

Submission by the National Research Institute on the Housing Industry Review Issues Paper

Scope of the Review

The focus of the Issues Paper seems to be on the formal housing industry. In adopting this focus, the Commission should keep in mind the important role played by the informal housing sector in Papua New Guinea.

The average household income of many Papua New Guineans is well below the minimum level required to construct, purchase or rent formal housing, particularly in urban areas. The cost of land and the most basic materials and infrastructure will prevent housing prices reaching such low levels, even in a competitive market. The housing needs of these households will, at least in the short to medium term until incomes rise, be met by the informal sector.

It should be recognised that PNG's housing needs will be met in the short to medium term through a mix of formal and informal arrangements. In addition to a National Housing Policy to address the constraints in the formal housing sector, the Government should also look at strategies to improve the welfare of those living in informal housing settlements. Such strategies could include upgrading of roads and infrastructure, provision of government services and improvements to sanitation. The recently amended land legislations to empower customary landowners to become active partners of developments on their land should also be widely promoted and used.

Overview of the current housing situation

There is a shortage of formal housing across the urban centres of PNG, which has driven up prices to a level that is beyond the reach of many. However, there is a lack of data to indicate the extent of the unmet demand, and the resulting inflation of rentals and housing prices. Media stories typically focus on housing prices in urban centres such as Port Moresby and Lae and little is known about the housing situation in other areas. For example, heads per household.

Information on the rate of housing construction, trends in rentals and purchase prices, vacancy rates, migration and population growth would help to understand the severity of the situation.

In a well-functioning market, any unmet needs would only be temporary with the market responding by increasing the supply of housing, which in turn would reduce prices and improve affordability. To understand why this is not happening, constraints on both the supply and demand sides need to be identified and addressed.

Although land is well-recognised as a major constraint to urban housing development and the main contributor to the housing shortage, there are

many other factors that influence the supply of housing. All factors need to be considered to ensure that when land becomes available, it can be developed efficiently. Other factors affecting supply include:

- Appropriate housing
- Planning and building approval processes and procedures
- Availability of, and access to, infrastructure
- Availability of affordable and appropriate building materials
- Availability of skilled personnel in different market segments
- Attractiveness of housing development projects to private investors (a factor of security of land tenure, access to finance, expected returns, insurance, tax and other commercial incentives, cost of land, risks to investment)

Although there is no shortage of demand, and an increase in demand without an increase in supply would only serve to raise prices further, demand side factors may be important in the medium to long term. When the Government develops the National Housing Policy, factors affecting the supply of housing should not be considered in isolation from demand side influences. Factors affecting the demand for housing include:

- Ability to pay (net household income and size of rental/mortgage payments and government charges)
- Access to, and cost of, finance
- Suitability of housing (size, location, type), appropriateness
- Awareness, understanding and access to the property market

Strategies to bridge the gap between housing supply and housing demand may either target suppliers (for example, by reducing costs to those involved in the supply of housing so that rental and purchase prices decrease) or target demand by households (for example, improving household's ability to pay or their access to finance).

Without more data or information from those involved in the industry, it is difficult to determine which of the above factors present the biggest constraints to the development of the housing industry. The Institute hopes that this information will be made available to the Commission during the course of its review, to enable strategies to be developed that will have the most impact in addressing the housing shortage.

Past and current Government intervention in the housing market

There is a long history of direct intervention by the Papua New Guinean Government in the formal housing market. Past and current interventions have included:

- Institutional housing — provision of institutional housing to a large number of public service employees, concentrated within certain professions, and subsidized at varying rates;
- Government housing sale schemes — sale of government housing stock, often to current tenants and at significantly discounted prices;

- Home ownership schemes — various schemes to facilitate and assist citizens achieve home ownership, including provision of loan guarantees and interest rate subsidies; and
- The construction of housing for sale or rent — the National Housing Corporation, formerly the National Housing Commission, has a mandate to construct housing for sale and manages government owned properties rented to individuals.

The costs and benefits of the various schemes are discussed below.

Institutional housing

The Government incurs substantial costs in providing housing to public service employees. In addition to the cost of constructing housing, there are high ongoing maintenance costs and administrative costs linked to the collection of rent. If employees are not required to pay a bond, and there are no penalties linked to any damage of property, then these maintenance costs could be high because tenants have no incentives to look after the property.

Institutional housing is an inefficient use of public money as the returns on the investment are poor. The income foregone through subsidisation of rent could be used to deliver services in priority development areas such as health and education. The tenants living in institutional housing benefit at the expense of other taxpayers and the wider community.

The inefficiencies linked to institutional housing also stem from the lack of competition between housing providers. Employees who are offered institutional housing generally have little choice but to accept the accommodation that is allocated to them. The agencies providing institutional housing do not have to compete with other housing providers in relation to the quality of housing provided.

This lack of competition also distorts the private housing market. Because those allocated institutional housing cannot make their own decisions about the type, size, location or value of the housing they would like, the private market is unable to grow and develop to meet these needs.

Providing all public servants with housing is unachievable. Therefore, free market oriented decisions will need to be made regarding the allocation of housing among public servants. Failure to do this can give rise to inequalities among public servants – particularly where rent is subsidised – and the lack of transparency in the process provides scope for corruption.

Government housing sale schemes

There have been a number of schemes where public housing stock has been sold off to reduce the costs associated with maintaining this housing stock. Typically, the Government has not received an appropriate return on these properties. Although they may increase the level of home ownership, these programs do not add to the housing stock and therefore

have no impact on the housing shortage. There have also been some administrative problems relating to land titles associated with past schemes.

Home ownership schemes

Previous Governments have instituted several different home ownership schemes with the objective of helping citizens achieve home ownership. These typically involved large up front costs, high risks and were not sustainable. Their success was also constrained by the availability of land.

There are also a range of different home ownership schemes that are operated by individual government departments and agencies. There are many different variations and each seems to have been developed independently of other schemes without any common policy principles being applied. Although the costs and benefits of these schemes have not been analysed, the high cost and limited reach of these schemes means they are not a solution to the current housing problems.

National Housing Corporation

The NHC became a corporation in the late 1980s and has been required to operate on a commercial basis, while providing affordable accommodation. This appears to be a conflict of objectives.

The construction of housing is not a core function of Government and it is unrealistic for the government to provide affordable accommodation for the population.

There needs to be a detailed review of the functions and activities of the NHC. It is unlikely that the NHC can construct housing more efficiently than the private sector and its ability to sell public assets should be reviewed. Until the review is completed, the focus of the NHC should be on conducting a stocktake of existing housing and identifying and prioritising maintenance works.

The future role of the Government

An appropriate role for Government in relation to the housing industry is one of facilitator and regulator of the private sector. The Government should not have a role in the direct provision of housing. In the absence of a competitive housing market, direct intervention by the Government would be an inefficient use of resources and would only lead to further market distortion.

The Government has a responsibility to spend public money efficiently and in a manner that is consistent with development priorities. The provision of housing is not a core function of government, and money spent on the provision of housing reduces the level of funding available for important development areas such as health and education. The Government must consider ways in which it can encourage, facilitate and assist households

look after their own housing needs, without relying solely on the Government.

There are many ways besides the direct provision of housing in which the Government can help ensure Papua New Guinea's housing needs are met. First, as noted above, it must recognise the importance of the informal sector – at least in the medium term – and develop strategies to improve the welfare of people living in informal settlements through appropriate market-oriented strategies. Second, it can implement a range of strategies that can influence the factors outlined above that affect supply and demand of housing in the private sector.

To determine which of the possible strategies will be most effective, more information on the magnitude of these constraints is required. The Government should then aim to reduce or remove the biggest obstacles to the development and growth of the private housing market. Identifying the biggest constraints will help identify which strategies will be appropriate for inclusion in the housing policy.

In the long-term, after land and other constraints to private sector development have been addressed, the Government's role could be reassessed. In the short to medium term, the Government can have the biggest impact on the housing situation by focusing on developing the private housing market.

The Government should focus on:

1. Ensuring land is available and accessible and has secure title
2. Ensuring appropriate regulatory, administrative and institutional arrangements are in place
3. Providing public goods and access to infrastructure services
4. Improving access to private sector finance, and
5. Ensure appropriate complimentary utilities industry such as electricity and water are efficiently provided.

These areas are expanded on in the sections below.

1. Ensuring land is available and accessible and has secure title

As noted above, one of the Government's primary functions in its role as facilitator and regulator of the housing market is to ensure that land is available and accessible and has secure title.

There are a number of components to this function, which include:

- Urban planning
- Efficient use and administration of state alienated land
- Effective and efficient land allocation process
- Administration of land titles
- Facilitating development of customary land
- Effective dispute resolution process

All of these issues were identified and examined by the National Land Development Taskforce in 2006. The recommendations of the Taskforce have been endorsed by Government and form the basis of the Government of PNG's National Land Development Program (NLDP) which is now in implementation stage.

Under the National Land Development Program, two major legislative revisions have been accomplished. The amendments to the *National Land Registration (Amendment) Act* and the *Land Group Incorporation (Amendment) Act* are intended to empower customary landowners by providing voluntary land development options by which they can organise formal land transactions, working through their incorporated land groups. These amendments, to be piloted by the Office of Urbanisation, are to assist address land impediment issues, the precursors to housing and related urbanisation problems. They represent only the first of many more revisions to bring major land legislations up to date.

The *National Land Registration (Amendment) Act* introduces new administrative frameworks for the registration of customary land whereas the *Land Group Incorporation (Amendment) Act* introduces stringent measure for greater accountability and transparency in the operations and management of incorporated land groups.

Urban planning systems and land allocation

New housing subdivisions can only proceed when they are incorporated into the relevant urban plans. These plans identify land that is available for development and ensure that new subdivisions have appropriate road access and infrastructure; such as water, electricity, and sewerage systems. The allocation of land must also be a transparent and equitable process to ensure that each portion of land is put to its most efficient and productive use.

At present, the urban planning process is said to be inefficient and outdated as planning approvals are slow and cumbersome, often frustrating the developer and the investor. In order to improve the situation for a vibrant land/property market, improvements are needed to the urban planning system and land allocation procedure.

Administration of land titling

The land titling system needs to be improved to enable investors and current and potential home-owners to secure credit from financial institutions. Security of title provides investors and financiers with a level of certainty that their investment will be protected from competing claims over the property. Currently, security of title in Papua New Guinea has been undermined by poor administration and record keeping, which has led to duplicate titles being issued, and titles being lost or falsely issued. In addition, security of property rights in relation to customary land is even more uncertain under the present system.

Customary land development

It is well known that nearly all land in Papua New Guinea is owned under customary title. The traditional landowners need to be given the opportunity to profit from their land in order to improve their own standard of living and foster national development.

In the current framework, customary landowners have a number of options that allow them to register and develop portions of their land to aid urban expansion. But the process is too cumbersome, expensive and frustrating for a simple customary landowner to understand and undertake. Often, this is a motivation for them to resort to participating in the informal property market as it is less procedural, there is quick money and culturally they assist another citizen who is in need of housing accommodation.

As part of the NLDP, amendments have been made to the *Land Group Incorporation Act (2009)* and the *Land Registration (Customary Land) Act (2009)* to enable traditional landowners to voluntarily register their land and enter into agreements for its development. These reforms empower customary landowner groups to take the initiative and control of any development of their land. It is proposed in the reforms that a set of manuals will be developed to explain the various processes that the landowner group must follow to register their customary land. This must be accompanied by a strengthening of land title administration to ensure security of title over customary land, together with improved processes for land administration.

Land dispute resolution

An accessible and efficient process for resolving land disputes is necessary to support the registration of customary land and the security of land titles. Any disputes between landowners regarding ownership of titles need to be resolved quickly, transparently, and in a consistent manner in order to maintain confidence in the land system. Alternative dispute resolution mechanisms need to be examined.

2. Ensuring appropriate regulatory, administrative and institutional arrangements are in place

The Government has three key responsibilities in relation to regulation of the housing sector. These are:

- To make regulation — ensuring that appropriate regulations are in place;
- To administer regulation — this might include assessing applications, issuing permits and licences, collecting fees, and providing market participants with information on relevant regulations;
- To enforce regulation — by monitoring compliance with regulation and taking enforcement action when appropriate and

necessary, and ensuring mechanisms are available for individuals to enforce their rights.

In determining whether regulation is appropriate, it is important to identify the objectives of the regulation and to weigh up the various costs and benefits. Regulation imposes costs on the government in terms of administration and enforcement and on market participants in the form of compliance costs and adverse impacts on competition, which can be passed on to consumers through higher prices. Only regulation that has a net benefit should be considered, and even then, the effectiveness of all less interventionist and costly alternatives should be explored.

It is important to ensure that any regulation is supported by institutional and administrative processes and systems that are efficient, accessible, transparent and well understood by regulated parties. Administrative processes that do not have these characteristics can undermine the whole regulatory system as they can lead to uncertainty, costly delays, corruption and inequity.

Enforcement is an essential aspect of any effective regulatory framework. Regulation must include provisions to enable appropriate enforcement action to be taken. This would generally involve a range of different sanctions and penalties to ensure flexibility and proportionality to the nature of non-compliance. The Government has a key role in promoting and monitoring regulatory compliance and taking enforcement action where appropriate. The regulatory framework must also enable private rights to be enforced by ensuring access to efficient and affordable dispute resolution mechanisms.

Without further information from stakeholders on the operation of existing regulations and perceived gaps, the Institute is unable to comment on whether or where change is required. Hopefully, this information will emerge as part of the ICCC's review.

One area of regulation that requires special comment is regulation of rentals. Recently, there have been calls in the media for an introduction of a cap on rental rates. The Institute considers a cap on rentals would lower potential returns for investors, deter private investment in the housing sector and should therefore be avoided. Rental rates should be determined by the market to send correct signals to investors and developers.

However, anecdotal evidence suggests there have been recent cases where rental increases have been excessive and unfair to tenants. To help protect tenants, the ICCC could consider the merits of introducing a cap on rental increases within a given period. Thus a regulator with adequate market information would best serve this possibility. Further information would be needed to assess what an allowable rate of increase could be, whether its introduction would be justified, whether it could be successfully monitored and enforced, and what would be an appropriate penalty.

3. Providing public goods and access to infrastructure

Housing development and construction requires access to economic infrastructure including electricity, sewerage, water, drainage, roads, telecommunications and public transport. The ability to access such infrastructure and its affordability will influence the costs of housing construction and development.

It is important for housing developments to be adequately planned and catered for in infrastructure plans. The capacity of current utilities and infrastructure to meet the needs of expanding urban centres, needs to be reviewed, and plans developed to ensure their continued expansion, upgrade and maintenance.

The Government is generally responsible for providing major infrastructure, although infrastructure may be constructed by the local level authorities or the developer and is then passed back to the State as public goods. If the Government constructs major infrastructure, the costs may be charged directly to the private developer or they may be met from budget allocations or recouped over time through rates.

In some cases, such as water and electricity the infrastructure is provided by a government monopoly and the private developer must accept the costs charged. In a more competitive market, the costs of the infrastructure would likely be lower. Similarly, there are no incentives in a monopoly market to construct infrastructure in a timely manner and the delays caused may be costly for private developers. The ICCC should consider the benefits of greater competition in the provision of basic infrastructure.

Where land is sold undeveloped, the private developer is responsible for constructing the basic infrastructure required to subdivide and develop the land. Where the Government sells land that is developed or sub-divided, the costs of the infrastructure are incurred by the Government and may be passed on to the private developer or individual buyer either as part of the price of the developed land or as separate infrastructure charges.

Infrastructure charges affect a developer's costs. Where these costs can't be passed on to end-purchasers, the level of housing investment is likely to be affected, because returns are reduced.

The high costs of infrastructure and the difficulties faced by private developers in establishing their own infrastructure are likely to be significant impediments to the development of customary land. Proper planning of infrastructure is also an important issue that needs to be addressed in relation to customary land.

Access to social infrastructure, such as schools, hospitals, police, parks, public space and shops will also influence the attractiveness of housing development to private investors because the housing constructed will be more attractive to prospective purchasers and therefore the returns on

investment are likely to be higher or more certain. Land made available in areas where there is inadequate social infrastructure will be less attractive investments. Further, if the costs of such infrastructure are met by developers or purchasers, then this will also influence investment decisions. If appropriate social infrastructure is not planned for, this is likely to have adverse effects on the community in the future.

4. Improving access to private sector finance

As facilitator of the private housing market, the Government may have a role in improving the accessibility of finance to households. To assess the appropriateness of any such measures, a sound understanding of the determinants of private sector housing finance and the extent to which these adversely affect the development of the private housing market, is required.

The ability of households to obtain private sector finance to purchase a home will depend on whether they can meet the requirements of the financial institutions, which are put in place by the institutions to help protect their investment by minimizing risk of default or loss in the event of default.

As facilitator of private sector finance, the Government could improve household's ability to obtain finance through measures that either lead to reductions or relaxations of the requirements by the financial institution, or that improve the household's ability to meet existing requirements. The likely benefits and costs need to be assessed.

The first requirement for obtaining private sector finance is accumulation of a deposit. Households may have difficulty or low incentives to save a deposit for a number of reasons including:

- Low income relative to necessary expenditure (particularly high rental rates)
- Poor financial management
- Lack of a savings culture
- Poor interest earning potential from money deposited with financial institutions
- Pressure from wantoks to distribute any excess income rather than accrue it
- Poor access to secure money storage facilities such as banks

The Government may be able to affect a number of these factors to improve household's ability to acquire deposits for housing purchases through programs such as:

- Incentive savings programs;
- Money management components in the education curriculum;
- Promoting a savings culture in the community;

The second requirement for obtaining finance is insurance. Households will generally be required to take out an appropriate insurance policy to protect their and the banks' financial investment in the event of fire or

other property damage. The cost of this insurance will depend, among other things, on the value of the property insured, the risk of property damage and the competitiveness of the insurance industry.

The third requirement for obtaining finance is the household's ability to make ongoing repayments. The amount of the repayments will vary depending on:

- the initial amount of the loan;
- the interest rate;
- the frequency of repayments;
- the term or duration of the loan; and
- the household's disposable income

There may also be other factors that influence a household's decision to seek housing finance, including:

- the level of bank fees and charges; and
- their knowledge and understanding of financial institutions' processes and requirements; and
- their ability to access independent financial and legal advice.

Development of a Housing Policy and the importance of a coordinated approach

The Institute emphasises the need for a National Housing Policy. In the absence of such a policy, the government's interventions in the housing market and attempts to ease the housing situation have been ad hoc and not addressed the underlying causes.

There are many different policy areas that affect the housing market, which are implemented by a range of agencies, and unless there is an overarching policy to coordinate activities, the different strategies could be counteracting each other. The Housing Policy should think beyond the National Housing Corporation or the housing needs of public servants and attempt to develop the private housing market.

The Housing policy needs to be evidence-based and target strategies toward the biggest constraints to private sector development. In the area of regulation, the costs need to be weighed against the benefits and the capacity of government to implement and enforce existing and new regulation should be considered.

In recognition of the Government's current direct involvement in the provision of housing, the Housing Policy will also need to outline transitional arrangements for the focus to shift from direct intervention to facilitation and regulation.

Phasing out Institutional housing

One area where transitional arrangements are needed is public service housing. Currently, rental subsidies, housing allowances and low salaries

in the public service are contributing to the confusion and distortion that surrounds the private housing market. There should be a review of these elements of public service remuneration with a long-term view to phasing out the elements that impede competition in the private housing market.

Until land issues are addressed and the private housing market is able to respond to current demand, institutional housing will remain a reality and an important factor in attracting employees to the public service. However, there are a number of measures the Government could take to improve the efficiency of institutional housing including:

- Reviewing methods for collection of rent and tracking of arrears
- Engaging private companies to take care of maintenance and manage the properties (this would require appropriate contract monitoring)
- Consider requiring bond payments or imposing penalties for property damage

In the long-term, institutional housing should be phased out except where there are unique and exceptional factors that justify the provision of housing to certain public service employees. Such institutional housing would be an exception rather than the norm. It would be location specific and only provided where the competitive private market will not meet the needs of the particular public servants. Relevant criteria to determine whether the private market could meet the public servants' needs include whether the position:

- is in a remote or rural location
- requires shift work or frequent on-call work
- places the employee at an increased security risk
- requires frequent relocation

Only when a number of these criteria are met would the provision of institutional housing likely to be appropriate.