focus

Government 'cracking down' on housing 'speculators'

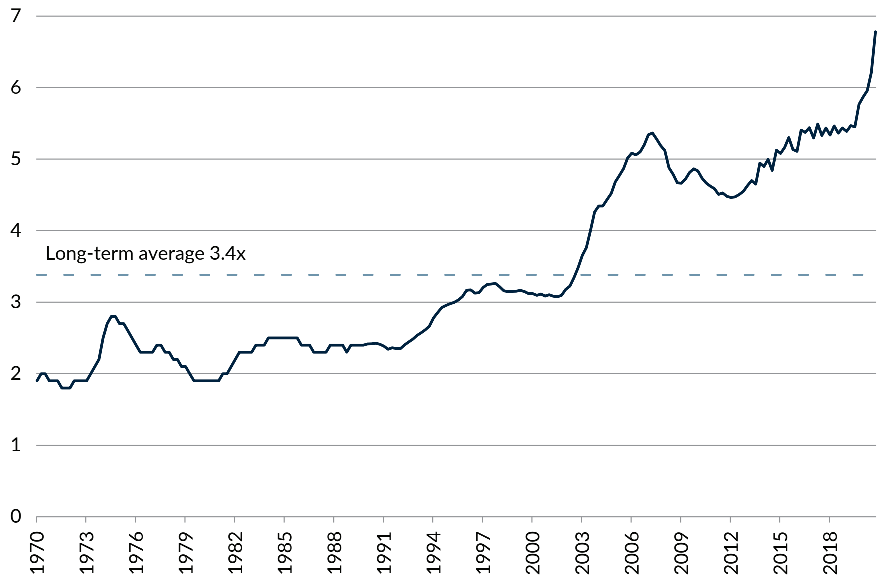
This week the Government released a policy package to address New Zealand's "housing crisis". In our view elevated house prices is principally a supply issue — the population has grown quickly, and the provision of new homes has failed to keep pace. The policy package does include some initiatives to help supply, but the focus is on the demand-side, specifically targeting investors who own around 35% of New Zealand's residential properties. It seems likely these policies will encourage some investors to switch from housing to other asset classes and, at very least, cause house price growth to slow. Ultimately though, more supply-side solutions are required.

FORSYTH BARR

The problem

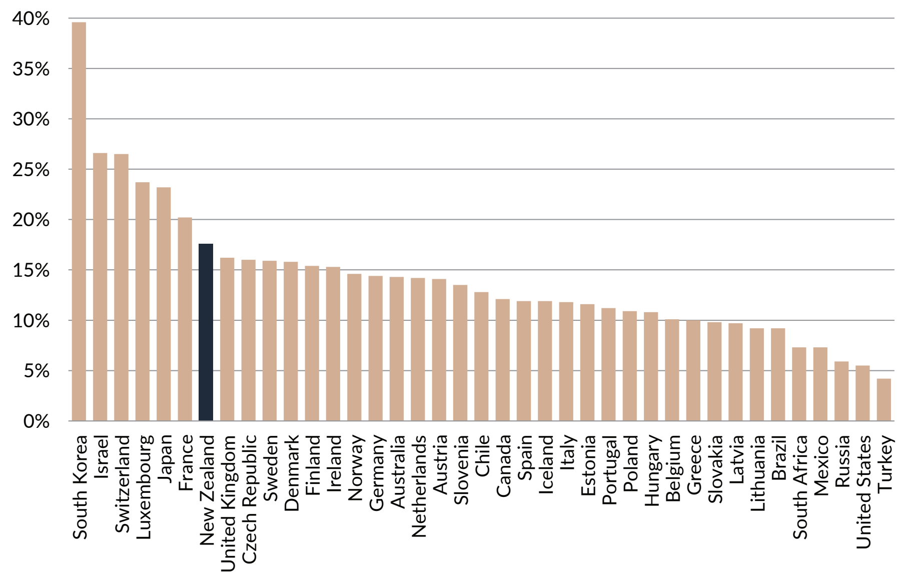
New Zealand house prices have soared and we now have some of the most expensive house prices in the world.

HOUSES EXPENSIVE VS. HISTORY: HOUSE PRICES/HOUSEHOLD DISPOSABLE INCOME (X)



Source: RBNZ, REINZ, Forsyth Barr analysis

HOUSES EXPENSIVE VS. INTERNATIONAL: HOUSE PRICES/ HOUSEHOLD DISPOSABLE INCOME (PER SQUARE METRE)

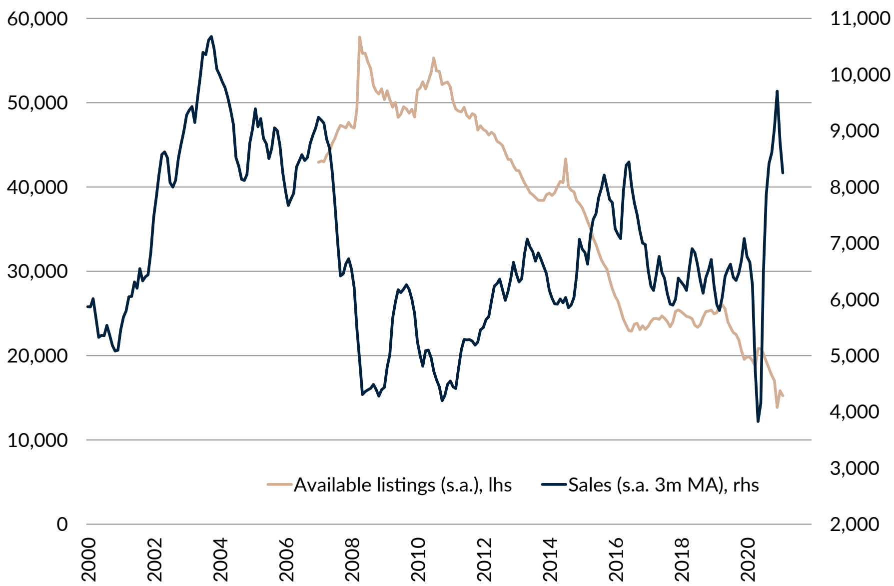


Source: Compare the market, Forsyth Barr analysis

In our view, the surge in house prices largely reflects:

1. Supply not keeping pace with demand due to restrictions on land use (only just over 1% of New Zealand's land is used for housing), increasing costly regulation, and other factors. Lack of supply is evident throughout the country.

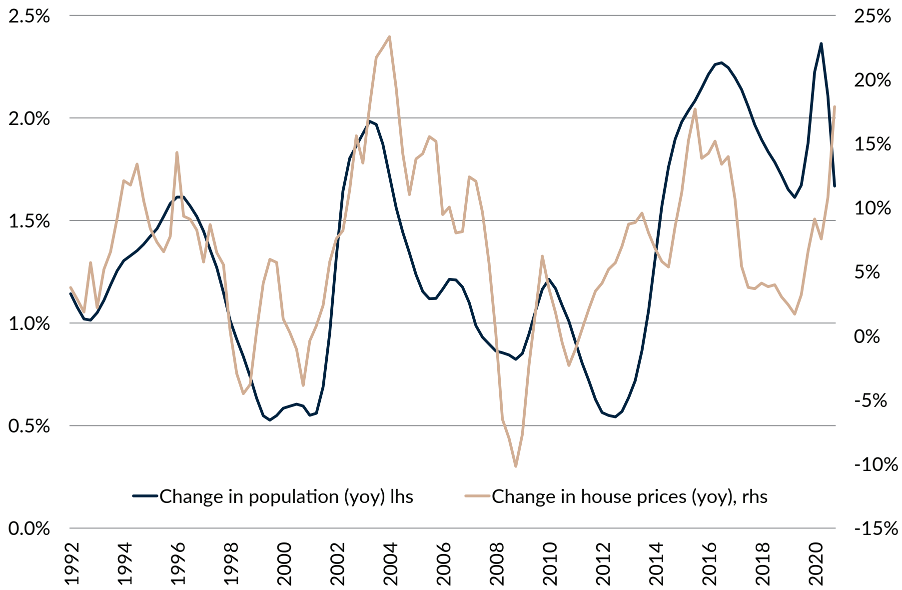
NOT ENOUGH HOUSES FOR SALE: HOUSE SALES VS. HOUSES AVAILABLE FOR SALE



Source: REINZ, RBNZ, interest.co.nz, Forsyth Barr research

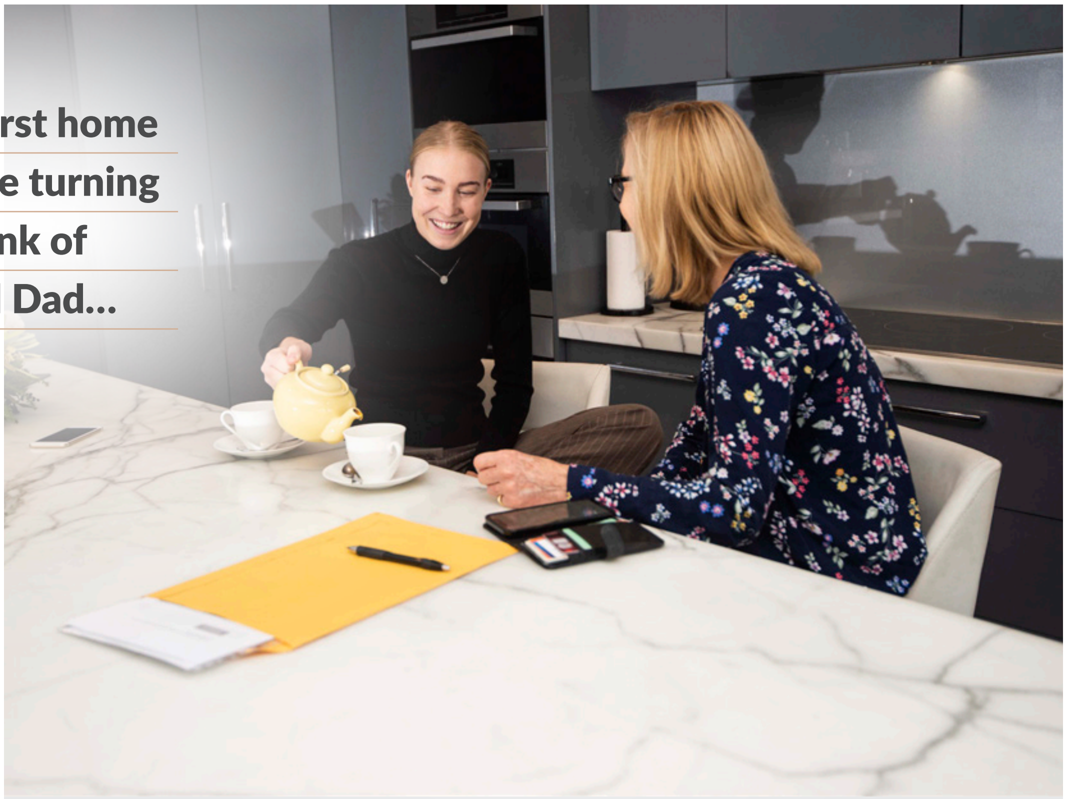
Booms in New Zealand house prices have typically coincided with booms in population – in the mid 1990s, early 2000s, and since 2013. When population surges sticky supply can't adequately respond.

HOUSE PRICES BOOM WHEN THE POPULATION BOOMS: POPULATION GROWTH VS. HOUSE PRICE GROWTH



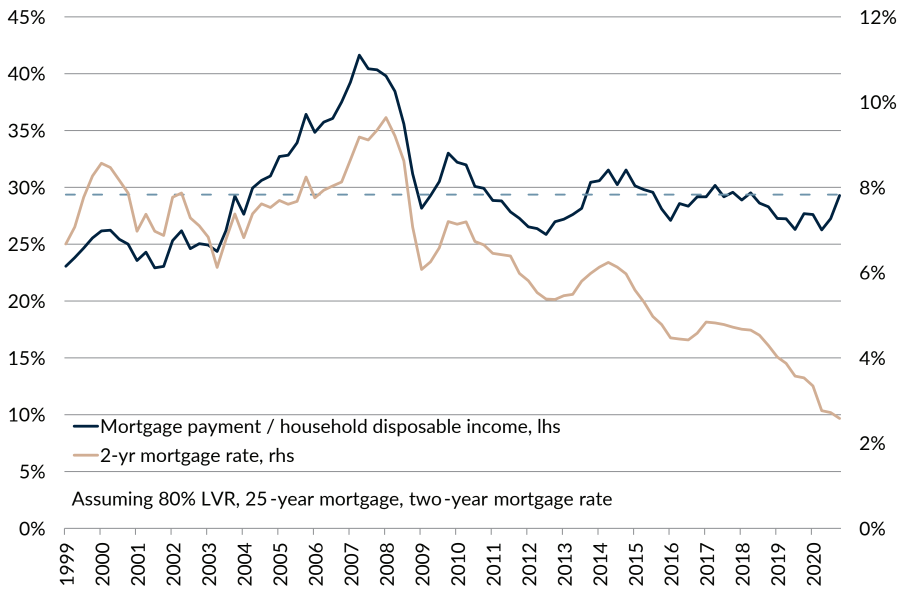
Source: Statistics NZ, REINZ, Forsyth Barr research

...Many first home buyers are turning to the Bank of Mum and Dad...



2. Falling mortgage rates enabling borrowers to service larger mortgages. We have published the chart below before – it shows the cost to a home buyer of servicing an 80% mortgage on the average New Zealand house. As mortgage rates have fallen, house prices have risen. Since 2008 the cost of servicing the mortgage as a proportion of income has been broadly stable.

COST OF SERVICING A MORTGAGE



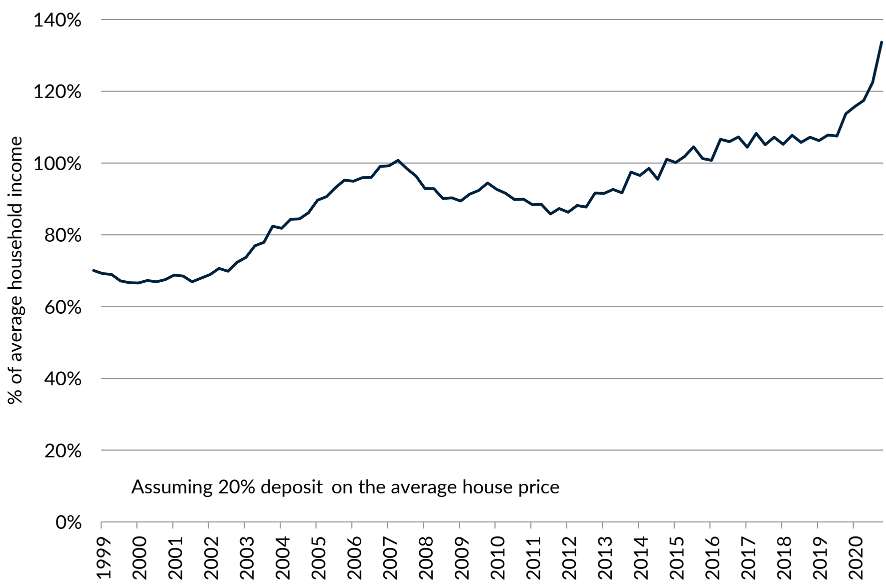
Source: REINZ, RBNZ, interest.co.nz, Forsyth Barr analysis

...housing affordability is the number one concern amongst New Zealanders...

Looking through this mortgage serviceability lens you could argue housing affordability has not worsened (albeit it does mean borrowers will hurt if mortgage rates rose). What has become more challenging is the house deposit. At the beginning of last decade the required deposit equated to around 90% of average household income. Today it is has increased by a half to 134%.

Many first home buyers are turning to the Bank of Mum and Dad – a 2018 report showed that more than half purchased homes with the help of their parents. But this option is not available to all. Rising house prices can contribute to greater inter-generational inequality.

RISING REQUIRED HOUSE DEPOSIT



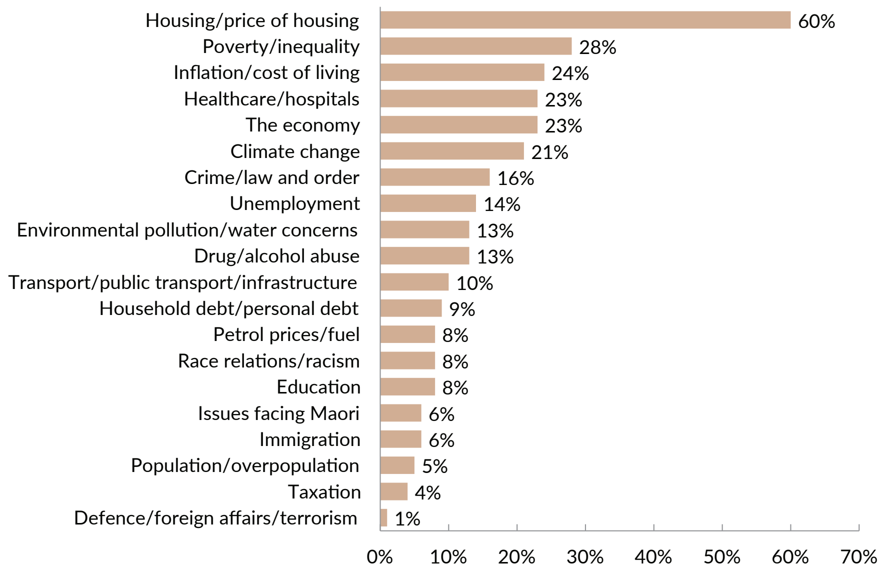
...A $3.8 billion Housing Acceleration Fund to help fund infrastructure...

Source: REINZ, RBNZ, interest.co.nz, Forsyth Barr analysis

More Government housing policies

According to market research firm Ipsos housing affordability is the number one concern amongst New Zealanders.

SURVEY "WHAT WOULD YOU SAY ARE THE THREE MOST IMPORTANT ISSUES FACING NEW ZEALAND TODAY?" (FEBRUARY 21)



Source: Ipsos, Forsyth Barr research

Addressing the problem is not easy. Successive governments have tried and failed. The KiwiBuild scheme introduced in this Government's first term is a case in point – it aimed to deliver 100,000 houses, but to date only around 800 have been completed (including a number built in the wrong place and sold below cost due to lack of demand).

The most notable policies from this latest package include:

- (The most surprising and significant) a removal of deductibility of interest on investment properties, "potentially" excluding new builds. In effect, this is equivalent to an additional tax on property investors. It will apply to properties purchased from 27 March, and be phased in over four years for owners of existing properties.

...It's hard to be specific about what the impacts of these new policies will be...

- Extending the bright-line from five to 10 years for existing properties, meaning capital gains tax will be applied to any house sold within 10 years except for a person's main residence. The bright-line for new builds will stay at five years.
- A $3.8 billion Housing Acceleration Fund to help fund infrastructure.
- Government has also asked the Reserve Bank to consider prohibiting investors' access to interest-only loans.

A shifting landscape for property investors

Many who have invested in property as part of their long-term retirement plan are probably feeling aggrieved. They've been labelled as "speculators" by the Government, and the investing rules have continually shifted.

- The initial two-year bright-line test was introduced by the National government in 2015. It was extended to five years by the Labour government in 2018.
- Since 2019 investment property has been ring-fenced for tax purposes, meaning property expenses can only be offset against property income (and not other taxable income).
- Last year the government reintroduced tax deductibility of depreciation for commercial properties (it was removed in 2011/12) as part of an economic stimulus package. It was not reinstated for residential property.
- Recently the Reserve Bank announced macro-prudential policy changes including a 40% deposit requirement for property investors from May this year.

Now the bright-line test is being extended further, and interest tax deductibility removed.

House prices likely to slow, but policies are no silver bullet

It's hard to be specific about what the impacts of these new policies will be. We expect the following are likely:

- Investor demand for existing property will fall, and we could see a shift to other asset classes such as shares, commercial property, and new house builds.

...Addressing New Zealand's housing unaffordability is clearly not straightforward...

- Growth in house prices will slow. We already expected this would happen near-term given house prices have largely capitalised in the large drop in mortgage rates, the doors are shut to new migrants, and the imposition of stricter loan-to-value (LVR) borrowing limits. The risk of house price declines has increased.
- Further support for New Zealand's construction boom. Funding for infrastructure is positive – many local councils are capital constrained. Housing investment will likely be directed toward new builds – in 2020 investors purchased around 40k homes, a similar number to houses built. But the industry is already stretched. We expect its ability to expand rapidly from here is limited.
- Where possible, investors will push for higher rents. The supply of rental properties may fall.
- The housing market has been one of the hottest parts of the economy. The measures to curb house prices eases pressure on the Reserve Bank, and may make it harder for it to meet its inflation targets. Medium and long-term interest rates and the New Zealand dollar fell after the policy announcement.

Addressing New Zealand's housing unaffordability is clearly not straightforward. We do expect the new demand-side policies will moderate growth in house prices, but ultimately a solution requires more houses to be built (including freeing up land and providing infrastructure) and/or slower population growth. We will watch with interest to see if the Government has the appetite and aptitude to address these tougher issues.

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