NZ Residential Rental Market

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Possible Headwinds for Investors?

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DATA SOURCE This index has been developed from private sector rental data supplied by the Department of Building and Housing (Bond Centre). Information on wage rates, demographics and the structure of the rental housing stock is drawn from Statistics NZ data. House price information has been extracted from Real Estate Institute and Quotable Value NZ statistics.

Taxation

A number of economic commentators have argued that the lack of a comprehensive capital gains tax (CGT) on property distorts the investment landscape. The argument goes New Zealanders tend to over invest in housing at the expense of more productive investments, such as might be found in the export sector. From a purist economic point of view there is a strong case for the introduction of a CGT, not just on property but on all assets. Most English speaking countries do have a CGT of some sort, usually excluding the family home. For administrative simplicity CGT is levied when an asset is sold, but in theory it could be an annual tax.

Of course any discussion about CGT inevitably has a strong political dimension. New Zealand is a country where over 60% of householders own their own homes and where significant numbers of politicians from both sides of the divide own multiple properties. It is often said introducing a comprehensive capital gains tax would be "political suicide" for a New Zealand government. However, in recognition of the growing disparity in wealth in our society (and a government looking for new sources of revenue) there may now be increasing acceptance that the time has arrived for a CGT. Clearly, introducing a comprehensive CGT to include the family home would be a step too far politically. Targeting investment property may be more palatable to the electorate because most home owners and renters would not be caught in the net.

The Prime Minister has said there will not be a CGT on his watch but both the Labour Party and the Green party have said that if they are elected they would introduce a CGT, but exclude the family home. Such a policy would clearly target property investors and represent a potential headwind for this group. The Labour policy would not make the tax retrospective. Thus it would only apply from the date the new law was implemented. The difference between the value of the property at the date of tax implementation and the net sale price would be used as the basis for the CGT. The tax rate would be set at a rate of 15% and would only apply when the property was sold. Setting the rate at a comparatively low level initially may minimise controversy but this rate could be altered from time to time, as seen with the GST.

When discussing a CGT it is important to distinguish between property investors and property speculators. Speculators trade in properties and their are activities are covered by existing taxation legislation. Speculators pay normal income tax on gains made by trading in property. Conversely property investors do not trade in properties and currently are exempt from taxation on the capital appreciation they may have made while holding an investment property.

So how productive would a CGT be in terms of generating tax revenue? In the short run the answer is likely to be not very productive because the tax is only levied when investment property is sold. In a given year perhaps only 10% of investors would be selling. In the initial years the capital gain in most localities would probably only be just ahead of the rate of inflation in the consumer price index. The exclusion of the family home from a CGT considerably narrows the tax base.

The private sector rental market forms approximately 30% of the New Zealand housing sector. This market is dominated by many small 'mum and dad' investors who often own only one or two rental properties. These rental properties are typically older standalone houses converted from owner occupier to rental accommodation.

So how would a capital CGT affect the property market? One lesson from the Australian experience was homeowners with multiple properties tended to sell their recreational beach property and buy and a more expensive family home in the city. When the property speculation tax legislation was introduced to New Zealand in the early 1970s it generated very little revenue because a number of people simply did not sell their rental properties in the belief that an incoming government would repeal the legislation. This in fact is what happened. So the effect on the property market was there were not so many investment properties put on the market. This meant prices tended to stabilise.

The introduction of a CGT in New Zealand would probably result in a proportion of property investors looking at other investment options, always considering such a tax would also apply to other assets such as stocks and shares. In the end it would be up to —

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investors to weigh up the risks and returns from the various options. The attraction of rental property will likely remain for the “mum and dad” investors because of their ability to control the cost side of the income stream by taking a hands on approach to their investments. For example, self managing a rental house instead of employing a property manager can save around 7%-8% of the gross rents. Furthermore a good proportion of investors have the skills to do much of the property maintenance work themselves.

Given most rental houses are not purpose built as rentals then investors who sell usually have the option to sell to owner occupiers, probably first home buyers. The prices paid for houses tend to be driven by the owner occupier market which is currently showing a serious shortage of supply, particularly in the Auckland and Christchurch markets. In summary, in the short term the introduction of a CGT seems unlikely to have a major effect on the property market.

Rental Levels

The national level of rent in August remained at $330 per week over the last quarter. There was a $10 per week (3.1%) increase from August 2012, but a $10 reduction since rents peaked in February 2013. The most significant annual increase in rents was in Christchurch (11.8%). In the Auckland area annual rental increases were led by Papakura (6.2%). A snapshot of rents itemised by the main urban local authorities is shown in the table in the right hand column.

Currently changes in rents appear to have become disconnected to changes in house prices, particularly in Auckland and Christchurch. This may be because the markets are somewhat different. The rental market is characterised by younger and lower paid people and the ownership market an older and more affluent sector of the population. Landlords find they need to keep rents in line with a tenants ability to pay. This means changes in rents are highly correlated with changes in wages and salaries. Also renters tend to “double up” in times of economic hardship and this can mean increasing vacancy rates for landlords. The typical buyer in the ownership market already has significant equity in a house and may have been encouraged by historically low mortgage interest rates to trade up to a more expensive house.

Median Rents	Aug-12	May-13	Aug-13
Whangarei	280	290	290
North Shore	447	460	460
Waitakere	370	390	400
Auckland	400	420	420
Manukau	390	400	420
Papakura	360	367	390
Hamilton	300	310	320
Tauranga	325	340	340
Rotorua	240	250	250
Gisborne	250	247	260
Hastings	270	290	260
Napier	295	300	300
New Plymouth	290	310	300
Wanganui	210	190	200
Palmerston North	250	265	260
Kapiti	310	320	340
Porirua	320	325	360
Upper Hutt	280	280	290
Lower Hutt	320	320	317
Wellington	380	390	390
Nelson	300	325	300
Christchurch	330	369	360
Dunedin	285	260	260
Invercargill	220	220	220
All NZ	320	330	330

Massey University Property Foundation

The Foundation is established to sponsor research and education in property related matters in New Zealand. Funding is obtained through sponsorship from corporations and firms within the property industry. The Foundation has established a Real Estate Analysis Unit to operate out of both Massey University’s Palmerston North and Albany campuses.

Massey University Real Estate Analysis Unit

The primary objective of the Massey University Real Estate Analysis Unit (MUREAU) is to provide reliable property information to the property industry, the land related professions and the public.

The Director of MUREAU is Professor RV (Bob) Hargreaves. MUREAU also offers a consulting service for individual clients. MUREAU publications available on the internet are:

1 The Home Affordability Report (Quarterly)
2 NZ Residential Rental Market Report (Quarterly)

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