

5th Australasian Housing Researchers' Conference



17-19 November 2010, University of Auckland, New Zealand.

New Zealand Housing Report 2009/2010: Structure, Pressures and Issues

David Brosnan

Department of Building and Housing
david.brosnan@dbh.govt.nz
Phone: +64-4-817-4280

Hilary Croke

Department of Building and Housing
hilary.croke@dbh.govt.nz
Phone: +64-4-817-4252

Julie Loke

Department of Building and Housing
julie.loke@dbh.govt.nz
Phone: +64-4-817-4278

Keywords: New Zealand Housing; housing demand; housing supply; housing issues;
building

Abstract

In 2008 the Department of the Prime Minister and Cabinet identified the need for a regular report on the state of the New Zealand housing market that specifically addresses the decline of affordability resulting from the acceleration of house price growth over household incomes. The Department of Building and Housing has now published a New Zealand Housing Report based on a framework developed by the Australian National Housing Supply Council in the publication of their annual *State of Supply Report*.

The inaugural *New Zealand Housing Report* pulls together the information available to look at the overall balance of housing demand and supply in New Zealand, specifically identifying the size and characteristics of the current and forecast housing demand-supply imbalance. The report focuses on the demographic factors influencing demand such as changes in household size and formation, natural increase in the population growth rate, and immigration, rather than demand arising from economic factors, which can be difficult to pin

down and quantify. Over the forecast horizon, the report finds current volumes of new housing supply are not sufficient to adequately meet expected household growth rates particularly in Auckland. The implication of this finding and the objective of this report is to establish a factual foundation from which the public and private sector can lead discussions on policy options to address issues affecting the housing market in the medium and long term. It is hoped that future reports will be more comprehensive and robust as more information is gathered.

1. Introduction

This paper is a summary of the *New Zealand Housing Report* published in October 2010. The full report is available at <http://www.dbh.govt.nz/nz-housing-report>

This first *New Zealand Housing Report* provides a broad overview of the housing market conditions in New Zealand's building and housing sector. It is the first document to pull together in one place all the information available and look at the overall balance of housing demand and supply. The report provides reference material that all participants in the sector (both public and private) can use to improve their understanding of the housing market and therefore the quality of their decisions.

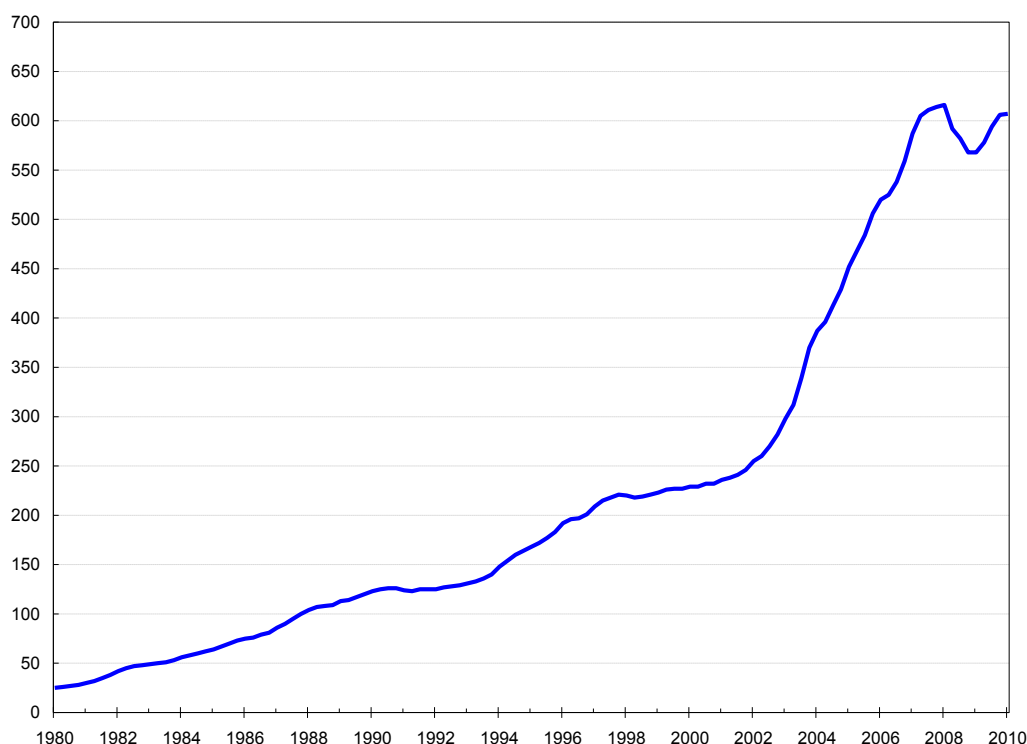
However, the report's conclusions must be treated with some caution, both because of the complex nature of the subject and because of some gaps in data. Caution is required in these two areas in particular:

- **Distinction between 'underlying' and 'effective' demand** – The underlying (or population-driven) volume of demand is distinct from effective (or economic) demand, which is the combined effect of consumer-investor aspirations or desire to rent or buy and their financial ability or willingness to do so. Forecasts of demand in this report are based on population-driven analysis; the impact of income limitations and buyer preferences is commented on but not quantified.
- **Numbers of permanently occupied houses** – Significant gaps in the available data mean we cannot be certain what proportion of new dwelling consents translate into permanently occupied houses. Nor do we know what proportion of dwellings that are recorded in Census data as not permanently occupied are vacant and available to be occupied, as some of these will be holiday homes, under repair, or unavailable for some other reason.

2. The Broader Impact of the Building and Housing Sector

The building and housing sector is a key component of our economy and is central to our well-being. Construction activity contributes 4–5% of GDP, while the sector employs 8% of the New Zealand workforce. The nation's housing stock is valued at approximately \$600 billion, which is 12 times greater than the capital value of the New Zealand share market (approximately \$50 billion).

Figure 1 – Value of housing, 1980–2009
(**\$ billion**)



Source: Reserve Bank of New Zealand

Housing accounts for 22% of average household expenditure for owner-occupied households, and 28% of average household expenditure for renters. Further, home-ownership is closely linked to household asset accumulation and wealth, with housing's share of total household assets amounting to approximately 75%.

An effective building and housing sector is an important component of successful cities, which in turn contribute to productivity, innovation and economic activity.

Housing contributes to social outcomes in many ways. Homes provide shelter and space for family living; where a person lives influences access to work, schools, shopping centres, leisure facilities and other private services and public activities used regularly by the household.

Housing adds to the health, safety and well-being of individuals and families. Good housing can create positive spill-overs for households, while poor housing can create negative ones. The positive spill-overs can be separated into those areas related to good-quality housing, stable housing, neighbourhood effects, and home-ownership.

Conversely, rising house prices and declining rates of home-ownership add to widening wealth and income inequalities. A volatile housing market complicates monetary policy, and there are potential spill-overs to the tradables sector and wider economic performance (through the housing 'wealth effect').

3. Significant Housing Policy Issues

There are a number of significant housing policy issues confronting the sector, including:

- the implications of declining home-ownership rates
- how to increase the supply of affordable housing and ensure that low-income households can access suitable dwellings
- the need to free-up regulatory constraints on new housing development
- how to turn around declining productivity in the sector at a time when input costs are rising faster than incomes.

4. Key Findings in the Report

Housing Demand

Housing demand is determined by the willingness of households to pay for somewhere to live. There are many ways to analyse the determinants of housing demand – for example, by looking at demand-to-own versus demand-to-rent, consumption versus investment preferences, or demand for apartments versus demand for stand-alone houses.

In the annual *State of Supply* reports released by the Australian National Housing Supply Council (NHSC, 2008 and 2010), the analysis is based on a distinction between ‘underlying’ demand and ‘effective’ demand. Underlying demand is a measure of the number of houses needed based on population growth rates and forecasts, and is based on assumptions – generally static – about household formation. Effective demand, by contrast, is a market-based concept, centred on the conception of a willing buyer who has access to sufficient income or finance to complete a transaction with a willing seller.

The difference between underlying and effective demand is a function of:

- buyer wealth and income
- the cost and availability of finance
- the state of the economy
- individual consumer preferences (for example, location, or between renting and owning)
- the attractiveness of housing as an investment good.

The report does not attempt to forecast effective demand. Instead, it sets out some of the key elements that would need to be factored into a model for estimating effective demand, and it comments on current trends in those variables.

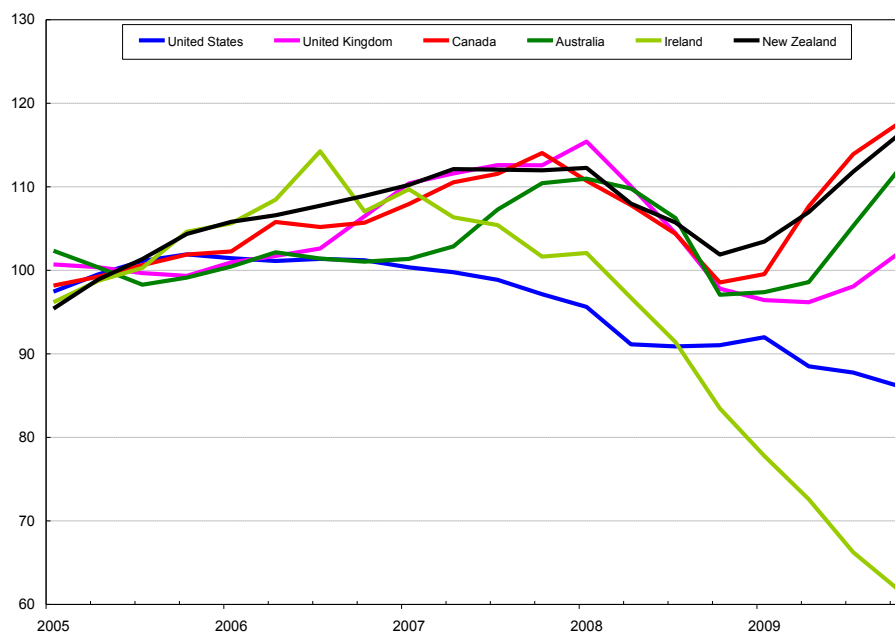
The report estimates underlying housing demand in New Zealand to grow by more than 20,000 households per year (on the basis of forecast population/household growth), with most of that growth occurring in the Auckland region.

In the future, household formation – and therefore housing demand – may be constrained by housing prices and affordability.

House prices have risen faster than incomes to a current level that is arguably unsustainable. Figure 2 shows the house-price-to-income ratio not only continues to be higher in New Zealand than other Organisation for Economic Co-operation and Development (OECD) countries, but that it has reached a new peak. The high house-price-to-income ratio has led to

changes in tenure, declining home-ownership rates, affordability issues, and further, it has the potential to exclude first-home buyers from entering the market.

**Figure 2 – Ratio of house prices to income
(Index 2005 = 100)**



Source: Organisation for Economic Co-operation and Development data to 2009Q4.

The high house-price-to-income ratio is linked to the changes in preference between ‘consumption’ demand and ‘investment’ demand for housing. Current house price levels appear to be the result of demand for housing as an investment good, rather than being the result of growth in household incomes or being justified by current and expected rental yields.

Housing in New Zealand has been considered an attractive investment for a number of reasons:

- Investing in a tangible asset – in ‘bricks and mortar’ – is seen to be safe.
- Demand for housing is reliable, because housing meets the basic need for shelter.
- Financial investments are seen as intangible, more complicated, and less easily understood.
- The New Zealand financial market is smaller, more volatile and more vulnerable to global events compared with other developed economies like Australia and the US.
- Both the global financial crisis and the recent string of financial corporate collapses have damaged individual investor confidence in financial markets.
- There are tax advantages to investing in housing, namely; the ability to deduct investment losses against other income and many investors not being liable for tax on capital gains.
- Housing investments generally provide high returns during periods of strong investor demand.

Too much investment in housing can create economic imbalances and a misallocation of resources. It can also introduce distortions and perverse incentives. Just like financial assets, house prices can become over-inflated as investors enter the market to make short-term gains. This drives prices up further, increasing the volatility of the market and creating or contributing to a boom-bust cycle.

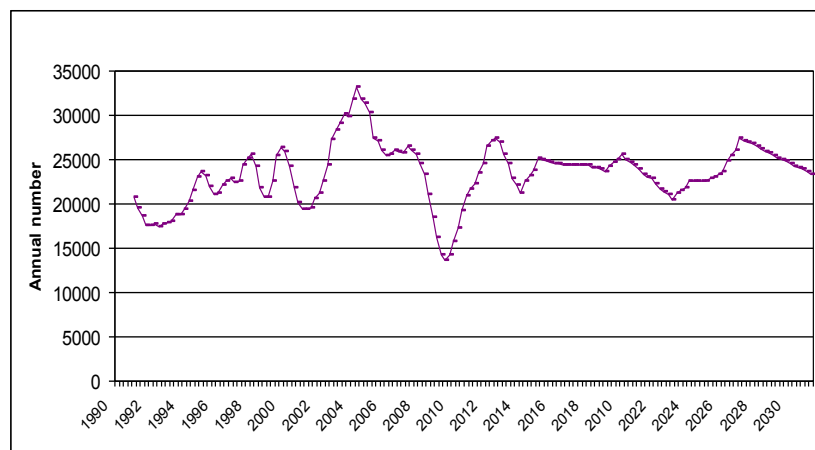
Further, when house prices are not accurately aligned with incomes and population growth rates, inflated values encourage homeowners to withdraw equity from their home to fund other consumption. The deregulation of credit markets, increase in financial innovation and competition from non-bank financial institutions have combined to make withdrawing home equity a relatively easy and cheap way for home-owners to obtain funds, whether this is done to pay off consumer debt, invest in other assets, or to fund consumption.

Of particular concern is that overinvestment in housing contributes to lower investment levels in more stable long-term assets that expand the economy’s productive capacity (that is, investment in business and infrastructure).

Housing Supply

The current annual rate of new housing construction (in mid-2010 about 16,000 dwellings) is below the rates of population and household growth, and is lower than the Infometrics forecasts of new dwelling consent volume used in the report.

Figure 3 – Projections of new dwelling consents, 2010–31



Source: Infometrics forecast, November 2009

Residential construction costs increased rapidly from 2003 to 2008, partly due to low productivity in the industry. Currently the residential construction industry is fragmented, with most residential construction firms being too small to take advantage of economies of scale. The fragmented structure of the industry and its reliance on high debt levels, both present a risk to future growth in activity levels.

Regulatory frameworks increase housing costs significantly. These include land supply constraints such as MULs (Metropolitan Urban Limits), restrictions on higher-density development, complex consenting processes, and levies on development and infrastructure.

Initiatives aimed at reducing regulatory costs include:

- the Better Building Blueprint, to make it easier and cheaper to build good-quality homes and buildings by supporting standardised solutions to deal with simple, straightforward consents

- multiProof, the new National Multiple-Use Approval service, which enables building designs that are to be replicated across different regions and districts to be pre-approved for Building Code compliance
- a review of the Building Act 2004, to find out how the Act could be updated to minimise the cost of compliance without compromising quality of building and construction.
- a review of the Resource Management Act 1991.

New Zealand will need to either release new supplies of residential land, or make more intensive use of existing residential land to meet the needs of its growing population.

The Shortfall between Demand and Supply

Comparing housing demand (measured by the number of households) with supply (measured by the number of private occupied dwellings) shows a growing shortfall in supply. Table i shows forecasts the shortfall will be 14,772 dwellings over 2011–16, 10,603 dwellings over 2016–21, and 14,054 dwellings over 2021–26. The trend is expected to reverse over 2026–31, with a forecast surplus of 2,322. This reversal is a result of an expected increase in new dwelling exceeds the expected increase in the number of households over 2026-31.

Table i – Current and projected national housing shortfall/surplus

Period	Expected increase in the number of households	Expected increase in the number of new dwellings that would add to supply	Shortfall/surplus
2006 – 2009	66,000	55,734	-10,266
2009 – 2011	45,000	28,419	-16,581
2011 – 2016	112,800	98,028	-14,772
2016 – 2021	108,000	97,397	-10,603
2021 – 2026	104,000	89,946	-14,054
2026 – 2031	99,000	101,322 ¹	2,322

Source: Statistics New Zealand, Department of Building and Housing estimates using data from Infometrics

At a regional level, the shortfall in the Auckland region is projected to be the largest in the 20 years to 2031.

There is a need for more data on building consents to allow better estimates and projections of housing supply and therefore of the shortfall between housing demand and supply. Alternative measures of housing pressures include homelessness, household crowding, and the number of unoccupied dwellings, but these are also subject to limitations imposed by the quality or availability of data.

The effects of low rates of new housing construction and a growing demand/supply shortfall appear to be offset, at present, by lower than expected rates of household formation. More people are remaining at home for longer, rather than flatting and forming new households. The result is that the average household size is increasing, and this is limiting the growth in demand for housing.

¹ The higher increase in new dwellings added to 2026 – 31 reflects the cyclical nature of new dwelling consents forecasts rather than specific events which are expected to cause a spike in new dwelling consents over this period.

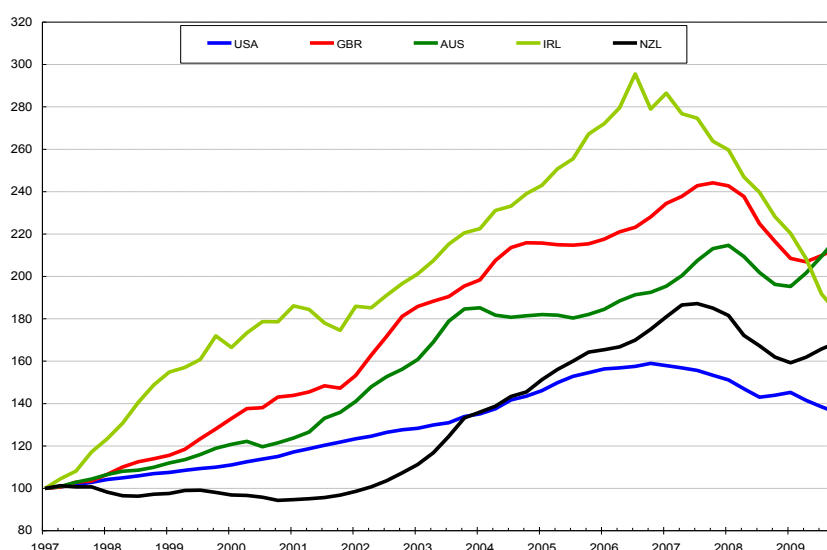
The 2009 *Social Report*, produced by the Ministry of Social Development (MSD), reported that in 2006 10% of New Zealand’s population were living in ‘crowded’ housing. The Report found that, by ethnicity, the proportion of the population living in households that required at least one additional bedroom in 2006, was highest among Pacific peoples (43%), Māori (23%), and the Asian community (20%). Only 4% of European New Zealanders are in living arrangements that meet the ‘crowding’ definition.

Cultural and economic factors were seen to be the main drivers of the differences in crowding levels among the ethnic groups. The population age structure of these groups also played a part, as the Māori and Pacific populations have a younger age structure compared to Europeans.

House Prices

Over the past decade in New Zealand, there was a surge in demand for housing, which saw house prices accelerate. High prices were driven by high immigration, lower interest rates, increasing availability of credit, a tax system bias that encouraged investment in rental property, and expectations of future increases in house prices. Figure 4 shows that several OECD countries also experienced an acceleration in house price growth over the same period.

**Figure 4 – Real House Price Index (base 1997)
(1997Q1 = 100)**



Source: Organisation for Economic Co-operation and Development

With house prices increasing faster than incomes, a large segment of first-home buyers have been effectively shut out from home-ownership. As a result, the composition of the private rental market is shifting towards intermediate private renters, such as older and family households who in the past would have expected to move into home-ownership. These people are likely to want more stable housing tenure options than the private rental market currently provides.

These changes point to the need for a growing supply of rental property that provides the greater stability of tenure required by this segment of the rental market. The question is raised whether more rental property will be supplied by private investors.

Combined with an increase in demand for social housing assistance, these changes could lead to an increasing number of households that will not be able to accumulate wealth through the traditional channel of home-ownership.

DTZ (2008) show in a projection under the scenario of ‘moderate house-price growth’, the number of households in the intermediate housing market is expected to increase to 200,880 in 2011, and to 261,160 in 2016. Table ii presents the impact of moderate house-price growth on the sizes of the three segments of the private rental market.

Table ii – Projected growth in private rental market based on moderate house-price growth

	2006		2011		2016	
	Number of households	% of rental market	Number of households	% of rental market	Number of households	% of rental market
Not-in-work renters	59,400	18%	63,600	16%	67,930	15%
Intermediate renters	187,260	58%	200,880	49%	261,160	57%
Relatively well-off renters	75,300	23%	143,890	35%	126,850	28%

Source: DTZ New Zealand Limited, July 2008

These projections of an increase in rental market demand mirror the *Housing Report’s* projections of the shortfall in housing supply in the major urban regions. They also reflect a continuing shift away from home-ownership to renting. According to DTZ report on *Private Rental Market in New Zealand* (2008) for the Department of Building and Housing, there are significant market and social implications, including:

- increased overcrowding, rental turnover, and demands for housing assistance
- sub-optimal settlement and commuting patterns
- the spill-over effects of a larger rental market on the mainstream economy – that is, the growing inability of workers in essential occupations (such as police, nurses and teachers) to own in areas where they work will affect the efficiency of the local labour market and the availability of labour in these key occupations
- the impact of the shift in conventional wealth accumulation through home-ownership on the level and type of consumption support that government needs to provide for those in the rental market during old age
- tenure stability and security for those in the rental market.

5. Conclusion

The *Housing Report* has described housing market trends and, given the economic and social importance of the sector to New Zealanders, points to the need to further develop knowledge about the drivers of trends in the building and housing sector. There are four areas where the sector can build up its knowledge on :

- **Deepening our understanding of the rental market.** The rental market in New Zealand is not as well understood as the homeownership market, despite it becoming an increasingly popular choice of tenure for New Zealanders. Some important work has been recently undertaken (such as that on the intermediate rental market), but gaps still remain and base information on the rental sector is inadequate.

It will be necessary to develop new information sources and to better tap the resources that do exist for research purposes.

- **Building an analytical framework for understanding effective demand.** Most projections of housing demand use underlying demand as their basis – factoring in population growth, household size dynamics and migration. However, the recent housing boom and then the financial crisis have served to highlight how important a range of economic and financial factors is in driving housing demand – what is known as effective demand. Understanding effective demand is a complex and multifaceted task, requiring a rigorous analytical framework to guide research and policy choices. Recent work on the links between monetary policy and the housing market, and the development of a simple model of rental and ownership² have filled important gaps in some areas, but many still remain if we are to gain a comprehensive understanding of effective demand.
- **Extending our understanding of the supply-side.** Several information gaps exist which limit the accuracy of any estimation of housing supply. Adjustment assumptions must currently be made in the absence of accurate information on, for example, the demolition rates for dwellings or the non-completion of dwelling consents. In addition, a deeper understanding of the housing supply chain and market structure is needed as these are critical factors influencing the quantity of new housing supplied and the cost and prices of this housing.
- **Measures of affordability.** Affordability is a key measure for policy makers and the industry. It can act as an indicator of how the broader market is tracking over time, particularly whether trends are improving or worsening for both owner-occupiers and renters. There is currently no official measure of housing or rental affordability, and it may be neither sensible nor desirable to determine one official measure due to differences in end uses of the measures. However, the 2009 Review of Housing Statistics recommended that there is a need for some investigation aimed at determining preferred methodologies. This work is now underway.

Filling these gaps in a timely manner will take a co-ordinated effort from the various organisations and individuals involved in housing research. Individual organisations are progressing work for their own purposes and it is important to ensure that linkages are made between these projects – with limited resource it is important that the value to the wider sector is leveraged and optimised.



² Coleman, A. and G. Scobie, (2009). "A Simple Model of Housing Rental and Ownership with Policy Simulations", Motu Working Paper 09/08 and Treasury Working Paper 09/05, December 2009. This research gained media attention – see "Model Predicts Policy Impacts", The Christchurch Press, 10 January 2010.