Housing Affordability

July 2105

During 2006 and on into 2008 I received regular updates on housing affordability from Hugh Pavletich of Demographia, and it became very clear to me that homes in New Zealand were becoming less and less affordable, especially in Auckland.

I was very concerned to note this trend, since I have long believed that home ownership brings manifold benefits for both families and the health of the nation. As housing becomes less affordable then the dream of home ownership becomes more distant, especially for young couples and their children, with potentially lifelong consequences.

Renting may be an option while people are young and in the workforce, but it means poverty for those who are still renting when they reach retirement. It can also result in instability and great stress for those who remain shut out of home ownership.

The benefits of home ownership extend beyond those considerations to damaging psychological and other effects when compared with the pride and purpose which arises from home ownership. As Mike Moore famously said, "No one ever washes a rental car", meaning that we take pride in what we own. Ownership motivates us to look after the repairs and maintenance of our properties and to plant gardens. Over time this provides us with an asset which contributes to our finances in retirement.

I was very concerned to see that the level of home ownership in New Zealand was declining rapidly. The Demographia figures measuring affordability were steadily deteriorating until, particularly in Auckland, they had reached the "severe unaffordability" category. Auckland housing had become some of the most expensive in the world.

Government needed to quickly identify why this was happening and take urgent steps to address and rectify the position. I was therefore delighted to lend my support to a proposal to the Commerce Select Committee by National that a public inquiry be undertaken. Initially the Prime Minister opposed the idea, but when she realised that National and I constituted a majority on the committee, Labour came on board and gave it their support.

Submissions were called for and in due time the committee began the process of working its way through the many well-researched papers which had come from many sectors of the community, from social agencies to the Reserve Bank.

The committee travelled to Auckland to hear many of the weightier submissions and I assumed the chair in the absence of Gerry Brownlee. I was very concerned with what we heard. Two submissions in particular stood out.

The first was based on research carried out by the Motu Economic and Public Policy Research group led by Arthur Grimes (then Chairman of the Reserve Bank) and was presented to the inquiry by Don Brash, the former Governor of the Reserve Bank.

He informed us that the Auckland Regional Council had, in 1999, introduced a Metropolitan Urban Limit (MUL), to establish a line of demarcation between the residential/commercial/industrial limits of the city and the rural areas which surround it. As a consequence, the land just inside the MUL was, in 2008, now 10 times the value of the land outside that line on the map. In other words, if that land had been valued at $300,000 per hectare before the establishment of the MUL, it was now worth $3,000,000 per hectare.
This, of course, increased the price of all the land inside the MUL since as anyone who has done Economics 001 will tell you if you restrict the supply of any commodity when demand is increasing, as it is in Auckland, then prices will rise. In fact land prices had more than doubled in the five years between 2002 and 2007 and have continued to increase at an alarming rate ever since. Given those realities Don Brash submitted that the MUL should be declared illegal immediately, and he is right. It is the product of a planning mentality which has

no understanding of simple economics, and the now defunct Auckland Regional Council got this badly wrong.

The second worrying submission informed the inquiry that as a result of the rapid rise in house prices 60 per cent of all households in South Auckland would *never* own their own home. This saddened me greatly since, as mentioned above, the consequences that flow from a lifetime of forced renting are negative for both the families involved and society as a whole.

But it all gets worse. People whose land has increased in value by 1000 per cent because of the MUL are not selling it for new housing because its value is continuing to increase year by year. This is called “land banking”. As if all of that was not tragic enough, where the land bankers owned the land before it was re-zoned by the creation of the MUL, the eventual proceeds of any sale will be *tax free* under New Zealand law.

The result of all this is that those fortunate owners who own this land have become millionaires overnight at the expense of the poorest people in Auckland. That is a fundamentally unjust policy blunder. It represents an enormous transfer of wealth from those who can least afford it to those who least need it, and New Zealanders should demand government intervention to speedily bring it to an end. Only government has the ability to resolve this issue.

This is undoubtedly the main reason for the increase in wealth inequality in New Zealand.

Is National up to the task? Everything I have written above was known to them before they became the Government in 2008, but they took no effective action until Nick Smith was appointed Minister of Housing in January 2013, more than five years later. I regard that delay as unforgiveable given the urgency of the matter.

Meantime National has made housing affordability worse by increasing the GST on new housing from 12.5 per cent to 15 per cent in the 2010 Budget, an action which increased the price of all existing housing stock. If you increase the price of new houses, the same supply-and-demand economic equation will push up the market value of existing houses, even although they are not subject to GST on sale. In short, far from assisting, the GST increase has exacerbated the affordability problem.

So what should be done to restore equity and justice to the housing sector? I suggest at least the following:

(a) An increase in the supply of land for subdivision. This will level out the price of land within the MUL so that the “10 times more” difference between that and the land outside the MUL will be brought to an end. Government should legislate to that effect immediately. The aim should be to see new homes coming onto the market at around 4.5 times the average income (in a number of states in the USA and in Canada new houses are available at just over twice the average income, so the 4.5-times goal, although ambitious, is not unreasonable). The average annual income in New Zealand is around $86,000, but it varies a great deal depending on locality. Just to provide some context, affordability in Auckland is currently around *nine* times the average annual income of those living in that city.

(b) End the development levies charged by local councils. They are, in reality, a new-house-purchaser infrastructure charge and can add as much as $25,000 to the cost of a new home. I believe that new infrastructure such as sewerage and roads should be financed by issuing council bonds. Since new homes mean new rates, this extra income can be used to fund repayments over decades.

(c) On a once-in-a-lifetime basis give a 50 per cent GST refund on, say, the first $350,000 or actual cost of building a new home. This is again a supply-side initiative because the problem we face can be overcome only by building thousands of new houses. If we could build 26,000 new houses in the mid-1960s when our population was just 2.2 million then there is no reason why we cannot gear up to build twice that number now. Where there is a will there is a way.

(d) A special tax of, say, 50 per cent should be introduced and levied on the windfall profit resulting from the sale of land following its rezoning for residential use. This tax could be paid to the local authority and used by them as a contribution to the cost of the new housing infrastructure required.

(e) Re-write the Building Act to simplify the issuing of building consents. The present situation is absurd with large building companies needing to provide 12-13 pages of plans to obtain a building consent, but just four to five pages of plans to actually build a new home. In addition, standard plans once consented to should be able to be fast tracked when used again to build further houses with just slight variations.

Regarding point (c) above, it would be worthwhile for the Government to ask Treasury and the Productivity Commission to look at refunding all of the GST paid by the purchaser of a new house and section. Since the GST rate is now 15 per cent, that tax has increased the price of all houses in New Zealand by 15 per cent. Although GST is not payable on the sale of second-hand houses, this nevertheless also increases the market value of those houses, since their replacement cost is increased as a result of the tax.

If GST were to be abolished (by refund to the new home buyer), then the Government's revenue would be reduced accordingly. But that may not matter if it results in a significant increase in the number of houses built each year. For example, if an additional 10,000 houses were built each year at an average price of $500,000 (section and house excluding furnishings and landscaping), then the economy would grow by more than $5 billion per annum with a commensurate increase in income tax plus the additional GST collected on the cost of furnishings, lawns and gardens, etc.

If that extra tax income is insufficient to cover the revenue loss, then consideration should be given to raising additional tax through a small increase in the top income tax rate for those earning over, say, $150,000 p.a. This would be justified on equity grounds since GST is a regressive tax, i.e. a tax which impacts disproportionally on the poor. Thousands of new jobs would be created.

The overall reduction in the price of housing would also have a positive impact on monetary policy by enabling the Reserve Bank to abolish such things as the Loan to Value Ratio (LVR) restrictions for first-home buyers. Nor would the Reserve Bank have to continue to increase interest rates for the entire nation in an attempt to “cool down” the price of houses in Auckland, as they have had to do over many years. It is not their primary role that is the task of government, and their only instrument is a blunt one. This would mean lower interest rates to the benefit of us all.

As outlined above it would be necessary to return GST to the new home buyer by way of a refund, since the materials and trade costs used to build a house cannot be separated from similar goods and services purchased for other purposes. Such refunds would need to be made by the IRD to the purchaser of the house and section once the house has been completed. This might require either the builder or the purchaser to arrange bridging finance in the interim, but it can be done.

The politics of all this also need also to be set to one side. I was dismayed to hear my former party leader Peter Dunne say in the 2014 election debate on this issue that the windfall capital gains arising from the housing price bubble for those who are already home owners must not be jeopardised. On this issue, those of us in that position need to step back and ask ourselves whether we want the housing inequality which now characterises our society, including its effects on our children and grandchildren, to continue? I for one, as the beneficiary of home ownership policies of the 1960s, answer “No”.

On a more humorous note, a delegation from Marton (the home of former Social Credit leader Bruce Beetham), came to the Inquiry to tell us that there is no housing affordability issue in their town and that they would welcome new residents!