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**Question:**

House prices are rising steeply in urban centres like Auckland and Christchurch. Discuss whether there is a case for Government intervention in the housing market. If so, suggest a policy intervention and evaluate the pros and cons. If not, evaluate the pros and cons of the status quo.

Word count = 1995

## Introduction

The property market in New Zealand has recently become the subject of vigorous debate in both the media and parliament. House prices, especially in densely populated urban centres such as Auckland have soared to unprecedented levels in recent years. Consequently, severely unaffordable house prices have begun to challenge some of society's most heavily entrenched ideals concerning property ownership and are preventing many potential first homebuyers from entering the market.

Using the Living Standards Framework as a guideline, the analysis conducted in this essay demonstrates that an even-handed supply-side policy approach that considers various economic variables, as well as New Zealand's unique geography and social structure, is likely to be the most effective form of Government intervention.

### The NZ Housing Market: A Pressing Case for Government Intervention

The national median house price rose by 7% in the year ending May 2015. However, excluding Auckland, this change was only equal to +2.6%, whilst Auckland alone has seen its median house price rise by 20% in the same year. In stark contrast to its previous annual change of +7%, a recent surge in construction has reduced Christchurch house price inflation to only 0.3% over the last three months (Real Estate Institute of New Zealand, 2015). This data suggests that New Zealand faces a complicated housing problem whereby the majority of house price inflation is being driven by Auckland, which is home to a third of the population and a large proportion of the housing stock.

An unaffordable housing market creates an assortment of interrelated problems that can have adverse effects on anything from wellbeing and social cohesion to

economic growth. The real price of housing in New Zealand is notably higher than a decade ago, which has seen home ownership in the most typical first home buyer age bracket of 30-39 fall from 55% to 43% since 2001, widening both the intragenerational and intergenerational purchasing power gap (Eaqub, 2014). This poses a threat to the economy and current inequality levels, as the baby boomers reach retirement age and the middle aged become more vulnerable to financial shocks as a result of higher debt accumulation.

Additionally, much of the property is being developed for the upper quartile of the housing market (New Zealand Productivity Commission, 2012), which is regrettably out of reach for the majority of New Zealanders. In the last year alone, the number of sales in Auckland equal to or greater than \$1 million have increased by 120% (Real Estate Institute of New Zealand, 2015) and the gap between Auckland lower quartile house prices in relation to the rest of New Zealand has increased by over 260% (New Zealand Productivity Commission, 2012). This should be of an immediate social concern to the Government as it has increased demand for rental accommodation, under which tenants possess far fewer rights than homeowners and is likely to put further stress on the social housing sector when the need for housing subsidies and welfare increases.

The current state of the property market in New Zealand is attributable to a combination of demand-side and supply-side factors. New Zealand has had years of strong natural population growth and immigration, which has raised 'underlying' demand for housing, especially in urban centres where jobs are readily available. This, coupled with an intention focused capital gains system that provides a favourable environment for speculation, high GDP growth and increased borrowing capacity by households has increased 'effective' housing demand; creating upward pressure on house prices (New

Zealand Productivity Commission, 2012). As incomes keep rising and unrealistic expectations concerning capital gains exist, it is likely that demand will continue to increase.

The New Zealand Housing Strategy currently has the vision that “all New Zealanders will have access to affordable, sustainable, good quality housing appropriate to their needs” (Thorns, 2006, p. 25). Unfortunately, many of the existing policies in place have failed to cool the overheated property market, and new proposals seek to treat the symptoms rather than confront the issue of supply constraints. The Reserve Bank of New Zealand has recently raised the LVR in the Auckland region to 30% (Real Estate Institute of New Zealand , 2015), which may funnel some property investment funds into the regions and ease inflationary pressures in Auckland. However, there are concerns that it will further exacerbate the problem by shutting out more low-income earners from the market.

It is clear that if the property market is left to operate free from any further intervention, house prices will rise further above already severely unaffordable levels. Any further capital gains laws should be treated with caution, as they require multifaceted, complex considerations that stretch beyond the housing market and have proven to be unsuccessful in Australia (Kelly, Hunter, Harrison, & Donegan, 2013). Hence, there is a need for sensible, regionally targeted policies that increase the supply and quality of housing in urban areas by relaxing regulation and encouraging more cooperation between the Government and the private sector. This will facilitate the correct functioning of the free market and optimise resource allocation, whilst also supporting those in society who are most vulnerable.

## Policy Proposal: The Supply of Land

House prices are an unconstrained variable, equilibrating short run demand with sticky short run supply. However, new supply does not immediately follow and fails to keep prices steady (Grimes, Hyland, Coleman, Kerr, & Collier, 2013). In New Zealand especially, the current regulatory environment has reduced the responsiveness of land supply to price increases by severely restricting the release of land for development. Construction costs have also remained high due to a complicated and drawn out consent process. With long-run supply elasticity less than one in New Zealand, any increase in demand will produce a more than proportionate price response (Gyourko & Molloy, 2014).

The price of land has grown faster than house prices over the last two decades, with land now accounting for 60% of the cost of new residences in Auckland and 40% in the rest of New Zealand (Zheng, 2013). This implies that a land supply focused policy is likely to be the most practical under the circumstances. Urban planning policies promoting residential intensification in our bigger cities, such the Metropolitan Urban Limit in Auckland have constrained the supply of land. In fact, land found closely within the MUL was valued at approximately ten times the price of land located closely outside the boundary, and has had a significantly larger price effect on lower value land (Zheng, 2013). This policy seems to have disregarded the unique geographical location of Auckland, which exists narrowly between two harbours and, therefore, experiences more demand for dwellings close to the centre of the city. So, whilst some urban intensification is desirable for growth, the MUL appears to have undermined the vision of affordable housing.

This paper recommends a decentralised approach, which delegates a higher level of responsibility to local councils or as suggested by the NZPC, multiple “Urban Development Authorities” in order to ensure an adequate and constant amount of land is being supplied to satisfy demand.

Firstly, existing binding urban limits should be relaxed to the extent that incremental expansion beyond them is allowed. In addition to this, councils should be tasked with facilitating the immediate release of more greenfield and brownfield land to the market in large cities. If councils deem certain land to be important to their own or society’s long-term interests, they would have the option of declaring those areas off limits for development (Zheng, 2013). Secondly, it is recommended that land acquisition powers be granted to a designated authority. This measure is justified, as there have been many occurrences of ‘land banking’ in urban areas (New Zealand Productivity Commission, 2015). This involves holding undeveloped land for the purpose of receiving capital gains; so it is in the interests of the public for the Government to directly intervene in some cases, so long as the compensation is fair. Acquisition powers would also assist the involved authorities with merging neighbouring sections of greenfield and brownfield land for large-scale development and redevelopment.

These measures would involve widespread changes to legislation and some public funding. For example, in line with the NZPC’s considerations, multiple Urban Development Authorities (UDAs) should be given the aforementioned powers and would be tasked with undertaking sustainable development for cities with substantial supply constraints. This authority would also be able to operate as a legal consultant to large-scale developers, helping to solve the difficult issue of ambiguity surrounding the

interactions between the Resource Management Act, the Local Government Act and the Land Transport Management Act.

### Living Standards Framework

One of the key issues within the New Zealand building sector is the focus on relatively small sized developments, which are a significant barrier to productivity growth (New Zealand Productivity Commission, 2012). By releasing large plots of greenfield and brownfield land for large-scale development projects, the Urban Development Authority will enable productivity improvements in the industry through economies of scale, which will increase output. Better functioning property markets have also been shown to augment the efficiency of the labour market by improving human capital mobility between cities and therefore reducing skill shortages (Yates, Randolph, & Holloway, 2006).

Any proposed changes to the RMA are a red herring and will likely fall short of making any significant impact on the housing market. Therefore, the policies proposed in this essay have been fashioned with the environmental function of the RMA in mind. Authorities will have many more powers concerning the preservation of important areas, and by continuously bringing underused land such as brownfield sections to the market, this ensures that the country's finite capital stocks are conserved and recycled for future use.

The clear advantage of lower house prices is that it increases social cohesion by bridging the generational inequality gap and increasing the level of home ownership (New Zealand Productivity Commission, 2012). Inside the policy framework, an

incremental expansion beyond the MUL through community and private consultation will promote densification in high growth areas, but also give homebuyers more options regarding where to purchase property that is appropriate for their needs and lifestyle choices. For example, lifestyle blocks on the fringes of Auckland have become more popular in recent years, and with a significant amount of evidence that suggests inner city living is unhealthy for small children, any policy that provides more options like these has merit (Carroll, Witten, & Kearns, 2011).

In a property market where the elasticity of supply is greater, the amount of time that prices remain above equilibrium is shorter and the misallocation of resources is less distinct (Grimes & Aitken, 2006). Further, any reduction in the price of housing in New Zealand from these policies will improve the incentive for skilled workers to migrate here, which will bring innovation and growth, and lower the Government's fiscal burden by reducing housing subsidies. As a result, the New Zealand economy will be better placed to manage risk, withstand adverse shocks and respond to changes in demand outside of the predicted house price cycle. The policy framework under which the UDA operates will provide support in the future when supply shortage problems occur.

#### Final considerations

It is important that the effects of these policies are monitored closely within the living standards framework to ensure that socially and economically desirable outcomes are achieved. More specifically, that fertile land is not being used for projects, as it will severely affect New Zealand's agricultural industry (New Zealand Productivity Commission, 2012). The UDA must also guarantee adequate infrastructure such as



transport for large-scale developments and expansion beyond the MUL; however this will be cumbersome and expensive.

It should be noted that there is a lag between when a policy takes effect and when an increase in the supply of the land becomes visible (Zheng, 2013). Moreover, it is likely that some sort of housing supply shortfall will always exist in highly populated urban areas throughout New Zealand. Therefore, the Government needs to provide more statistics on housing quantity and quality, as well as overseas speculation habits so that it can make better-educated interventions in the future.

### Conclusion

Rising house prices if left unchecked pose a significant risk to New Zealand's long-term fiscal position and standard of living. This essay has validated the claim that the New Zealand property market is facing a complex problem involving sticky supply, and proposed a lasting solution that will not only stabilise prices in urban areas, but also improve many key aspects within the Living Standards Framework for the whole country. Nevertheless, the current regulatory environment severely impacts the way in which the market functions, and it is strongly advised that the Government takes further steps to provide information so that effective demand side policies can be considered.

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