SUBMISSION OF THE SALVATION ARMY TO THE PRODUCTIVITY COMMISSION'S DRAFT REPORT ON ITS HOUSING AFFORDABILITY INQUIRY

Overview:

The Salvation Army welcomes the Productivity Commissions draft report on its Housing Affordability Inquiry. While the Army does not agree with all the perspectives, conclusions and recommendations contained within the draft report we commend the Commission for its work in this report. In particular we commend the Commission for the thoroughness of its analysis and consultation and for the way in which it has ventured off the track of its brief to consider issues which are in our view critical to the challenge of improving housing affordability in New Zealand.

This submission discusses briefly some of the perspectives offered in the draft report and then goes on to comment on some of the individual findings and recommendations. We have followed the subject headings provided in the report as the basis for these responses.

Macroeconomic factors:

The Salvation Army is disappointed at the fairly light treatment of macroeconomic factors in the draft report and we believe that the final report would be enhanced if more attention was paid to this dimension of the housing question.

The draft report accurately identifies the many and often complex links between housing markets, the business cycle and the broader economy. These links are well known but perhaps not well understood as the draft report itself identifies that the global financial crisis has at least taught central banks and policymakers some expensive lessons in the need to manage asset bubbles more actively. The report also identifies the mechanisms by which New Zealand, and Australia for that matter, have escaped the worst of the house price corrections which we have seen in the United States and the Eurozone.

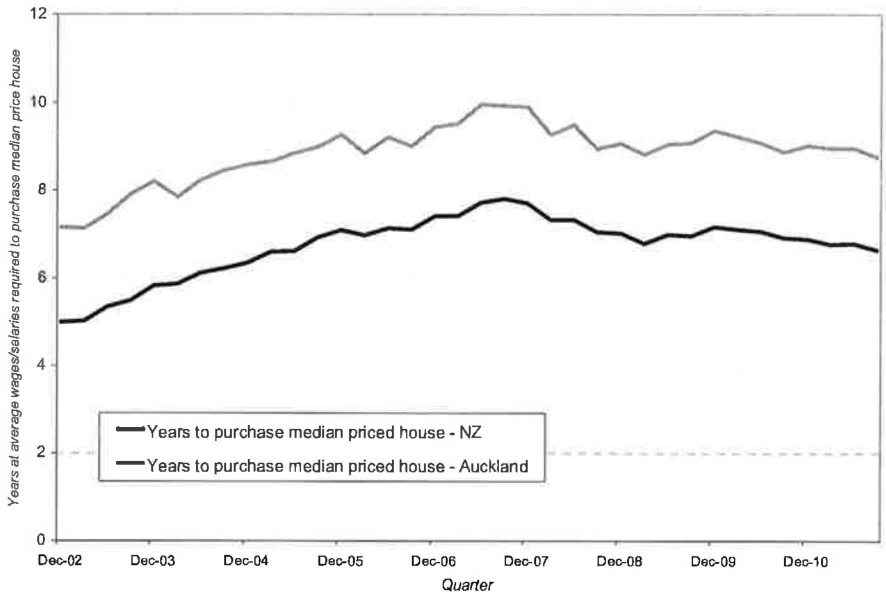
The draft report does not however discuss two aspects of current housing market settings which we believe are important both for undertaking a deeper reflection on what went wrong in policy terms and for understanding the medium term prospects for the housing market. These two aspects are house prices and housing related debt.

In addition the draft report, in our view, fails to adequately critique the distorting effect which the housing price boom had on the wider economy and particularly on the tradeable sector. We see such a critique as being essential in an exercise such as this as the macroeconomic distortions of the housing price boom have impacted on the productivity of the New Zealand in a number of ways. These ways may include through changing saving behaviours, encouraging excessive consumer spending through equity withdrawal and by creating an over-valued dollar with the need to borrow offshore to finance housing investment. It is perhaps arguable that such outcomes impact directly on productivity although this perspective depends in part on how loosely or how tightly we define productivity. Some may also argue that these outcomes are not distorting since they are the result of consumer choice although such a line of argument is based on a philosophical view of how the economy should be run.

The questions of housing prices and housing related debt remain daunting for the future of New Zealand's housing market as most likely the Commission is well aware. House prices have to date headed for a soft landing whereby we have witnessed more or less static nominal house prices against a background of modest inflation and growth in wages and salaries meaning of course declining real value and gradually improving affordability.

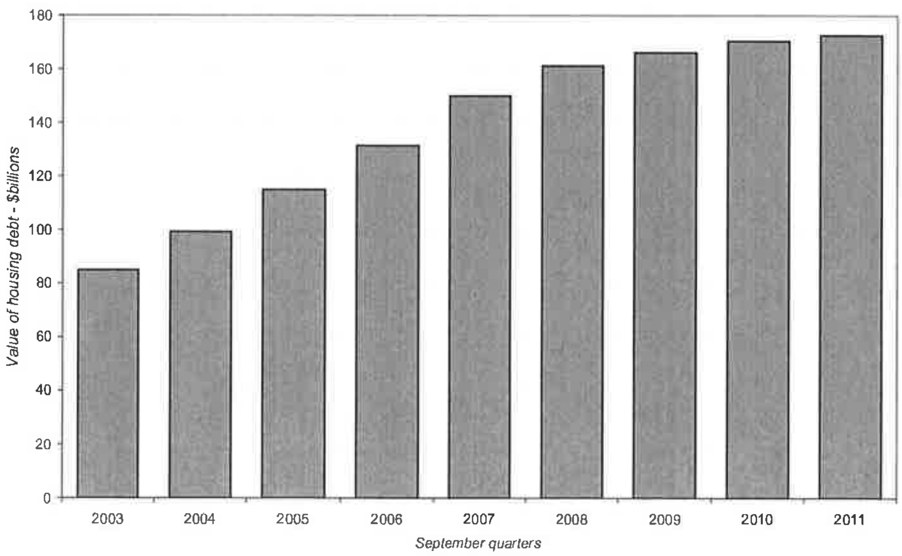
This trend of improving affordability is illustrated in the following graph which simply compares the median house price with average value of wages and salaries to estimate the number years it would take to purchase a house[1]. Clearly affordability - by this measure has improved gradually since late 2007 but the progress is exceedingly slow and at this rate it will take a considerable time for affordability to regain the levels prior to housing price boom.

FIGURE 1: Housing affordability trends 2002-2011



A similar picture of gradual improvement emerges around housing related debt as shown in the graph below. This debt doubled in nominal terms between 2003 and 2010 and increased as a share of GDP from 63% in 2003 to 90% in 2010 but has since fallen to 86%. These trends are no doubt well known to the Commission.

FIGURE 2: Housing debt trends 2003-2011



These trends in house prices and housing debt may act as drag anchor on the housing market and on consumer spending for the next decade or more. The economic settings are not encouraging for a quick recovery. The present household income and house price settings are not stimulating new house construction of sufficient volumes to meet latent housing demand despite the historically low mortgage interest rates. If households choose to pay down debt - as they appear now to be doing

[1] The Salvation Army suggests that measures such as these present a more realistic picture of housing affordability than those affordability indicators which include interest rates and mortgage servicing costs because such rates and costs can change quickly so that indicators based on them do not accurately portrait longer-term more structural trends

then consumer demand will be muted - as it appears to be at present. Moreover wages and salaries have barely moved in real terms over the past two years which suggest that the capacity of households to finance more housing will be quite limited at least in the short term.

The housing market landing may indeed be soft but we may take a decade or more to glide toward it and all the time jettisoning the housing needs and aspirations of younger generations. Perhaps the only comforting feature in such a scenario is that the same future may also play out across the Tasman meaning that these younger generations are no better off there and so are unlikely to leave New Zealand simply because of their rather bleak housing prospects.

As discussed below, the poor prospects for a market led adjustment to New Zealand's housing market doldrums create real concern - at least for The Salvation Army, that we will see a growing housing shortage especially in the private rental market and particularly in Auckland. These concerns appear to be shared with the Commission.

From The Salvation Army's perspective the most regrettable shortcoming in the draft report's discussion of macroeconomic factors is its failure to consider what macroeconomic policy levers could have been used to moderate the excesses illustrated in the above graphs and what policy levers are available now to avert a looming housing shortage. The Army acknowledges the Commission's suggestions for regulatory reform and for greater spending on social housing but is of the view that the proposed reforms will at best be only a partial measure and that any increased spending by Government on supply side measures such as new house building will lack any ambition to address the problems. On any account it is important that regulatory reform and fiscal measures, such as increased public spending on housing, are cast into a macroeconomic policy framework to ensure that they are effective and not counter-productive. The default housing policy settings of the past decade of benign tax treatment and under-regulated mortgage finance markets illustrate well what happens when we ignore the wider implications and impacts of housing markets on the broader economy.

Right now the "head in the sand" approach of policymakers and their unspoken belief that market processes will work away the problems of unaffordable housing, high housing debt and a limp rental housing market need to be challenged. The Salvation Army believes that the Commission could offer this challenge in this report by taking a broader perspective on the macroeconomic settings of the present housing crisis.

Taxation

While The Salvation Army supports most of the conclusions in the Commission's discussion on the tax treatment of housing we believe that it has taken a fairly narrow view of taxation policy and that this has limited the scope of any conclusions or recommendations which may have emerged from this discussion.

The Army accepts the Commission's claims that the taxation of housing and especially of owner-occupied housing is a complex and multi-faceted question and that the extent to which housing has been favourably treated by recent tax policy may have been over-stated. It is however difficult to see that the massive investment in rental housing by small scale investors over the past decade or so was not motivated almost entirely by tax avoidance and capital gains. Certainly the returns from rents, by themselves, would make rental property investment unattractive. Tax policy therefore has influenced the rental property market and while it may not be the case that this influence in turn led to inflated house prices it is certainly the case that this influence has skewed households' investment decisions at the expense of investment other types of assets[2]

The Army also accepts the Commissions suggestions that it is important to take a comprehensive view to tax policy and that we should not engage in knee-jerk policy responses to mend perceived holes in the tax net around housing. In undertaking such a comprehensive assessment it is however

[2] Reserve Bank figures on household assets and liabilities report that the share of household wealth held in housing increased from 83% in 2000 to 97% in 2010 while net financial assets declined from $50 billion to $29 billion over the same period

important to be mindful that taxation and tax policy can be used to serve a number of purposes and not just that of raising revenue for the State. For example taxation can and is used to ensure beneficiaries of a programme or policy pay for them or to moderate behaviour or to re-distribute wealth and income.

With the exception of the beneficiary pays principle and its application to infrastructure charges, the Commission's discussion around taxation has largely ignored its role as a policy tool. Instead the Commission's approach to taxation appears to be one of limiting the market distorting effects of taxation which from The Salvation Army's perspective is a shame. While we concede that the use of taxation to achieve a wider range of policy goals is a vexed and risky, it is important to place the whole menu of opportunities on the table rather than to imply, by omission, that our choices are limited to whatever will not upset the status quo too much. This in our view is a failing of the draft report.

Urban planning:

The Salvation Army largely agrees with the Productivity Commission's analysis of the problems around urban planning especially as this is practiced in Auckland. The Army's Social Policy and Parliamentary Unit has already made extensive submissions to Auckland Council on its spatial plan raising similar concerns about the lack of interest in housing affordability in that plan specifically and in the work of that Council in general.

The Army agrees with the Commission's assessment that councils are not good at managing and balancing the range of social, economic and environmental objectives they are required to focus on under the Resource Management Act and the Local Government Act. This task is a difficult one especially within an urban region such as Auckland which is growing quickly and changing rapidly. This task is not made easier by the inadequate legislation which local government is required to work under. Large parts of the Local Government Act date back to 1974 and other parts have been amended in quite ad hoc ways by meddling local government ministers who have little knowledge of this sector. The Resource Management Act is not an urban planning statute but an act designed to manage the environmental effects of resource uses. Add to these complications and contradictions the requirement by Government that Auckland's infrastructure and public assets are run by independent statutory boards with open access to ratepayers' pockets and it is little wonder that the planners of Auckland Council are struggling.

At the heart of what is a long running dispute around urban planning in Auckland is the degree of regulation or constraint that should be placed on development of rural land on the urban fringe. The Commission in our view appears to lack a depth of knowledge about this issue to be able to appreciate both the game playing involved and the truly difficult trade-offs which are required of Auckland Council. It is for example quite naïve to believe either that Auckland Council planners are hell bent on urban containment/consolidation at the expense of housing affordability or that the regulatory regime under which urban expansion can be coordinated is a straightforward process.

A more flexible approach to re-zoning land for more intensive development is certainly required whether this land is brownfields or greenfields. There is however some risk with having a too liberal zoning regime whereby large tracts of land are re-zoned in anticipation of housing demand in that the resulting development can be fragmented and disconnected making them difficult to service. Such fragmentation and disconnection is a significant threat to the livability of urban environments where residents have limited incomes as would be the case in developments of affordable housing. These concerns of livability and isolation for low-income communities are seldom the concern of landowners or developers or their advocates so are unlikely to be heard by review bodies such as the Productivity Commission or even the planning committees of Auckland Council. They are however a concern for The Salvation Army and it our advice to the Commission that it should be mindful of the social and economic environments which are likely to be created by an unduly permissive approach to urban expansion and re-zoning of land on the urban fringe.

It is also important to learn from recent history in order to examine the premise which underpins the argument that it is urban containment policies which have forced up house prices and made housing unaffordable for modest income Aucklanders. Land on Auckland's urban periphery has been released recently in places such as Hingaia and Takanini in the south and in Silverdale and Hobsonville in the north. The housing developed in these areas has ranged from around $400,000 per unit in Takanini to $600,000 to $800,000 elsewhere. There appears to be sufficient vacant land to meet demand in all these areas so it is not scarcity which is keeping prices high but rather the expectations and marketing of the developers. The lesson to be drawn here is that market driven greenfields development is unlikely to provide the opportunities for development of affordable housing which the Commission and The Salvation Army believe is required.

In fact the opposite may result. Landowners and developers may deliberately set out to prevent affordable housing development from taking place in their developments through such techniques as restrictive covenants, minimum lot sizes and maximum densities. Such approaches are often supported by local residents who wish to maintain their property values and fear that nearby affordable housing will risk these values. The difficulty which Housing New Zealand has had in undertaking developments in middle income communities illustrates well the resentment such communities have toward affordable housing.

A trickle down type argument might be advanced by those in favour of a more liberal approach to urban expansion and re-zoning. This argument runs that supply constraints in higher priced housing sub-markets knock down to lower priced markets and so cause land values and hence house prices to be higher across the board. These sort of impacts are easy to model econometrically but difficult to prove empirically outside of observing that land prices vary away from the centre and across zone boundaries. The fact is that house prices are conditioned by a number of factors some of which have been identified in the draft report. These include surges in immigration and easy liquidity in capital markets which made it relatively easy to borrow as well as constraints on land supply through restrictive or unresponsive zoning..

Affordability where it bites:

The Salvation Army is glad to see the inclusion of this discussion of affordability as it provides some useful insights into the current somewhat confused mix of housing assistance programmes and of the challenges New Zealand faces in ensuring that modest income households will be able to rent affordable good quality accommodation.

We share the Commission's concern that the private rental market will not be able to provide sufficient dwellings to accommodate households in the so-called intermediate market. The Army's Social Policy and Parliamentary Unit estimate that over the next 20 years a further 70,000 to 75,000 rental units will be required to meet demand, about two thirds of which will be needed in Auckland. This to us seems a huge challenge particularly given the low returns presently being generated from private sector rents and the uncertain future around house values.

It seems likely to us that rents will begin to rise in real terms as housing shortages increase especially in Auckland and some other North Island cities. Such increases not only impact on the financial wellbeing of tenant households but also pose a fiscal risk to the Crown in terms of needing to fund higher and higher Accommodation Supplement payments. We concur with the suggestion by HSAG that the annual cost of the Supplement could top $2.2 billion by 2015.

Such a blow out in the cost of the Accommodation Supplement suggests to us that the Crown has few if any low cost options for dealing with the affordable housing problem. Its options in fact are quite stark and involve continuing to fund what are often quite poor housing outcomes through the Accommodation Supplement, or injecting more capital into Housing New Zealand for it to build more state homes or for this capital to be available to the community housing sector for its expansion particularly into the intermediate rental market.

The Salvation Army supports the Commission's enthusiasm for future investment into the community housing sector. In supporting this sector we ask the Commission to be mindful that the sector requires significant sums of capital from the Crown if it is to grow to the scale now being achieved in Australia. An adequate capital budget would be in excess of $100 million per year and be available as part of five to ten year programme. Current funding arrangements which suppose significant levels of equity from community housing organisations are not viable even over the medium term as these organisations use up the equity on their balance sheets and as the scale of developments begins to outstrip the capacity of the philanthropic sector to offer co-funding.

The Army also supports the Commission's call for clarity around the governance arrangements for the Social Housing Unit and prefers that this Unit be set up as an autonomous state owned enterprise.

Conclusions:

The Salvation Army supports the Commissions recommendations as follows

R7.1 calling for Auckland Council to account for its planning for affordable housing

R7.3 suggesting that Auckland Council consider collaborative models for the assembly of development opportunities.

R8.1 suggesting the updating of the best practice guideline for development contributions and their inclusion into statute

R11.1 suggesting the establishment of the Social Housing Unit as a separate Crown Entity

R11.2 recommending an increase in funding available for the constrution of social housing units and the use of the community housing sector to provide these.

Finally we would like to thank the Commission for the thorough and thoughtful analysis which is behind the draft report and for its clear identification of many of the complex issues behind New Zealand's affordable housing problems.