Submission to the
New Zealand Productivity Commission

Inquiry into Housing Affordability

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Submission prepared by the
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Inquiry into Housing Affordability
Submission of the New Zealand Property Investors' Federation

New Zealand Property Investors' Federation

This submission has been prepared by the New Zealand Property Investors' Federation Inc (the Federation) in response to the New Zealand Productivity Commission's invitation to make comments on the Inquiry into Housing Affordability issues paper.

The Federation established in 1983, comprises twenty local associations located throughout New Zealand, and is the national body representing the interests of over 7000 property investors.

The Federation represents and promotes its members' views on all matters affecting investment property and rental-housing issues.

The Federation would welcome an opportunity to meet with and address the Commission at a convenient date and time.

Submission

There has been exhaustive public discussion about housing and housing affordability in New Zealand in recent years. Government[1], officials[2] and private experts[3] have much examined and researched the relevant issues as well as many self-appointed uninformed and emotive commentators.

Overall, the analysis has been compounded by a common perception held by many generations of New Zealanders that not owning your own home (and renting) is somehow a negative. Consequently such views are widespread. Moreover, some commentators have manipulated them. This has inevitably led to the unfounded conclusion that residential property investors are some how singly to blame for the increasing unaffordability of housing and that some form of Government intervention preferably by way of tax changes is therefore required to fix the problem.

In view of this, the Productivity Commission's terms of reference specifically state that particular attention be given to:

- "the efficiency of taxes, levies and charges imposed at all stages of the housing supply chain and
- "the efficiency of the tax treatment of owner-occupied and rental housing"

[1] Commerce Select Committee inquiry 2007 and the Finance & Expenditure Committee consideration of its 2007-08 monetary policy inquiry
[2] Treasury and Reserve Bank Supplementary Stabilisation Instruments (SSI) report released 2006
[3] 2001 McLeod Tax Review and Tax Working Group report Jan 2010, Savings Working Group report Feb 2011

The Federation wishes to ensure that the proceedings of this inquiry are objective and will not merely enable industry opponents and others to grandstand tax policy as the magic bullet to remedy the very complex social and economic issue of housing affordability, as well as being a means for collecting extra revenue.

We do not believe that house prices cause poor productivity in the economy. Accordingly, this submission intends to refute the view that the actions of residential property investors have caused the housing to be unaffordable, and to address the over-emphasis by some people on one policy measure – namely tax – as a means to achieving housing affordability. Additionally, we urge the Commission to find ways to further encourage the private rental sector to increase its responsiveness to house New Zealanders, not block them by proposing new impediments.

Given the magnitude of the Inquiry and the extensive question set, the Federation will offer its comments in those areas of direct relevance to private residential rental property providers.

Setting the scene - What is the extent of the rental industry?

In any discussion about the rental property industry it is vital that some key facts are placed upfront and recognised by the Commission.

The Federation believes that the private rental industry provides an effective and valuable service and makes a significant economic contribution to New Zealand Inc by housing New Zealanders. Unfortunately this fact is often overlooked or ignored, often for the sake of dramatic headlines.

It has been estimated that there are over 180,000 landlords in New Zealand[4] and Statistics New Zealand figures that over 472,000 households live in rented accommodation worth around $60 to$80 billion. There has also been a higher estimate of $200billion[5,6].

According to the Real ITO, the real estate industry's training organisation, about $7billion of rent is paid each year by residential tenants[7].

Assuming a 20% equity rate on a $170,000 property, the amount spent on mortgage interest payments, at 8% interest, ($10,800pa) is $3.5 billion per annum.

The residential rental industry also makes a huge economic contribution by sustaining a range of small local businesses that employ and provide an ongoing livelihood for significant numbers of New Zealanders and their families including the financial, legal, accountancy, property managers, tradespersons, cleaners, gardeners, suppliers (of appliances, carpets, wall coverings, etc) and other professionals often

[4] "Taxing times for landlords", NZ Herald 6/2/10
[5] Tax Working Group has estimated the figure at $200billion
[6] "Rental property value overinflated", NZ Herald 19/5/10
[7] Commercial property, page D16, Sunday Star Times 24/4/11

over decades. Rental property actually creates an incentive to invest in complimentary businesses and their productivity.

Overall small scale private residential landlords are currently ensuring, and will continue to be, the largest efficient providers of a good range of quality and well maintained rental accommodation in New Zealand.

Q 19: To what extent are changes in home ownership explained by changing tenure preferences?
Many New Zealanders for a raft of personal lifestyle reasons e.g. employment opportunities, taking up overseas travel, embarking on higher education, marrying later prefer the renting option.

Accordingly, private landlords provide rental accommodation to those seeking short or long-term housing options.

Private rental housing owners provide the most flexible and cost effective means of providing housing stock and accommodation to New Zealanders. And for many, choosing to rent is considerably more flexible and affordable than actual home ownership.

Q 22: What are the characteristics of investors in housing?
Around two-thirds of property investors (Federation members) have been engaged in the business for five or more years (33% more than 10 years).

The majority of investors (88 %) are planning to keep their property investments for the longer term[8], which dispels the myth that people are investing in property to make a "quick buck".

Rental property ownership is highest among those aged 45 to 65 and is often liquidated when the household head reaches 65 years.

Experienced property investors are price followers as they generally try to minimise the price they pay for property rather than outbid owner-occupiers.

It is generally owner-occupiers who push up house prices due to emotional attachment.

Q23: What are the factors that have influenced recent investor activity in housing markets?
Residential property investors are using their rental income business as a mechanism for saving for retirement and are professional and committed long-term players in the housing market.

[8] 2010 ANZ Property Investor Survey

Further, it may be observed that investors have a lack of faith with alternative and competing types of investments such as equities and services offered by finance companies. Many thousands of local retail investors have seen about $8billion dollars of their life savings in managed funds lost and or destroyed[9]. It is worth recalling the 1987 share market crash, which was also disastrous for many ordinary New Zealand investors. Investment in residential rental property is therefore influenced by the perceived security of returns, ability for more direct control and a sense of lower risk being involved, rather than tax incentives.

Q70: To what extent, and in what way, is the tax treatment of investment housing concessional relative to other income earning assets?

There is a view held by some people that there is a favourable tax treatment for residential rental investments thus helping to make property more attractive than other investments. Additionally, there are those who consider that the activities of residential property investors are negatively affecting housing affordability.

Typically, these people advocate for the imposition of a Capital Gains Tax (CGT) or other tax measures as a way to curb so-called investor demand.

The Federation holds the strong view that rental property does not have any special tax advantage over other investments or businesses.

We are pleased to see that the Commission at page 39 of the issues paper acknowledges the same:

> *"the tax arrangements for rental property investors also equally apply to investment in other asset classes".*

This was confirmed by the Deputy Commissioner of Inland Revenue, Robin Oliver in 2007, in cross examination by a Parliamentary Select Committee. Oliver said:

> *"Rules about expenses for deducting costs such as interest, upkeep and maintenance, as well as paying tax on income, are the same for investments in shares or anything else. In fact under the housing case...there are tighter rules regarding what is a capital gain".*

Similarly, influential tax expert PricewaterhouseCoopers Chairman John Shewan has said:

> *""It's a complete misunderstanding because exactly the same tax regime applies to any kind of investment!"*[10]

We have noted that often the proponents of draconian tax measures are generally the media, financial advisers, consultants and other financial intermediaries, as they do not receive any commission in the property transaction.

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[9] "Law firm seeks funding for class action" 4/7/11 NZ Herald

[10] "All eyes on rental properties", 22/10/07 The Press

What is wrong with a CGT and other tax proposals?
The Federation believes that a simplistic CGT will not curtail real estate inflation, which is the result of many complex factors, and consequently make property affordable for first homebuyers.

One reason for this is that - the majority of Federation members - serious investors, not "mum and dads" – as alluded to elsewhere in this paper, hold their properties for the long term. These people are different to speculators, developers and regular property traders, who have clearly bought properties with the purpose of making gains, and are already targeted in the Inland Revenue Department (IRD) audit and compliance net[11].

However, the unintentional effect of the imposition of a wide-ranging CGT could be two fold.

On the one hand it could spark an investor exodus from the country's property market. People might try to avoid triggering the CGT by selling investment properties before the implementation date. This could create a housing slump and affect the existing ownership base.

On the other hand sales could dry up as investors hold, pushing residential property prices up further, worsening supply and affordability. A reduced supply of houses would not only mean increased prices but ultimately increased rents as well. Both have negative effects on first homeowners, tenants and landlords.

The degree of uncertainty about the near-term outlook would be huge and would carry with it severe political repercussions – as experienced with the recent debate about a mortgage interest levy.

Looking at the Australian and the United Kingdom capital gains tax (and stamp duty) experience for some guidance – these being the regimes many people would like to model New Zealand's upon – confirms the failure of this approach. It has been noted by the Minister of Housing[12] that in both these overseas markets the tax(es) have not stopped recent house price rises or made housing in Australia ("the most unaffordable in the English-speaking world" [13]) or London[14] more affordable or cheaper. And because overseas countries have a CGT it does not make it rational that New Zealand should follow suit.

The Federation and its residential property investor members therefore join with successive governments, influential Parliamentarians[15], departmental officials, some

[11] It is noted for example, in the 2010 Budget IRD was given a $119.3 million increase in funding to enforce the tax regime, target the "hidden" economy, and chase speculators who dodge tax on property deals.
[12] "Call to reduce property tax breaks", One News 26/3/07
[13] "Banks v investors on Oz housing battle", NZ Herald 2/7/11
[14] "Affordability worsens for first time buyers in UK" 11/10/06 NZ Herald
[15] Hon Peter Dunne, United Future press release 2/4/07, Hon Bill English 18/3/07 NZ Herald

members of the Tax Working Group[16] and the 2001 McLeod tax review[17] to strongly and collectively restate our concerns over the practical challenges arising from a CGT.

Furthermore, the Federation especially notes and welcomes the Prime Minister's statement to the 2010 opening of Parliament[18] when he said the Government would not be developing any proposals for a capital gains tax for taxing residential investment properties. He explained that:

> *"A comprehensive capital gains tax extends the tax net and is highly progressive. However in the Government's view it would make the tax system more complex to administer and comply with, and may encourage taxpayers to hold on to assets longer simply to avoid tax".*
>
> *"These new taxes are therefore off the table".*

And on 17 May 2011 in an answer to a Parliamentary Question[19] he said:

> *"**Rt Hon JOHN KEY**: " if one looks at the Tax Working Group and its analysis of a capital gains tax, one will see that the Tax Working Group went on to say that on balance the majority of the experts did not agree with the capital gains tax, because of its inefficiency and its difficulty to apply. Once one takes the domestic family home out of a capital gains tax, it becomes a more inefficient tax".*

And finally defending the lack of a CGT, the IRD's Robin Oliver said:

> *"It's not purist, just a practicality," he says, noting that IRD changed from advocating capital gains to believing it couldn't be done efficiently.*
>
> *"No one taxes the family home and, in New Zealand, what do you do about farming? The common farming career progression is to trade to larger farms. A capital gains tax would kill that. What would you do about communally owned Maori land? Capital taxes are levied at death. You can't tax Maori land that way".*
>
> *The alternative is a capital gains tax as complex as Australia's, where "they have whole conferences on what should be in and what should be out"*[20]

As already stated, the regular buying and selling of real estate (e.g. by speculators and traders) or on those holding property for short periods of time readily attracts the vigilant attention of tax officials and taxes on those gains.

Income tax already applies to gains realised on property sold when the property was acquired with the purpose or intention of resale. There would be little public gain in terms of affordability and little extra revenue yield from imposing a CGT on rental properties.

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[16] The Tax Working Group final report January 2010
[17] http://www.treasury.govt.nz/publications/reviews-consultation/taxreview2001/taxreview2001-report.pdf
[18] Hansard 9/2/10
[19] Question 3 – Question for oral answer, Hansard 17/5/11
[20] "Departing expert reflects on a long taxing career", 25/5/11, www. stuff.co.nz

Holding entities
It is alleged by some parties that Loss Attributing Qualifying Company (LAQCs), used by some investors (and small business owners) because of their perceived tax advantages, are also the cause of housing unaffordability.

As a Government response, we note that on 1 April 2011 LAQCs were removed, replaced with LTCs (look through companies).

Removing LAQCs now means some property investors (and unintentionally some others) have to, expensively, restructure their affairs and convey the property back to the individual or another entity. Changing entity-holding rules will not improve housing affordability in New Zealand.

Deductibility
Providing New Zealanders with good rental accommodation is a taxable income generating business – the landlord business. In doing so landlords incur revenue costs such as interest on borrowings, repairs, maintenance, insurance, council rates and so forth, which are deductible against other assessable income.

Industry opponents believe this aspect of tax law treats property investors favourably when in fact we are treated the same as most other forms of investment and business.

Depreciation
Another huge misconception is that there is some sort of "favourable" tax treatment going on with regard to depreciation allowances – and that this regime somehow encourages property investors. This is not so.

Disappointingly, from 1 April of this year, depreciation allowances on buildings have been abolished and landlords are no longer able to claim depreciation on their buildings.

The reality is that property investors operate a rental business and, just like other income producing businesses, should continue to have the right to attribute legitimate costs of operation against revenue.

Depreciation is a genuine on-going business expense that takes into account the fact that buildings do show wear and tear and lose value over time, e.g. "leaky homes", "earthquake homes". Against this background we note that chattels such as carpets, curtains and light fittings can still be depreciated.

On balance, the Federation considers that the change to building depreciation looks likely to reduce the supply of rental property and further increase rental prices. In itself, the depreciation rule changes will not improve housing affordability.

NO new taxes necessary

According to the OECD[21] current tax policy settings are sound but should not be considered as a compelling tool for influencing housing market fluctuations. Achieving an improvement in housing affordability can be better managed by other means, such as state loan schemes, equity partnerships and public building programs to name but two examples. Changing the current tax policy settings is unlikely to have much influence because of the number of complex and interrelated macroeconomic forces at work.

Tax changes for expediency reasons would bring enormous disruption and financially hurt those hard working and self-reliant New Zealanders, who have operated in good faith and within the current approach and case law.

This is especially so for those folk who are retired, or are approaching retirement, as their rental properties are providing them with an income, enabling them to be less of a burden on the state.

Finally, the argument that people should place their savings in "more productive assets", i.e. shares may seem virtuous but for many New Zealanders is a poor alternative. For example, in recent times savings invested in finance companies and their services have failed and values have been totally destroyed. Where is the prudent investor to turn to diversify?

Conclusion

It is the view of the Federation that current tax settings seem to be efficient and are not overly lenient for residential rental property providers and taxation policy instruments will not of themselves significantly make much difference to the current cycle of housing and renting trends in New Zealand.

The notion that residential property investors knowingly lose money to save tax is ludicrous and is not supported by hard facts. Good investors do not like losses.

A more likely scenario is that ill-considered and hastily imposed tax measures, as suggested by some, will discourage people into helping house the New Zealanders, who currently need rental accommodation and paradoxically exacerbate housing affordability by making it and rents more expensive.

Most certainly a CGT or some such will not make housing any more affordable, as it hasn't in markets such as the US, Australia and the UK.

We would strongly urge the Commission to not ignore the current Government position that it is not intending to develop any proposals for a capital gains tax for taxing residential investment properties.

[21] Economic survey of New Zealand 2007: Raising New Zealand's living standards 23/4/07 OECD

Recommendations

The Federation recommends that the Commission:

- Acknowledge that long-term property investors are providing a much-needed housing and accommodation service to New Zealanders
- Agree that the view that property investors are favoured is not supported by the empirical evidence
- Distinguish between speculation, which people resent, and legitimate investment
- Agree that IRD already has sufficient existing powers to tax speculative investors
- Agree that retaliatory taxes, such as a CGT, levied against ordinary New Zealanders will not significantly make housing more affordable but instead will penalise ordinary hardworking and self-reliant New Zealanders
- Recall that the Prime Minister and successive governments have ruled out introducing a capital gains tax.

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3 August 2011

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To the Commission

Inquiry into Housing Affordability

Please find attached a copy of the New Zealand Property Investors' Federation submission to the Commission inquiry into housing affordability.

I would be grateful if you could register the Federation's wish to appear before the Commission to speak to its written submission.

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Yours sincerely

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