

EXECUTIVE SUMMARY

Economic advice prepared to assist with responses to the Consultation Regulation Impact Statement on minimum accessibility standards for housing in the National Construction Code

Note to the reader: The issues raised in the analysis and in our response are highly technical. We have found it difficult to produce a non-technical summary without losing important details. We prepared the following, more concise executive summary to improve accessibility. If you have particular questions, please contact us at md-i@unimelb.edu.au.

Prepared for:

The Melbourne Disability Institute, University of Melbourne and the Summer Foundation
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1. Executive Summary

1.1. Introduction and overview

The Melbourne Disability Institute and the Summer Foundation asked for our help in responding to a Regulatory Impact Statement (RIS) Consultation document released by the Australian Building Codes Board (ABCB). The RIS, prepared by the Centre for International Economics (CIE), evaluates the economic impact of introducing rules to include minimum accessibility standards in the National Building Code. Our task is to provide insights on the estimates of the cost-benefit impacts in the report.

In our view the CIE has provided a very helpful review of a complex set of issues. Two key sets of cost-benefit analysis (CBA) results are presented in the Report:

1. 'a problem reduction approach' targeted on those with housing accessibility needs; and
2. a broader societal approach based on 'willingness-to-pay' analysis, which includes benefits to the general community from improved design and accessibility.

Based on our review of the CIE's report, we conclude that there are important issues associated with the CBA results that deserve further consideration.

We cover four key issues that would significantly impact the results of the CIE report and their associated policy implications. We start with the 'problem reduction approach' favoured by the CIE, then cover the broader 'willingness to pay' approach that we favour.

It is also important to note that maximising 'societal welfare' requires thinking beyond the everyday things that can be bought and sold in markets. Things that have an advertised price are easy to measure. It also requires thinking about the kind of society we want to live in, and putting 'dollar' values to things that are harder to measure but affect how good we feel about ourselves and the society in which we live. Although much harder to measure, these things are equally at the heart of the economics discipline.

We were pleased, therefore, to see that the CIE Social Benefit Cost Analysis included a measure of societal benefit in both its 'problem reduction' and broader 'willingness-to-pay' approaches to their CBA. However, we conclude that the method they applied, which focused on the individual, was unlikely to have captured the full benefits to the Australian community.

1.2 The principle of symmetry in the reporting of costs and benefits

In social benefit cost analysis, analysts should identify all costs and all benefits and be transparent in their inclusion/exclusion decisions and associated measurement/valuation steps.

The principle of symmetry requires that benefits and costs are reported in a simple, clear way that avoids bias. If all the costs are counted then all the benefits should be counted.

1.3 Problem 1: The CIE 'problem reduction approach' over-counts the cost side

In the 'problem reduction approach', favoured by CIE, all costs of the options are included, but the benefits primarily focus only upon the savings that the new building codes rule would offer. In this approach, significant benefits that flow directly from improved design and functionality to the general community are not included. In our view, it is problematic to count all the costs of implementing each option, but only a component of the associated benefits.

Further, while CIE prefers the ‘problem-reduction approach’ we believe that a ‘willingness to pay’ approach is the more appropriate methodology to use in this CBA as it aims to capture the full range of benefits, plus the cost-savings estimates in the ‘problem-reduction’ approach.

1.4 Problem 2: The CIE ‘willingness to pay’ approach under-counts the benefit side

In a full CBA such as this, the normal expectation is that all costs and benefits are included. The CIE report explains that:

“The key difference between this approach and the problem-reduction approach is that this approach includes, for Options 1-4, benefits to households that do not currently contain any persons with limited mobility” (p.114, RIS).

The costs identified in the two approaches are identical and comprehensive, but the types of benefits identified in each of the ‘problem reduction’ and ‘willingness to pay’ approaches are very different. Importantly, the two sets of benefits should be combined. That is, the benefits from the ‘problem-reduction’ approach (largely savings) should be added to the value to people of the benefits of improved accessibility (with any overlap excluded) in the ‘willingness to pay’ approach if all of the benefits of more accessible housing are included and compared to costs.

For example, a wider hallway improves access for all occupants and visitors, particularly for visitors with a disability. Given that 20% of the Australian population have a disability, many if not most Australians have friends or family members with a disability. Benefits such as these should all be included.

Moving from the symmetry principle, we now consider the ways in which the cost of space was assessed. We suggest that key components of benefit were not included in the CIE analysis.

1.5 Problem 3: The CIE approach to measuring the opportunity cost of space ignored capital gain and ‘utility in use’

The CIE report correctly included the estimated cost of space needed to accommodate the revisions to the National Construction Code (NCC). Our concern is that the ‘value’ of this space to the occupants only captures the benefits of their improved accessibility. Importantly, the value of the space is the sum of both the value of the improved accessibility *plus the capital value of building addition*.

In our suggested re-analysis we include a minimum combined estimate for gain in building space and increased accessibility as being at least equal to the market price of the building space at the time of purchase.

While the re-analysis presented so far provides a very different policy picture to that presented in the CIE report, no adjustment has been made to the discount rate. The CIE report itself raises this as an important matter and includes a sensitivity analysis with 3%, 5% and 10% alternate rates, rather than the 7% adopted by the CIE in their main analyses.

1.6 Problem 4: The discount rate used does not reflect current financial/economic thinking or practice

We argue that the choice of a 7% discount rate in the base run analysis does not reflect current thinking and/or practice in the calculation of net present value (NPV).

A discount rate of 7%, whilst in line with the central recommendation from the Australian Office of Best Practice Regulation in 2016, ignores their comment in their 2016 guideline that:

"...the preferred approach is to base the discount rate on market-based interest rates, which indicate the value to the current population of future net benefits".¹

The 30-year bond rate in Australia, which is close to the life of a dwelling, is 1.86%. In the RIS prepared by the Department of Planning and Community Development in Victoria in 2010, entitled *Visible and Adaptable Features in Housing*, a discount rate of 3% was used. Further the discount rate widely used in the health sector is 3%.

It is important to note that the choice of discount rate is not just an esoteric issue for economists and financial analysts - the choice has a huge impact on the benefit-cost ratios reported for the CBA in the RIS. Given that the costs of accessibility are up front and the benefits are largely in the future, any reduction in discount rate will favour the benefit side more than the cost side, adding further weight to the economic merits of implementing a compulsory regulation.

The table below shows the results if the four problems we have raised are addressed. A ratio greater than 1.0 means the benefits are greater than the costs. For example, a ratio of 2 implies the benefits are twice the costs.

Benefit-cost ratios in the CIE Report and after adjustment using Dalton and Carter Assumptions

	Option 1	Option 2	Option 3	Option 4	Option 5
1. Base case benefit-cost ratios in CIE report in RIS	0.77	0.14	0.11	0.09	1.00
2. Adjust for symmetry in cost and benefits using the 'willingness to pay' approach (25% overlap to allow for building modification being reflected in both approaches)	2.00	0.68	0.54	0.39	1.48
3. Symmetry applied to WTO approach (25% overlap), plus add capital value of space to benefit side	2.46	1.10	0.95	1.03	1.48
4. Add in effect of 3% discount rate to row 3.	2.99	1.34	1.16	1.26	1.81

1.7 Other Issues that have a smaller impact

There are a range of other technical issues with the CBA. Individually these issues will have a minor impact on the CIE results, but when combined they would further improve the economic credentials of the proposed regulation.

1.8 Summary and Conclusions

We conclude that the economic credentials for all options considered by the CIE are considerably stronger than those presented in their report.

¹ P.6; Guidance Note. Cost Benefit Analysis. *Office of Best Practice Regulation, Dept of Prime Minister and Cabinet*; February 2016; <https://www.pmc.gov.au/sites/default/files/publications/cost-benefit-analysis.docx>

While the CIE favoured continuation of a voluntary code, we conclude, based on our four key recommendations there is a strong case for adding a regulation to the National Building Code for all new Class 1a and Class 2 buildings.

The additional methodological and social justice issues in Sections 2 and 3 of our report serve to further strengthen these conclusions.

We appreciate that the choice of which particular option to specify in a regulation will reflect factors in addition to these benefit cost ratios, including functionality for the elderly and those with disabilities, particularly for those in wheelchairs. Option 2 (Gold standard) has particular merit in this regard, as the most cost-effective of the options that achieve functionality for those in wheelchairs.

Further, we note that encouraging a match between the stock of accessible housing and those with accessible housing needs is central to the calculation of net benefit and therefore suggest that a combination of options could be highly desirable. In particular, combining Option 5 (a subsidy program to encourage availability of accessible rental properties) with Option 1 (Silver standard) and Option 2 (Gold standard) should be assessed.

An additional option that might be considered for analysis, is a policy package that also included an enhanced matching service between suitable housing and those with housing needs.