initial issues

4.1 Identifying markets for study

Residential housing may take many forms, including apartments, townhouses or detached houses. One approach to assist in identifying markets for study is to look at the major cost components for a standard residential house.

The key cost components for services are³:

- Design – e.g. architects, architectural designers, engineers, quantity surveyors
- Building construction – e.g. builders, roofers.
- Building installation – e.g. plumbers, electricians.
- Building completion – e.g. painters, plasterers, glaziers.

The key cost components for materials and products are:

- Building equipment
- Foundation
- Frame
- Roof
- Insulation
- Wall cladding
- Windows / exterior door
- Interior doors
- Fixtures and fittings (hardware)
- Wall lining
- Paint / wallpaper
- Plumbing
- Electrical.

Within each of these cost components, a variety of building materials and products may be used. We understand that there are over 45,000 product lines used in the industry.

The supply chain for these materials and products extends from the point of extraction or import of the basic commodities (such as timber, concrete, and steel) to the manufacture of building materials and products, and their distribution to wholesale and retail customers.

³ Many of these services are affected by Restricted Building Work which came into effect in March 2012 and restricts specific types of building work for households to licensed building practitioners.

Consequently, markets for housing and housing material and products are also divided along functional lines. For example:

- Housing material and products markets contain both wholesale and retail elements.
- Purchase decisions for housing may be made by individual home buyers or by contractors on their behalf. In the latter case, contractors may look to purchase multiple rather than single units before on-selling these to individual purchasers.

In such cases there is the scope for considerable information asymmetries to arise.

Questions

- 1 What bottlenecks or inefficiencies exist in the building sector supply chain? The supply chain extends from the point of manufacture or import of core materials used in construction through to the supply of various building products and building services and the building of residential housing.
- 2 What is the extent to which competition occurs across geographical regions within New Zealand for building services and materials, taking into account transport costs?
- 3 To what extent does competition:
 - For the supply of particular building materials; and
 - Between building materials used for similar purposes, provide a constraint on prices and ensures reasonable quality of the products?

4.2 Characteristics of the residential construction sector

The characteristics of the residential building and construction sector were considered by the Productivity Commission and will need to be carefully considered in this study.

Briefly, in relation to the supply of services:

- The industry is dominated by small firms that build one house at a time, are unable to generate economies of scale, and often lack management capability.
- Many specialist services are required to build a house and the fragmented nature of supply presents difficulties in the management of the supply chain.

In relation to the supply of building materials:

- For many materials, there are only one or two manufacturers within New Zealand. This market concentration may arise from the need for economies of scale in production and the small size of the market meaning that a large number of competitors cannot be profitably sustained.
- Given high transport costs, some manufacturers may operate at relatively small scale on a regional basis in order to be close to the respective customer bases.
- Some building materials are internationally traded commodities, and subject to international market conditions.

On the demand side it appears that:

- The building sector is subject to boom and bust cycles that may vary regionally.
- New houses tend to be bespoke one-off designs.
- There is asymmetric information available between some buyers and sellers of construction services.

Customers within the residential construction sector exist at several levels along the supply chain and have a variety of characteristics. Ultimately, those having houses constructed or renovated represent the final consumers within the sector. They can range in size from individual households, through to large scale developers and government.

At other levels of the supply chain, individual builders can be said to be customers of, for example, building materials or subcontracting services. These trade consumers may also range in scale from small owner-operator firms that might be involved in only several constructions each year through to large operations with many employees undertaking larger, multi-home developments. Suppliers of building materials and services may differentiate between trade and final customers on the basis of price and services depending on the customers' sophistication and volume of purchases.

Questions

- 4 What is the extent of entry, expansion, consolidation and exit of suppliers and products in the construction sector in the past 5 years? Please include any examples.
- 5 How has international trade in building commodities impacted on construction costs and competition in New Zealand in recent years?
- 6 What are the major impediments to establishing new building services or introducing new building materials to the market?
- 7 What are the barriers to imports of building materials and should they be reviewed to improve competition?
- 8 Are there barriers to the use of more prefabricated / modular housing and, if so, what are these?
- 9 What is the impact of vertical integration or any exclusive arrangements in the supply chain for building materials and how does this impact on competition and efficiency?
- 10 Building services are generally supplied through a lead contractor with subcontractors. What features of this contracting model could be improved to enhance competition and efficiency?
- 11 Is more standardisation and/or economies of scale possible in the New Zealand market?
- 12 Why is the construction industry so fragmented?
- 13 What can be done to address the lack of scale / fragmentation in the industry?
- 14 Are new entrants and smaller market participants able to access sufficient capital to enable them to operate on an adequate scale within the market?
- 15 What is driving the flat productivity in the building and construction sector relative to other New Zealand industries, and relative to other jurisdictions?

4.3 Competition in the residential construction sector

Competition may occur on price, quality and degree of customisation. The Productivity Commission noted that some submissions had raised concerns about competition in the supply of building materials. The Commerce Commission has previously carried out enforcement actions in relation to the construction sector. These enforcement actions included:

- Suspected predatory pricing behaviour in the insulation market – in the early 1980s the incumbent dominant manufacturer responded to a new competitor's supply of a new wool insulation product by supplying its own new wool/polyester insulation product at prices below cost (a '2 for 1' deal). This conduct was subsequently found to not contravene the competition law.
- Price fixing and exclusionary conduct for wood chemicals – between 1998 and 2002 a number of companies engaged in cartel conduct in two wood chemical markets having significant detrimental effects on the New Zealand treated timber market. The High Court imposed record penalties of over \$5 million.
- Misleading and deceptive conduct in relation to grading of timber – between July 2001 and November 2003, Carter Holt Harvey sold timber labelled as a high-strength grade (MGP10) when it knew the timber did not consistently meet that grade. The company was fined \$900,000.

The Commerce Commission is also engaged in raising awareness of competition issues in the non-residential construction services sector. The commercial builders interviewed raised a variety of concerns about contracting and procurement practices. In particular the Commission found that some builders engaged in the practice of 'cover pricing' in commercial tenders. Cover pricing is a practice where a tenderer collaborates with a competitor in order to invent a believable but not genuine bid for a job. The cover price is not meant to win the tender but it has the effect of making the competitor's bid appear relatively favourable. This practice may or may not be unlawful depending on the particular facts of the case.

There are a wide range of practices within the market that may not contravene competition or fair trading law but could still act as barriers to the market functioning more competitively. Individually, these "sharp" practices may even be extremely competitive in intent, but collectively might produce a less than optimal competitive outcome. It is useful to examine these practices, and the options available for turning them towards optimising, rather than inhibiting, the competitiveness of the sector.

Questions

- 16 What evidence exists of active competition and rivalry between suppliers of building materials on prices or quality of goods supplied?
- 17 What evidence exists of exclusive or discriminatory practices in the building materials and services markets impeding existing or potential competitors?
- 18 What evidence exists of excessive price-cutting of building materials impeding the entry of new products or services to the market?
- 19 What evidence exists of building material or service suppliers earning excessive profits?
- 20 What evidence exists that behaviour in the markets by buyers or lead building contractors may impede competition?
- 21 What measures might enhance competition and industry competitiveness?
- 22 Has the Canterbury rebuild effort identified any particular issues with competition in the construction sector?

4.4 Market performance

The residential construction industry generally demonstrates poor productivity. Statistics NZ figures indicate that both labour and multifactor productivity growth in the construction industry have lagged well behind other industries. There is also some indication that productivity is lower than that of the construction industries in other countries. In addition to increases in the costs of residential construction, the Productivity Commission report identified a number of other performance issues. These included budget or timing overruns, poor design or layout and defective or lower-quality work.

Poor performance by the construction industry raises the costs of housing in a variety of ways. High construction costs make new houses less affordable and make it more expensive to renovate older housing stock. In addition, poor quality construction leads to houses that are likely to have a higher lifetime cost due to an increased requirement for repairs or refits.

The Building and Construction Sector Productivity Partnership exists to develop practical proposals to improve productivity in the construction sector.

Questions

- 23 Does the quality of building services or building materials supplied meet buyers' requirements and if not, what measures that could be used to improve quality?
- 24 What is the extent of innovation in the supply of building materials and services and what impediments to innovation should be addressed?
- 25 Are there any impediments within the market that prevent existing participants from pursuing productivity gains?
- 26 Are dispute resolution mechanisms between suppliers and/or between suppliers and buyers effective?
- 27 Are there any regional differences in the performance of building markets?
- 28 Are there any differences in the performance of different building sub-industries?

4.5 Relative costs of building materials and services with Australia

The Productivity Commission outlined a comparison of trade prices for various building materials in New Zealand and Australia for a typical modest-specification home built by the same company.

Trade prices for building materials in New Zealand and Australia

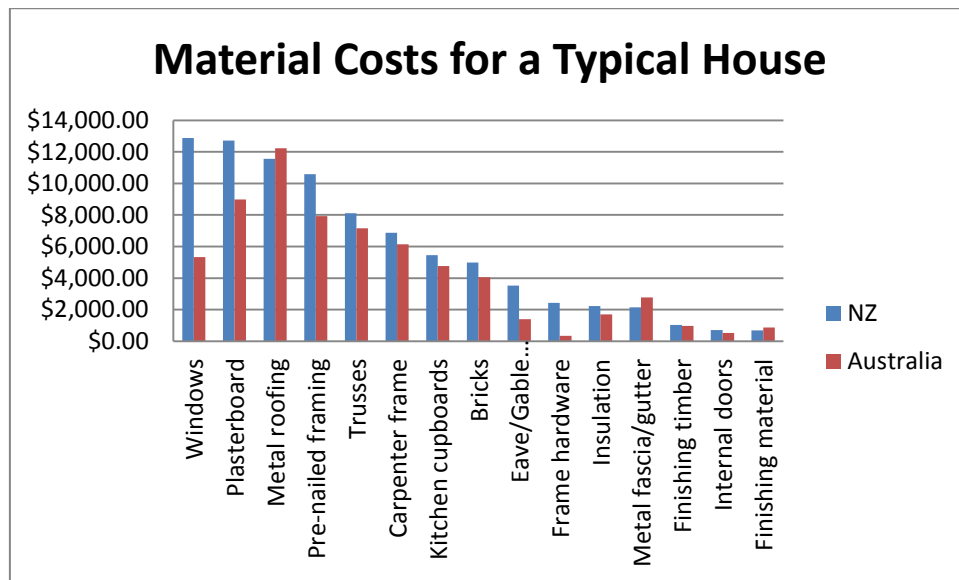
Material	New Zealand price (\$NZ)	Australian price (PPP adjusted to \$NZ)	Australian price as a % of NZ price
Bricks	\$4,978	\$4,051	81%
Frame hardware	\$2,428	\$344	14%
Pre-nailed framing	\$10,575	\$7,920	75%
Eave/Gable material	\$3,524	\$1,395	40%
Finishing timber	\$1,032	\$978	95%
Finishing material	\$677	\$867	128%
Internal doors	\$713	\$526	74%
Carpenter frame	\$6,870	\$6,142	89%
Trusses	\$8,111	\$7,158	88%
Metal fascia/gutter	\$2,148	\$2,777	129%
Metal roofing	\$11,567	\$12,226	106%
Windows ¹	\$12,873	\$5,325	41%
Kitchen cupboards	\$5,442	\$4,758	87%
Insulation	\$2,227	\$1,699	76%
Plasterboard ²	\$12,713	\$8,973	71%
Total	\$85,878	\$65,139	76%

Notes:

1. The windows in the New Zealand house are double-glazed while the Australian house uses single-glazed windows.
2. This figure includes labour costs for installation.

Source: Productivity Commission *Inquiry into Housing Affordability*, material supplied in confidence, page 176.

Although some of these price differences are not large, others are substantial and collectively represent a significant disparity in the materials cost for a typical house. It is possible that New Zealand goods are priced at import parity; representing the cost of importing Australian goods. If this is not the case, however, then some other factor could be at play.



The above graph demonstrates visually that the overall differences between material prices for the average house in New Zealand and Australia (as listed in the above table) are contributed to by a number of factors.

The majority of the material components of the typical house are more expensive in New Zealand. However, many of these represent a sufficiently small part of the overall cost of construction that they barely contribute to the overall differential. This study will consider those materials that have the most significant impact on the cost of houses in New Zealand. The above chart indicates windows, plasterboard and pre-nailed framing as clear candidates for further investigation. Preliminary investigation suggests that these markets are all concentrated, and in the case of the former two, some barriers to international competition exist.

Questions

- 29 Why are there differences in the prices of building materials between Australia and New Zealand?
- 30 Are New Zealand building materials priced at import parity (taking into account the costs of transporting the goods from Australia), and if not, why not?
- 31 Can import competition lower prices for building materials, and if so what, if anything, is preventing this?
- 32 Do price margins between New Zealand and Australian materials reduce when building volumes in New Zealand are high?

Appendix 1: Productivity Commission Key Findings

Key findings of Productivity Commission on the performance of the building industry

- F10.1** During the recent housing boom, the cost of building a standard house has increased at a greater rate than inflation.
The cost of both building materials and building a standard house is substantially higher than in Australia.
A trend toward larger and higher specification houses is also contributing to increased costs. Factors driving this trend include changing consumer preferences, the use of covenants, and a desire to avoid under-capitalising given high section prices.
- F10.2** Industry productivity is flat-lining, and this is reflected in growing building costs and evidence of poor building quality. Evidence suggests that the productivity performance of the construction industry over the past thirty years has been poor relative to other New Zealand industries, and relative to other jurisdictions.
- F10.3** The lack of scale in the New Zealand residential construction industry presents a significant barrier to productivity growth.
- Small builders are less able to generate economies of scale.
 - Scale home builders can reduce construction costs through the delivery of standardised housing, but scale building firms occupy a comparatively small share of New Zealand's building market [relative to Australia].
 - A lack of available land can present a significant barrier to productivity through inhibiting the development of group home builders and scale developments.
- F10.4** The fragmented nature of the residential construction industry supply chain presents a number of management difficulties which can dampen innovation and result in lower building quality and higher construction costs.
- F10.5** The National Infrastructure Plan represents a good mechanism for providing, where possible, forward visibility of government investment which is reliant on the residential construction sector.
- F10.6** Skills issues, particularly at the management level, require attention in order for the residential construction industry to better respond to industry cycles and to improve productivity performance. The Productivity Partnership Skills Strategy focuses on a number of skill issues, which, if addressed, would help lift industry productivity growth.

Appendix 2: Summary of Questions

Market definition

- 1 What bottlenecks or inefficiencies exist in the building sector supply chain? The supply chain extends from the point of manufacture or import of core materials used in construction through to the supply of various building products and building services and the building of residential housing.
- 2 What is the extent to which competition occurs across geographical regions within New Zealand for building services and materials, taking into account transport costs?
- 3 To what extent does competition:
 - For the supply of particular building materials; and
 - Between building materials used for similar purposes.Provide a constraint on prices and ensures reasonable quality of the products?

Characteristics of the residential construction sector

- 4 What is the extent of entry, expansion, consolidation and exit of suppliers and products in the construction sector in the past 5 years? Please include any examples.
- 5 How has international trade in building commodities impacted on construction costs and competition in New Zealand in recent years?
- 6 What are the major impediments to establishing new building services or introducing new building materials to the market?
- 7 What are the barriers to imports of building materials and should they be reviewed to improve competition?
- 8 Are there barriers to the use of more prefabricated / modular housing and, if so, what are these?
- 9 What is the impact of vertical integration or any exclusive arrangements in the supply chain for building materials and how does this impact on competition and efficiency?
- 10 Building services are generally supplied through a lead contractor with subcontractors. What features of this contracting model could be improved to enhance competition and efficiency?
- 11 Is more standardisation and/or economies of scale possible in the New Zealand market?
- 12 Why is the construction industry so fragmented?
- 13 What can be done to address the lack of scale / fragmentation in the industry?
- 14 Are new entrants and smaller market participants able to access sufficient capital to enable them to operate on an adequate scale within the market?
- 15 What is driving the flat productivity in the building and construction sector relative to other New Zealand industries, and relative to other jurisdictions?

Competition in the residential construction sector

- 16 What evidence exists of active competition and rivalry between suppliers of building materials on prices or quality of goods supplied?
- 17 What evidence exists of exclusive or discriminatory practices in the building materials and services markets impeding existing or potential competitors?
- 18 What evidence exists of excessive price-cutting of building materials impeding the entry of new products or services to the market?
- 19 What evidence exists of building material or service suppliers earning excessive profits?
- 20 What evidence exists that behaviour in the markets by buyers or lead building contractors may impede competition?
- 21 What measures might enhance competition and industry competitiveness?
- 22 Has the Canterbury rebuild effort identified any particular issues with competition in the construction sector?

Market performance

- 23 Does the quality of building services or building materials supplied meet buyers' requirements and if not, what measures that could be used to improve quality?
- 24 What is the extent of innovation in the supply of building materials and services and what impediments to innovation should be addressed?
- 25 Are there any impediments within the market that impede existing participants from pursuing productivity gains?
- 26 Are dispute resolution mechanisms between suppliers and/or between suppliers and buyers effective?
- 27 Are there any regional differences in the performance of building markets?
- 28 Are there any differences in the performance of different building sub-industries?

Comparison with Australia

- 29 Why are there differences in the pricing of building materials between Australia and New Zealand?
- 30 Are New Zealand building materials priced at import parity (taking into account the costs of transporting the goods from Australia), and if not, why not?
- 31 Can import competition lower prices for building materials, and if so what, if anything, is preventing this?
- 32 Do price margins between New Zealand and Australian materials reduce when building volumes in New Zealand are high?