

Arthur Grimes

HOUSING Pressures and Policies

Introduction

Do we have a housing crisis in New Zealand that is in need of a ‘policy fix’? It depends on where you are and who you are. Imagine, for instance, that you bought a house in Auckland in March 2007 and wanted to sell in March 2017, a decade later. Provided you chose to leave Auckland, you would have done very well financially. Over the decade to March 2017 the typical Auckland house doubled in value: the REINZ house price index (HPI) for the Auckland region showed an increase of 102%. By contrast, the price of the typical house in the Manawatu–Wanganui region increased by only 17%, which was slower than the rate of consumer price inflation of 21% over the same period. Figure 1 shows a time series for house prices (indexed to 100 in January 1992) for Auckland, Manawatu–Wanganui, New Zealand and New Zealand ex-Auckland.

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The capital gain in Manawatu–Wanganui was less than the after-tax compound return (39%) on a bank deposit over the same period.¹ Nationwide average hourly earnings rose by 32% during the decade. Quite clearly, housing would have been a poor investment in Manawatu–Wanganui over the past decade. More generally, an analysis of housing affordability conducted by the Ministry of Business, Innovation and Employment shows that national-level housing affordability for both first home buyers and renters in June 2015 was broadly on a par with affordability levels since 2005 (Ministry of Business, Innovation and Employment, 2017). However, given the rise in the HPI for New Zealand since 2015, first home-buyer affordability is likely to have deteriorated nationally since then.

These contrasting experiences tell us two things: (1) the Auckland housing market is facing severe pressures, with house price rises greatly exceeding those in incomes and in prices of other goods and services; and (2) not all regions are suffering severe housing stress. In

addition, these experiences affected different people in different ways. People wanting to purchase their first home were likely to have been priced out of the Auckland market, while, in real terms, houses in Manawatu–Wanganui became more affordable.

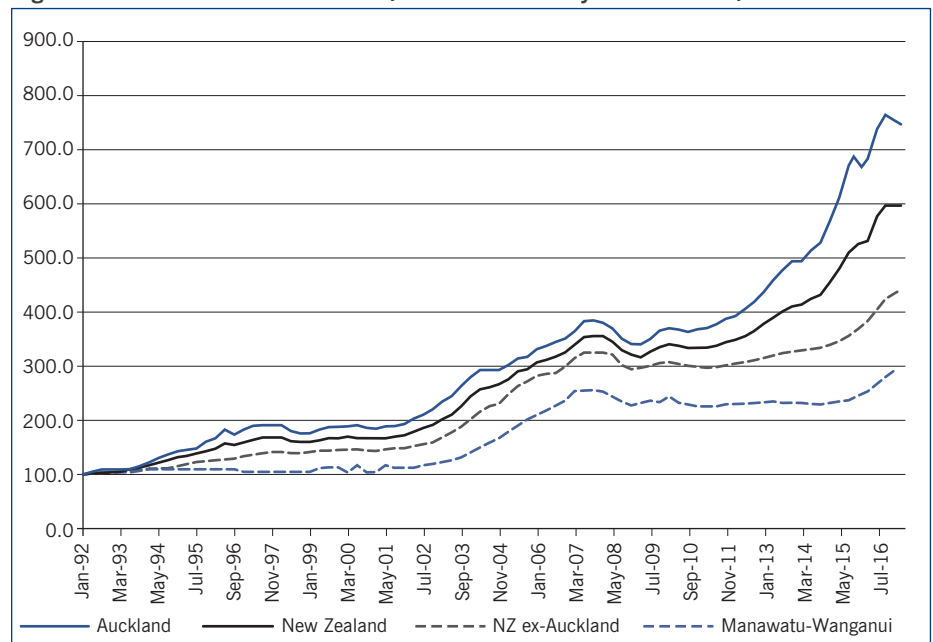
Given these contrasting experiences, housing policies must be flexible enough to cater for differing circumstances in different regions. Section 2 of this article provides a framework to help understand what determines house prices and other housing outcomes; section 3 discusses policy issues in relation to this framework. Section 4 concentrates on a national-level housing issue concerning housing quality. Even in regions where housing stress – as reflected in rents and house prices – is absent, quality issues still abound and are an important area to be addressed.

Understanding housing markets

Factors that affect local housing affordability are multifaceted, and include housing supply, land availability (affected by both geographical and planning constraints), interest rates, construction costs, housing subsidies, taxes and migration. Based on a number of papers by the author,² we can consider four relationships that interact to determine housing outcomes at the settlement (town or city) level for: house prices, population, land prices and the housing stock (number of dwellings).

The first relationship is for house prices, which are determined primarily by (after-tax) finance costs, incomes and the ratio of population to the housing stock. As interest rates decline, people can afford to increase their expenditure on housing, so house prices rise. Higher incomes – including through government-funded subsidies such as the accommodation supplement – enable prospective purchasers (and renters) to spend more on housing, so rents and house prices rise. As the population rises relative to the available housing stock, house prices increase since people have to bid more to purchase (or rent) a dwelling. Goodyear and Fabian (2014) report that between 2006 and 2013 the number of dwellings in Auckland rose by 7.6%, while Auckland’s actual population rose by 8.5%. The

Figure 1: REINZ House Price Index (rebased to January 1992 = 100)



prospective population (if houses had been available at former prices) would have risen by a much greater rate, and this gap is likely to have widened since 2013 as population growth has outstripped new housing supply, contributing to house price growth.³

The second relationship is for regional population. People from within and outside the country are attracted to regions that have high wages, attractive natural amenities and attractive civic amenities. Their choice of location is also affected by the cost of housing (both rental and owner-occupied).

The third relationship is the responsiveness of new housing supply to changes in prices and costs. The supply of houses increases over time until the market price of a house equals the sum of all costs of producing a new house. These costs include the price of land associated with the dwelling (i.e. the ‘section price’), construction and other costs (including regulatory costs). The time taken for this convergence to occur will, in part, be affected by the regulatory process.

The fourth relationship is for section prices. The average section price rises in a city as the local population expands, since land close to the city centre becomes more sought after. While the section price on the urban fringe may stay low – determined crucially by the strength of planning and geographic constraints – the

increased price of land in existing parts of the city will increase the average section price of the city.

These four relationships interact with each other to produce long-term housing market outcomes. Short-term outcomes may diverge temporarily from the long-term relationships, possibly due to ‘bubbles’, or to short-term migration swings. Nevertheless, concentration on the long-run determinants of housing outcomes helps direct where housing policies should focus.

Policy issues

Given these four relationships, policy needs to focus on multiple factors if the concern is to alleviate housing stress. Here I concentrate on key aspects that should receive policy focus.

There is strong evidence that population flows have affected house prices markedly (upwards and downwards) across New Zealand. Some population flows relate to New Zealanders moving within the country; others relate to New Zealanders leaving for overseas or moving back to New Zealand. Little can be done to alter these flows.

Inward migration of citizens from other countries is, however, subject to policy influence. Many factors determine how many, and which, migrants we wish to attract to this country. Humanitarian concerns (e.g. family reunification and

refugees) and economic concerns (e.g. attracting skilled migrants and attracting unskilled migrants to undertake jobs such as fruit picking) are likely to remain major determinants of our immigration policies.⁴ Nevertheless, given their effect on housing outcomes, especially in 'gateway cities' such as Auckland, the effects of migrants on housing outcomes should also enter the migration policy calculus.

The expeditious supply of new dwellings (houses and apartments) is another major policy issue. Local authority zoning and planning regulations need to be sufficiently flexible to enable new land to be brought into urban use quickly in growing settlements. In addition,

amenities and existing residents' housing quality and enabling new supply to come on stream. Growing cities inevitably intensify as land becomes more expensive. The planning regime (including urban aspects of the Resource Management Act) needs to be addressed so that planning restrictions (e.g. building height limits) can be revised as cities grow.

Financial factors affecting regional housing outcomes, such as incomes and interest rate setting, are outside the remit of housing policy. However, two financial-related policy areas require attention. The first is the accommodation supplement. When housing becomes unaffordable, one policy option to mitigate the short-term effects is to increase the accommodation

people with specialist skills. There is, therefore, an important longer-term policy issue of expanding, and retaining, the construction workforce over time. Volatility in the construction sector often sees workers departing for Australia during a local downturn, with few returning.

An explicit policy of promoting house construction is one avenue that can be considered to help reduce this volatility. When economic conditions deteriorate, house construction diminishes, and it is at these times that local and central government could implement policies that underpin the financing and construction of (pre-designed and pre-consented) houses (as one form of Keynesian stabilisation policy). By contrast, a government policy of building more houses during a construction boom does little or nothing to assist housing supply, since this is likely just to crowd out private sector construction.

Policy-promoted construction of houses during economic downturns could also be used to address a second housing concern. Developers of new subdivisions typically find that larger houses have higher profit margins than smaller houses; hence the size of houses built in New Zealand is substantially larger today than it was three decades ago (Coleman, 2017). This construction pattern increases the price of the average dwelling, since the average dwelling keeps getting larger. Government agencies could promote construction of smaller dwellings, thus supplying the market with more affordable dwellings. (Current Housing New Zealand policy is to build homes in a 'range of sizes'.)

Housing quality and quality policymaking

Many New Zealand houses are of poor quality. The 'leaky building' saga has left legacy issues which still need to be dealt with. Another major issue is the high number of damp and/or cold houses with insufficient energy-efficient heating (Howden-Chapman et al., 2012). There is a strong evidence base to support high benefit–cost ratios of targeted policy actions to insulate older houses, and strong evidence also for other interventions to improve housing quality (see, e.g. Keall et al., 2017).

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infrastructure needs to be provided early enough to enable the construction of new dwellings and commercial premises. This requires forward planning on the part of local authorities rather than a reactive (or just-in-time) approach, but financing such infrastructure is an outstanding policy issue. A combination of financing mechanisms, including central government funding for local councils in fast-growing areas⁵ and local government borrowing,⁶ plus development contributions are likely to be required. Another option is value capture, in which a portion of the value uplift of land rezoned as urban and/or serviced by new publicly funded infrastructure is taxed to help fund the infrastructure costs (Coleman and Grimes, 2010).

Regulatory settings regarding buildings are another factor that can affect the speed and cost of new housing supply (Grimes and Mitchell, 2015). A balance is required between preserving natural

supplement, as occurred in the 2017 Budget. However, a rise in the supplement increases the demand for housing, while doing little to affect the underlying supply issues in the market. Accommodation supplement rises may therefore increase underlying housing pressures (though they do reduce housing stress for an individual in receipt of supplement).

The second important financial policy issue is taxation. It is now well established that housing is tax-favoured relative to other savings instruments, such as Kiwisaver (Coleman, 2017). Rather than tinkering with the tax system, a fundamental review of the tax treatment of housing relative to other forms of saving is a policy priority.

A major constraint with respect to new housing supply in New Zealand is the shortage of skilled workers in the construction industry. This is not an issue that is amenable to fast policy action, other than through increased migration of

Some of the advantages of improving housing quality accrue privately to house owners. However, information asymmetries and power relationships between landlords and tenants mean that renters are less likely to have access to warm, dry houses than are homeowners. Even for homeowners, there are spillover (externality) benefits of programmes that improve housing quality. Most health care in New Zealand is funded by taxes. Thus, interventions that reduce health costs have a social payoff beyond the private owner. A social investment approach should theoretically take these (large) benefits into account. To date, there is little evidence that it has done so. A key policy issue over coming years is, therefore, whether a state-supported programme of improving housing quality will be reinvigorated.

This example highlights another issue of policy importance: the silo approach to public policy. The termination of the insulation programme, which had a demonstrated high benefit-to-cost ratio, may have been due to a research finding that the Warm Up New Zealand: Heat Smart insulation scheme led to large health benefits but to only a small reduction in energy use (Grimes et al., 2016). Officials concerned with energy efficiency may not have supported a scheme that did not reduce energy bills. Meanwhile, health officials, concentrating on health system issues rather than housing issues, may not have focused on the health benefits flowing from a 'housing' scheme.

In the end, despite the existence of a social investment approach that is supposed to prioritise evidence-based

policy, policymakers did not utilise the existing evidence base to support a programme that had high benefits relative to costs. An additional lesson, therefore, is that the broader policy process related to housing requires as much attention as do individual housing policies.

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- 1 Based on a person with a 30% tax rate, investing in six-month bank term deposits (Reserve Bank of New Zealand statistical series).
- 2 See Grimes and Aitken (2010), Grimes and Hyland (2015) and Greenaway-McGrevy, Grimes and Holmes (2016).
- 3 Another aspect to consider is household structure. An ageing population, family break-ups and a trend towards fewer children all increase the demand for dwellings relative to a given population size.
- 4 Fry and Wilson discuss these issues further in this issue of *Policy Quarterly*.
- 5 The government has announced a \$1 billion Housing Infrastructure Fund for high-growth areas, but the 2017 Budget Economic and Fiscal Update shows that only \$200 million of this fund is set to be allocated in the year to June 2019, with only \$600 million to be allocated by June 2021 (Tarrant, 2017).
- 6 Local governments have publicly stated an intention to limit their borrowing, because of a desire to retain their AA credit rating. It is unclear why this particular rating – and hence the self-imposed tight borrowing constraint – has been adopted.

School of Government

Te Kura Kāwantanga

Forthcoming Events

Title	Panel	Date
Policy Forum – New Zealand General Election	Panel being confirmed	Friday 15th September: 12:30 – 1:30pm Rutherford House, lecture theatre 2 23 Lambton Quay. RSVP: maggy.hope@vuw.ac.nz

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