

# The Treasury

## Budget 2017 Information Release

### Release Document July 2017

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[40]	Not in scope	

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## Treasury Report: Impact of Accommodation Supplement Increases on the Housing Market

<b>Date:</b>	07 March 2017	<b>Report No:</b>	T2017/261
		<b>File Number:</b>	SH-3-2-18

### Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Steven Joyce)	<b>Note</b> the contents of the report	none
Associate Minister of Finance (Hon Amy Adams)	<b>Note</b> the contents of the report	none
Associate Minister of Finance (Hon Simon Bridges)	<b>Note</b> the contents of the report	none

### Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Corwin Wallens	Senior Analyst, Housing	[39] N/A (mob)	✓
Tom Hall	Manager, Housing	[39] [23] (mob)	

### Actions for the Minister's Office Staff (if required)

**Return** the signed report to Treasury.

Note any feedback on the quality of the report

**Enclosure:** No

# Treasury Report: Impact of Accommodation Supplement Increases on the Housing Market

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## Executive Summary

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Any changes to the Accommodation Supplement (AS) will impact on the household incomes of those receiving the subsidy, market rents, house prices, housing supply, labour supply, and the uptake of other forms of income assistance.

It is uncertain what impact an increase in the AS will have on private rental prices in New Zealand. Theoretically, this will depend on the impact price changes have on supply and the impact income changes have on demand. The supply of housing in some areas of New Zealand, in particular Auckland, is unresponsive to price changes in the short term. However, the impact on demand is unclear. Factors such as the structure of AS, knowledge of AS changes, and reaction to those changes by landlords and tenants also make the existence and extent of 'landlord capture' of any increased payment uncertain, and the extent of landlord capture may differ in the short term and the longer term.

Empirical research provides a wide range of potential impacts. The first stage of a study undertaken by MSD and MOTU into changes made to AS in New Zealand in 2005 (still in draft) found no statistically significant impact on rents paid by recipients as a result of increased payments. Internationally, a literature review commissioned in February 2015 as part of the Child Material Hardship Package estimates a range of landlord capture from 30-78% of housing subsidies. More-recent international literature suggests that the lower bound of the range of landlord capture is closer to zero.

Based on theory and on observation of unresponsive supply, there is risk of some landlord capture if the AS is increased, but there is no robust evidence of the extent of this effect. Demand characteristics of recipients, design features of the AS, and displacement of Temporary Additional Support (TAS), may limit this impact; the tight housing market in Auckland is likely to increase landlord capture more there compared with elsewhere.

Given uncertainty about the level of landlord capture, Ministers' willingness to accept risks:

- of low value-for-money (in the form of landlord capture)
- of possibly increased rents in the low end of the rental market for non-AS recipients

will be important factors in considering changes to AS.

## Recommended Action

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We recommend that you:

a **note** the contents of the report.

*Agree/disagree.*

Tom Hall  
**Manager, Housing**

Steven Joyce  
**Minister of Finance**

Hon Amy Adams  
**Associate Minister of Finance**

Hon Simon Bridges  
**Associate Minister of Finance**

# Treasury Report: Impact of Accommodation Supplement Increases on the Housing Market

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## Purpose of Report

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1. This report outlines the likely impact of increasing Accommodation Supplement (AS) payments on the housing market, responding to your request for advice on the topic. The report focusses on impacts on the rental housing market. However, the flow-through to house prices is also briefly discussed.

## Analysis

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### ***Accommodation Supplement***

2. The AS is a weekly payment to low-income tenants, boarders and homeowners in the private rental market. The payment is calculated based on incomes, family type, location and housing costs. In 2015/2016 \$1.2 billion in payments was made to around 290,000 recipients.

### ***Proposal to increase the Accommodation Supplement***

3. A proposal currently under consideration is an increase of \$475m per year in AS payments, with an offsetting reduction in TAS of \$117m for a net increase of \$358m in year one (a 30% increase in AS and TAS combined).
4. This has been modelled to result in 250,000 recipients receiving an average weekly income gain of \$24.50 (\$1,275 a year). Any new household formation or increase in market rents resulting from this change will add to the fiscal cost over time.
5. The proposed increase would involve three changes to the status quo:
  - Higher maximum payment levels, i.e. the maximum payment for households of three persons or more, living in area 1 (the highest cost AS area), moving from \$225 to \$330 per week.
  - Region reallocations (more regions to qualify for higher maximum payments).
  - Increased co-payment (AS to subsidise 75% of accommodation costs above thresholds, rather than 70%).

### ***Potential impact of increased housing demand on prices***

6. An increase in the AS may result in increased housing demand, which can impact the housing market in five ways:
  - AS recipients may have a higher willingness to pay for housing, leading to higher rents.
  - Renters of similar dwellings as AS recipients, but who are not receiving the supplement paying higher rents, face increased competition from AS recipients.
  - Renters of more expensive houses pay slightly higher rents, as a price premium compared to less desirable houses is maintained,

- House prices increase as their Net Present Value (taking into account the increased income stream from rentals) increases making rental housing a more attractive and 'bankable' investment. These increases in value may perpetuate any sentiment of further increases in capital values.
  - Substitution on the margin of properties from homeownership to rentals, increasing the supply of rental housing.
7. The impact of a change in AS on the housing market depends on the net effect of these interactions.

### ***Impact on supply of rental housing***

8. If the supply of housing is sensitive to price, increased housing subsidies would be comparatively effective. Suppliers of housing would respond aggressively to increases in demand for housing, resulting in more of an increase in quantity of housing than in its price.
9. Conversely, if supply is insensitive to price, increased housing subsidies would primarily serve to inflate prices, since the modest increase in quantity supplied would not offset the increase in demand.
10. A number of indicators in New Zealand, and particularly in Auckland, point to a supply-constrained housing market in the medium term, with the level of constraint varying by regional market:
- Rapidly inflating house prices (66% real increase from 2005 to 2015 in Auckland and 29% NZ).
  - Limited supply response to increases in prices, (11% increase in housing supply from 1,638,000 in 2006 to 1,817,000 in 2016).
  - Mortgage rate reductions from 2014 to 2016 coincided and possibly helped lead to a house price increase rather than a reduction in housing costs. Providing housing is a capital intensive business, and the cost of capital was reducing over the period. In a market with responsive supply lower capital costs can be expected to reduce prices.
11. In the longer term, housing supply will be influenced by a number of factors such as availability of land for housing (likely to be influenced by the Auckland unitary plan), cost of development, return on property (including rental returns).

### ***Impact of demand on rental housing***

12. The combination of the supply and demand response determines the likelihood and extent to which landlord capture results from an increase in the AS. As discussed above, in New Zealand, it appears there will be limited supply response to increases in demand for rental housing – especially in Auckland. Given this, the extent to which households spend any additional income (resulting from an increase in AS) on housing is likely to determine the level of 'landlord capture'.
13. The design of the AS means those receiving less than the maxima have greater incentive to consume housing over other goods (as the AS pays 70% of additional housing costs). However it is unclear the extent to which recipients understand or act in line with this 'optimisation strategy', as discussed further in the following section.

### *Factors in demand choices of AS recipients*

14. With the proposed AS subsidy design providing for 75% of housing costs above the threshold and below the maximum, households will face 25% of any increase in housing spending, and 100% of spending on other goods. When/if households reach the new maxima they will pay 100% of additional housing costs. The maxima increase will benefit those currently at maximum entitlements. This group of AS recipients has the highest current level of housing stress.
15. Currently over 20% (64,000) of AS recipients are also receiving TAS (almost always to help meet accommodation costs). TAS pays 100% of accommodation costs (up to a maximum level), as opposed to the 70% of costs which are met by the AS. Since TAS gives less incentive to reduce rent costs than AS, it is more likely to result in landlord capture than the same dollar increase in AS. Given an increase in the AS will reduce the incidence of TAS, there will be an offset in the likelihood of landlord capture.
16. The design of TAS is also more harmful for work incentives as it has a 100% abatement rate. Given 95% (62,000) of TAS recipients are beneficiaries, reducing the incidence of TAS receipt through an increase to AS is likely to improve incentives to leave benefit.
17. The awareness of both landlords and AS recipients of the amount of AS received may affect the decisions of tenants and landlords in the short term. Many AS recipients and landlords are not aware that the tenants are receiving AS. However, a major Budget announcement regarding AS changes may counteract this.
18. The impact of AS on demand is likely to be much smaller than other demand influences such as population changes, including internal movements and migration influences.

### ***Results of previous empirical studies***

19. Estimates from empirical studies should be treated with caution for a number of reasons:
  - a housing market can change, implying the need for care in making inferences about housing markets – even in the same area – at other times.
  - the characteristics of housing markets vary, limiting the applicability of overseas research to New Zealand in 2016.
  - separating out the influence of subsidies and other factors with confidence is challenging, generally resulting in significant assumptions, and
  - in many cases the method and modelling used are able to explain only a small part of the overall variation in rents.

### *A draft New Zealand study indicates no statistically significant market impact*

20. The Ministry of Social Development has recently undertaken analysis of the effect of the 2005 Working for Families changes to AS on rent paid by AS recipients. Draft findings from the first phase of a research study undertaken by MSD and MOTU indicates that the changes to AS made in 2005 (as part of the Working for Families package), that created a new boundary for the Auckland AS area, had no statistically significant impact on rents paid by recipients in the new area (now subsidised more generously), nor had any impact on the number of recipients in the new area (i.e. no movement toward the area with higher AS payments).

21. This is phase one of the analysis and is currently in draft form, with the first phase expected to be finalised in March. The authors expect to have completed the second phase by the end of April, which will include an exploration of impacts on rents paid by all recipients using MBIE bond data.
22. Treasury has compared rents paid by AS recipients with those paid by renters across New Zealand as a whole. Appendix 1 graphs these rents (in real terms) from 2000 to 2016 – a period that incorporates the AS changes which were part of Working for Families changes. The graph shows, at an aggregate level, that there does not seem to have been any change in the trend of real rents for AS recipients as a result of the Working for Families changes.

*International literature provides a wide range of market impact through housing subsidies*

23. There is no international consensus on the impact of accommodation support on rents, partly because the design of the support and specific market conditions can cause widely different impacts on rent prices.
24. A Literature review produced by AHURI on the impact of demand-side housing subsidies on the housing market was commissioned as part of the Child Material Hardship Package. This review looked at eight empirical papers from four countries (New Zealand, France, Finland and UK) that investigated the effect of demand-side housing subsidies on the housing market.
25. The report key findings were:
  - strong evidence to support the contention that a proportion of demand-side housing subsidies is capitalised into higher rents in the private rental market.
  - all studies noted that the extent to which housing supply responds to price changes is the key factor that impacts on the degree of landlord capture, and
  - estimates of the magnitude of landlord capture vary from 30 per cent to 78 per cent.
26. More recent international literature looks at the impact of cuts to housing benefits in the UK in 2011-12. This research concludes that the impact of these reductions fell on tenants rather than landlords, suggesting that the lower bound of the landlord capture range might be closer to zero.

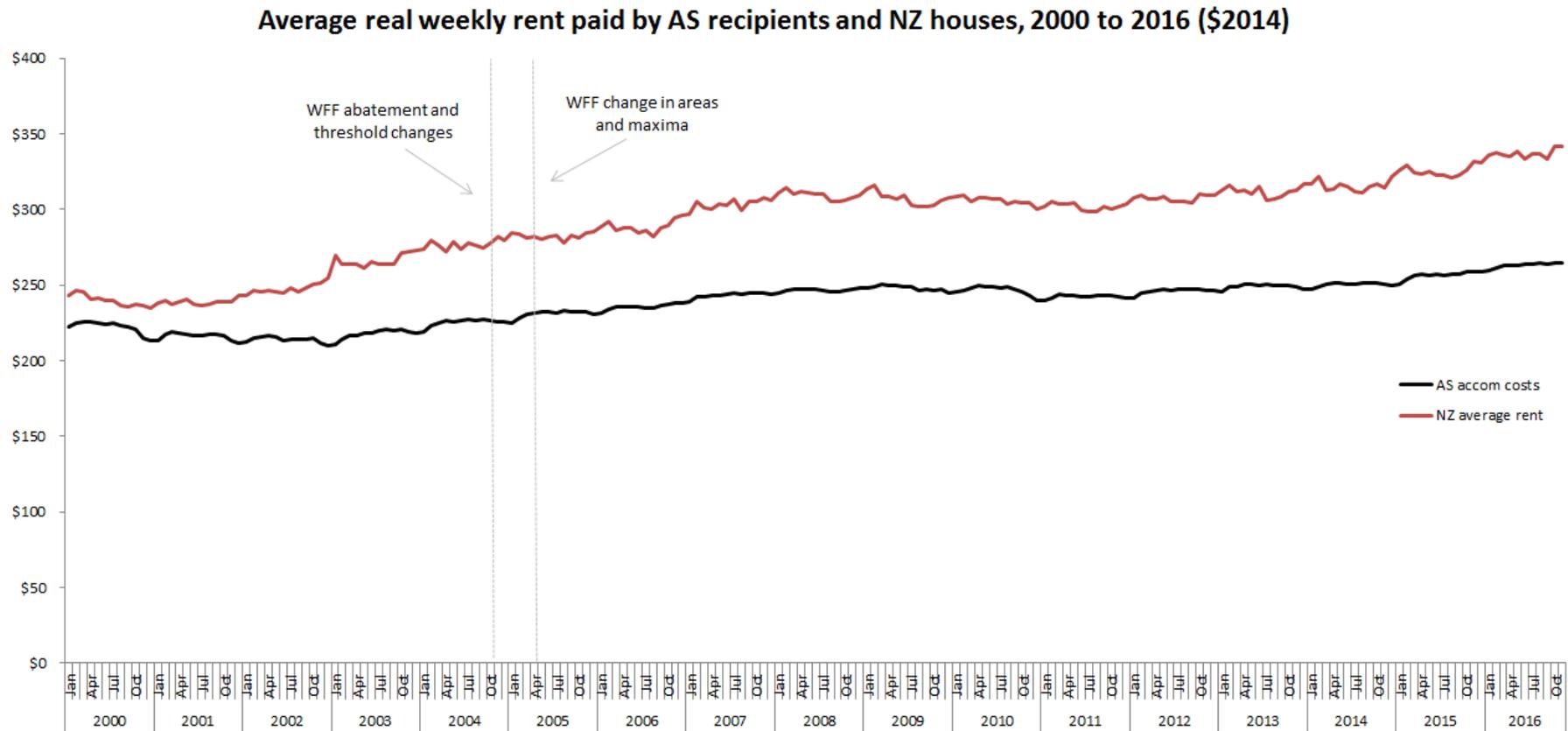
*Summary*

Empirical research suggests the likely level of landlord capture is uncertain. New Zealand research is limited and the international literature provides a wide range of market impacts. Given this uncertainty, Ministers' willingness to accept risks:

- of low value-for-money (in the form of landlord capture)
- of possibly increased rents in the low end of the rental market for non-AS recipients

will be important factors in considering changes to AS.

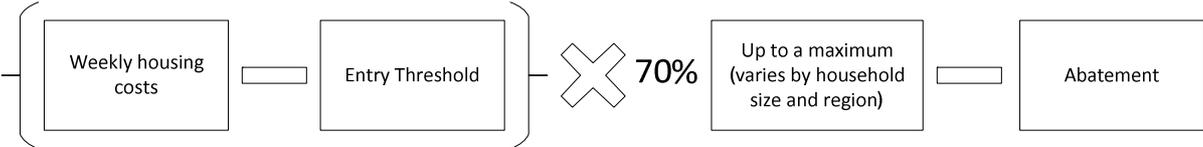
Appendix 1:



Appendix 2: Accommodation Supplement Information

- 27. The Accommodation Supplement subsidises 70% of accommodation costs above thresholds. These thresholds ('entry threshold') are set at 25% of the relevant benefit rate (and include 25% of the first-child rate of the Family Tax Credit (FTC) for families with children). For homeowners they are set at 30%.
- 28. Maximum levels of assistance are set for four different areas. AS abates at 25c on the dollar as income increases (once benefits have been fully withdrawn).

*The AS Formula*



- 29. In 2015/2016 \$1.2 billion in payments were made to 290,000 recipients. AS recipients are mainly at the lower end of the income distribution with almost two-thirds of recipients having an annual gross taxable income between \$10,000 and \$20,000. More information on who receives the AS is available in (T2016/2527).
- 30. Most AS households are single adults or sole parents, beneficiaries and working age. Uptake of AS by non-beneficiary households is low, likely associated with these households having no relationship with MSD.
- 31. The regional distribution of recipients is broadly reflective of the total population, with some variation due to demographic and economic characteristics of each region. While Auckland accounts for 31% of AS recipients, it accounts for 44% of AS expenditure. This reflects a higher average AS payment to recipients in Auckland than in other regions.

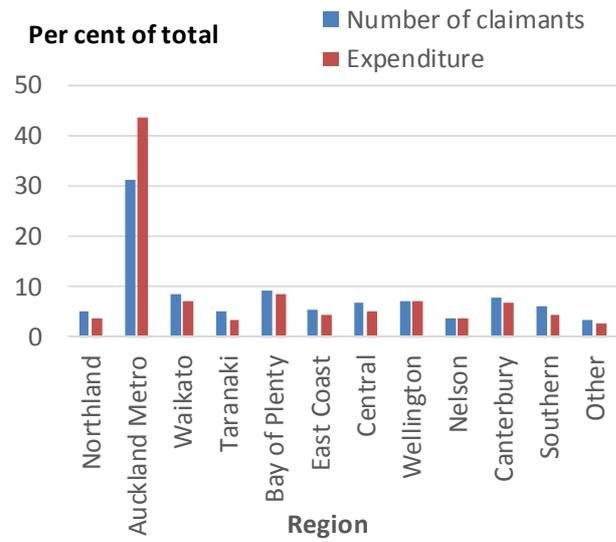
## Appendix 3: NZ Rental Market Context

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NZ Renting Households	555,900
Mean rent	\$381 per week
NZ annual rent estimate	\$11,013m
Net AS Increase (year 1)	\$358m

## Appendix 4: Regional Rental Market Breakdown

### AS recipients by region



### NZ rental market

