

# Cut to the chase

## Housing affordability inquiry

Draft report – December 2011



The challenges faced in the social housing sector are much more complex than simply providing a house to those who cannot afford to rent or buy.

Proposals to rely more on community-based support groups (ranging from charitable trusts to the Salvation Army) to provide more social housing and support services are appropriate. Overseas experience is that these organisations can deliver better outcomes to tenants than government or council housing departments or private landlords.

But this sector is still very under-developed in New Zealand. It lacks scale, some capability and access to capital. While there appear to be groups ready and willing to step up to the challenge of providing integrated housing and social services, it will take time and more funding before the sector can operate successfully at the scale envisaged.

Māori rural housing may require particular solutions which reflect the need to improve the Māori housing stock, the importance to Māori culture of maintaining a connection to the land and the difficulties of accessing finance to build on communally owned land. The Commission has proposed some ideas in the draft report and will be discussing these further.

### Tax

The Commission does not see the tax system as a major driver of the house price boom over the 2000s. The present tax position is long-standing and any tax benefits for housing can be expected to have been subsumed into house prices long ago.

The Commission has found that housing is less tax-advantaged than often suggested. That judgement reflects: lenders pay tax on income derived from mortgages; the application of GST to both rental and owner-occupied housing; the universal application of a property tax (local body rates); and that capital gains on housing are already taxed when those buying and selling houses are 'in trade'.

### Housing is less tax-advantaged than often suggested

There are some tax 'wrinkles', mostly relating to the deductibility and assessability of interest. However, these are general flaws in the tax system and would be best addressed as such, rather than specifically in the context of housing.

The Commission would not support taxing capital gains from housing alone given taxation is best approached in a comprehensive and principled way across the economy, rather than targeting it at particular industries or sectors. Without that broader approach, there is a significant risk of unintended and unhelpful consequences. Designing a regime to bring capital gains and losses more generally within the tax system would also present a number of difficult conceptual and practical challenges, such as how to define and keep track of capital gains and losses, particularly in the presence of inflation.

To see the full version of the draft report – including information on how to make a submission – please visit our website [www.productivity.govt.nz](http://www.productivity.govt.nz) or call us on 04 903 5150.

### The New Zealand Productivity Commission

The Commission – an independent Crown Entity – completes in-depth inquiry reports on topics selected by the Government, carries out productivity-related research, and promotes understanding of productivity issues.

### The inquiry process

Cut to the Chase summarises the Commission's draft findings and recommendations from the housing affordability inquiry. The draft report follows the release of an earlier issues paper (June 2011); consideration of about 60 submissions on that paper; a large number of meetings with interested parties; and the Commission undertaking its own research and analysis of issues central to housing affordability. Submissions on the draft report are invited by 10 February.

### Home ownership is now beyond the reach of increasing numbers of New Zealanders

### The importance of housing affordability

Access to affordable quality housing has an important impact on people's wellbeing. But the aspiration of home ownership is now beyond the reach of increasing numbers of New Zealanders. This tends to be the case for younger people and others on lower incomes, particularly those living in Auckland and other rapidly growing cities. Given forecasts of strong population growth for those cities, there is a good chance that housing affordability pressures will intensify going forward if housing supply cannot be improved.

Affordability pressures have been intensifying for some time. However, the house price boom from 2001 to 2007, which saw (inflation-adjusted) house prices almost double on a national basis, exacerbated affordability concerns.

During the boom, house prices increased strongly across most regions. In Auckland, this continued a well-established trend of strong price increases for houses that were already among the most expensive in the country. So the premium for Auckland housing has continued to increase. This could have big repercussions for future home ownership, with Auckland forecast to be home to almost half of the new households created over the next 20 years.

It is particularly important that Auckland is able to provide entry-level priced housing in volume for the many people and families who wish to live there. At present, it is falling behind in that task.

### The Commission sees an urgent need to increase land availability for housing

## The property ladder's missing rung

An emerging feature of the New Zealand housing scene is a 'missing rung' on the property ladder. This is apparent from large increases in the number of 'intermediate renters' – households with at least one member in paid employment that are still unable to purchase a modest home. In some parts of the country, the 'starter' house that once eased New Zealanders into property ownership seems to be a thing of the past.

The intermediate renter group increased by over 150% (to 187,000 households) in the years 2001 to 2006. Although the number of intermediate renters has drifted down a little since the peak of the housing boom, they still make up a large share of rental households.

The presence of large numbers of intermediate renters raises questions about New Zealand's private rental market, which is highly fragmented and dominated by small-scale landlords. For these and other reasons, the rental market will struggle to provide the stability and quality of housing required given that renting is increasingly a long-term reality for many New Zealanders.

## What can we do to increase housing affordability?

In a nutshell, housing supply needs to be more responsive to emerging demand. More new and affordable houses need to be built to ease competition for existing houses, reduce price pressures, and increase housing quality and the choices available for tenants and prospective buyers.

## Land release for development

Probably the single biggest source of adverse impact on housing affordability is the insufficient release of new land for housing.

This has already led to very high section prices. Land costs now account for almost 60% of the cost of a new dwelling in Auckland, and for 40% across the rest of New Zealand.

In large part, this land scarcity is created by policy and planning practices – in particular the preference for the 'compact urban form' model that aims to limit urban 'sprawl' by encouraging greater density of housing within existing city boundaries.

Intensification of land use will be an essential part of the solution to New Zealand's housing needs, especially in redeveloping existing urban areas. But it will need to be complemented by greater use of undeveloped land (greenfields) if house prices are to moderate. Conventional homes on greenfield sites are generally cheaper to build than infill, multi-storey or brownfield (previously developed but underused or abandoned) development.

The Commission sees an urgent need to increase land availability to create opportunities for the construction at scale of affordable new homes in rapidly growing cities. This is likely to require councils and developers to work together to identify significant tracts of new and underdeveloped land and to speed up planning approval, design and construction processes.

**It costs around 25% more to build a house in Auckland than in Melbourne**

## Construction costs

Construction costs increased by 30% in real terms in the nine years to 2011 and are substantially higher than in Australia. Putting land costs aside, it costs around 25% more to build a house in Auckland than it would cost to build the same house in Melbourne.

This price difference reflects the higher cost of building materials in New Zealand and also the fact that our residential construction industry has the characteristics of a 'cottage industry', dominated by small firms building small numbers of houses.

The Commission considers that there is scope to improve productivity in the construction sector. The Building and Construction Sector Productivity Partnership, established in 2010 as a joint industry-government initiative, has a range of work streams already underway.

The Christchurch rebuild will also provide an opportunity to demonstrate the efficiency gains from building at scale, with greater use of standardised components and strong project management skills to synchronise the deployment of sub-contractors.

## Local government regulatory performance

Local government can also affect housing prices directly through its charges and indirectly through the efficiency with which it enforces building regulations. Slow or inconsistent enforcement can delay job completion and increase compliance costs.

Development contributions are charges designed to cover the council's cost of expanding existing infrastructure to accommodate new areas of housing (for example, hooking up the water supply and sewerage system). They are a major source of grievance for property developers as the calculation and purpose of the charges are often unclear. While not all councils apply them, most do, and in some cases charges can be as high as \$40,000 per section.

The Commission has identified a number of ways in which the charging regime could be made more transparent. These include considering a merits-based test so that developers can challenge both the use and the number of charges.

## Building and land use consent processes need to be made faster

The building consent process is another area of concern, with substantial regional variation in associated costs. Currently, only the council Building Consent Authority (BCA) can issue building consents and code compliance certificates. There are a number of ways in which building consent processes could be made faster and more cost effective. This could involve, for instance, creating a more contestable market, either from private building certifiers or from any registered BCA, not just the BCA attached to the local authority. It might also involve greater standardisation across the country and better use of technology to drive efficiency.

## Social housing

Affordable housing for those in greatest need is provided by the Government's various social housing programmes, including state and community housing, accommodation supplements and home ownership assistance schemes. Current spending commitments for these programmes are nearly \$3 billion a year. Without rapid progress to increase the supply of affordable housing, the expenditure risk to the Government from providing this support will continue to mount.

**Government spending on housing programmes – about \$3 billion a year – must improve**

