



Responding to the decline in private rental housing

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For the past two decades at least, New Zealand has followed something of a default housing policy. This policy has relied on thousands of small-scale, private investors investing in rental housing as the basis for providing housing to new households. Private sector renting thus became the tenure of necessity for those households too poor to afford home ownership, and not poor enough to qualify for state or social housing. Over the past five years two-thirds of new households fell in to private sector rental housing.

This default housing policy no longer looks sustainable. This is because of the poor yields which rents have provided to investors, and the diminishing prospects of capital gains on residential property. Most likely there will still be further investment in private rental housing, but this investment probably won't keep pace with demand. The result will be rents rising faster than household incomes, increasing levels of housing-related poverty and unmet housing need, alongside growing numbers of people sleeping rough on our streets and in our parks and carparks.

This paper considers this prospect and what policy ideas might work in response. The basic argument offered here is that a more deliberate set of housing policies are needed, which will require greater direct involvement by Government. This involvement will be in the provision of more state and social housing, and in the subsidising of home-ownership programmes for modest income households.

The paper begins by considering the place that private rental housing has played in New Zealand's society, including the provision of housing and the accumulation of wealth. It then goes on to consider the prospects of the private rental housing market over the next decade or so. As a basis for considering where we might go as a nation in our efforts to ensure that everyone is adequately housed, the paper provides a brief overview of the current housing policy framework and offers a brief critique of this as well. The paper then concludes with some often quite radical proposals for policy reform.

THE PLACE OF PRIVATE RENTAL HOUSING

A significant but somewhat unmarked trend in New Zealand society over the past 25 years or so has been the gradual decline in rates of home ownership. This rate has fallen from around 74% in 1991 to an estimated 63% today. This fall has meant that more and more households rely on private rental housing. In fact, almost three quarters of new households formed in the past decade most likely have only been able to find housing as private tenants.

This divide around the ownership of housing is a sharp one. On one hand, tenants, as might be expected, have a much worse economic position than home owners and landlords. Tenants have poorer quality housing; they pay more of their income in housing costs and have much less wealth than those who own property. On the other hand, not only have landlords more wealth, but they have managed to accumulate more as house prices and rents have continued to rise faster than wages, salaries, pensions and benefits.

There may, however, be something of a 'contest of rights' emerging with greater academic and policy attention being paid to the quality of rental housing and to the emergence of more strident tenants' rights groups.

This 'contest of rights' drives a re-consideration of private rental housing for at least three reasons:

- 1 The **emergence of the post-ownership society**, whereby New Zealand is on the road to **becoming a society where less than half the population own everything and where more than half have little or no material stake.**
- 2 The **economic position of tenants**, where private sector tenants are amongst the poorest people in New Zealand,

pay the most for their housing relative to their incomes and have the worst housing outcomes.

- 3 The **continuing concentration of wealth**, through both the dominance of private property rights and the conduct of public policy that supports these. The most obvious examples of such public policy are: the very light taxation of capital gains from land and real property ownership, and the subsidising of the rental market through the Accommodation Supplement (AS).

As we consider the future role of private sector rental housing, within the broader context of New Zealand's housing system, it is important that we regard these questions and potential issues that might drive policy change.

SOME FUTURE PROSPECTS FOR THE PRIVATE RENTAL HOUSING MARKET

For the past 25 years, the private rental housing market has been the default setting for New Zealand's housing policy. Over this period, home ownership rates have declined, in part due to the ending of any meaningful first-time home ownership support programmes. Also, social housing has been residualised—declining steadily from 4.0% of the national housing stock in 2008 to 3.4% in 2017.¹ In other words, private sector rental accommodation is where everyone goes who is not wealthy enough to afford home ownership, or poor enough to qualify for social housing. This group might be seen as the 'left outs'.

The problem is that this 'left out' group of households is not small. Over the five years to June 2018, two-thirds of the new households formed—or around 80,000 in total, where private sector tenant households.

An even bigger problem is that the investment, which has supported this expansion in private rental housing, has relied on the sentiments of thousands of small-scale investors who have invested in private rental housing, despite the low and falling yields that rents offer. The problem here is that this sentiment appears to be driven by expectations of capital gains and such expectations into the future might be misplaced given our position in the property cycle.

If we continue to assume that small-scale 'mum and dad' investors will provide the investment necessary to provide sufficient housing for the majority of new households, the question needs to be asked: What scale of investment is required? Answering this is not straightforward as it requires some starting assumptions around tenure patterns, population growth rates and household formation rates. The projections of such investment over the next 10 years are in the range of 40,000–50,000 additional rental units in Auckland and a further 50,000–60,000 across the rest of New Zealand. To provide this additional housing will require annual investment of \$3.0–\$3.4 billion.

This requirement is in the face of low and falling investment yields from rents. In aggregate, the investment yield on residential rental property across New Zealand is 4% while it may be as low as 2.5% in Auckland.

These low yields are likely to become problematic for future investment, especially if the promise of further value appreciation diminishes—as appears to be happening. It was the prospect of capital gains on residential property that has allowed property investors to offset, or at least overlook, these low yields, and it seems unlikely that such a stance will continue in an era of stable, or even falling, property prices.

This means that yields will rise, eventually, simply because an ever growing shortage of rental housing will continue to push rents higher. These rent increases most likely will be greater than increases in wages and salaries, meaning that some

households will be priced out of the market and forced into overcrowded living arrangements or outright homelessness. The ever-lengthening social housing waiting queue is probably already evidence of this.²

At this point the private rental housing market has not so much failed, but shown that its outcomes are far from socially optimal. The need for more extensive State intervention is becoming more apparent and any review of housing policy, including that of tenancy law, should consider the extent and nature of such increased intervention. It is probably now no longer sufficient to review policy in the light of past market conditions and expect that the outcomes will be adequate. A tighter rental market—where landlords have a stronger negotiating position—will be at tenants’ expense, regardless of law changes around such things as rent auctions, key money and poor quality housing. Put simply, economic power will trump legal rights, especially when enforcement regimes and legislative penalties are minimal, as they are in current and proposed tenancy law.

THE CURRENT HOUSING POLICY LANDSCAPE

A review of the prospects and policy options for the private rental market needs, of course, to be based in the context of what else is happening in policy and in other housing markets, in order to establish where there is scope for innovation and change. Such scope is considered in [Chapter 3](#).

Some insights that might be drawn from this review of this wider landscape include:

Tenancy law reform—there is some need to recast tenancy law given the passage of time since the original Residential Tenancy Act was drafted, and the changes in the overall housing market since then. The most significant change has been the continuing declines of home-ownership rates and, with this, an increasing number of households having to accept private rental housing as their tenure for life. No longer then can private rental housing be considered as secondary but temporary tenure. This suggests that more attention needs to be given to elevating the status of private sector tenants by offering them greater tenure protection.

Accommodation Supplement—the AS is a clumsy subsidy that offers those receiving it, and taxpayers paying for it, no guarantees that the housing outcomes it pays for are fair, healthy or affordable. While recent increases in the maximums that may be paid under this programme were overdue, they will not provide much relief from likely further rapid increases in rents. There is a need for a radical review of the AS perhaps with a view to better integrating it into other incomes support programmes, such as the working-age benefits, Working for Families and New Zealand Superannuation.

Home ownership subsidies—until the recent increase in the take-up of the HomeStart grant scheme, Government efforts in providing home ownership support were tokenism at best. Even now, the HomeStart programme—at around \$100 million

annually—is minor when compared with the almost \$3 billion due to be spent on the AS and income-related rent subsidies. Furthermore, there is little evidence to support claims that the Welcome Home Loans and HomeStart programmes contribute at all to broadening the range of people/households gaining access to home ownership opportunities.

Public and social housing—is under considerable pressure from growing waiting lists; the legacy of under-investment in public housing; and a pre-occupation with transfers rather than construction. This means there has been little progress to date in coping with this pressure. Plans to expand the stock of social housing by 6,400 over the next four years might be achievable, although early indications of the Government’s plans for re-developing the current state house estate suggests that, in reality, new state housing is not a priority. On any account, given the problems with diminishing expectations of further investment in private sector rental housing, it seems likely that waiting lists will continue to grow and will easily consume Government’s modest plans for 6,400 additional units by 2022.

KiwiBuild—the income thresholds set for KiwiBuild, along with the absence of any meaningful subsidies and the expectation that current house construction costs are affordable, pose real threats for the success of KiwiBuild. It might evolve that KiwiBuild does little more than replace the market as a source of new housing for higher-middle income households.

RESPONDING TO CHALLENGES IN THE PRIVATE RENTAL HOUSING MARKET

The first three chapters of this paper pose the idea that New Zealanders face four somewhat antagonistic challenges around the private rental housing market. These challenges are:

- 1 Concentrating wealth** and rising wealth inequalities that have emerged from recent settings around residential property investment and property ownership more generally.
- The **poor housing outcomes** experienced by many and, perhaps, the majority of tenants. These poor outcomes include insecure tenure and poor quality housing.
- Diminishing availability of private rental housing**, especially for low-income households and families. This restricted availability will in turn lead to rents continuing to rise faster than wages and salaries and cause higher levels of housing-related poverty.
- The **value for money** and the fairness of current housing subsidies, which will rise from \$2 billion per year presently to almost \$3 billion by 2022.³

While these challenges are not necessarily directly related to each other, they are collectively relevant both to the inequality and poverty faced by many private sector tenants, presently as well as historically, and to the likely prospect that poorer tenants’ material positions will deteriorate further without

Table 1: Strategic framework for addressing challenges from the private rental housing market

STRATEGIC APPROACHES	CHALLENGES			
	Concentrating wealth	Poor housing outcomes	Inadequate supply	Value for money
Reforming tenancy law		▲▲	▼▼	▲
Encouraging private investment	▼		▲	
Subsidising home ownership	▲▲	▲▲	▲▲	
More social housing		▲▲	▲▲	
Reform of rental subsidies		▲	▼	▲▲

▲ positive contribution ▼ negative contribution

radical interventions by the State. The final chapter offers some ideas for the nature and scope of such responses. These responses are based on the following framework.

Reforming tenancy laws

Proposed changes to tenancy laws appear reasonable in their intent, although perhaps not in their ambition. The proposed reforms have attempted to incrementally extend tenants' rights, but do not really address the broader question of the balance of power between landlords and tenants.

Underlying such a broader question is that of the balance between property rights and social rights. The framing of tenancy law as being more about social rights and less about the mediation of property rights, would have expanded the scope of what is possible and necessary in the reform of tenancy law.

If a broader approach was taken to reform tenancy law, it could, usefully, include the following responses:

- Providing tenants with greater tenure security, such as a requirement for standard long- and fixed-term tenancies (3–5 years) with limits on rent increases and the grounds for landlords to repossess a property.
- Increasing the penalties associated with illegal or prohibited acts, such as retaliation and intimidation as a means of discouraging such behaviours.
- Use of interest from the \$500 million of tenants' bond monies held by the Crown to provide tenants' advocacy and support services, rather than funding MBIE to operate the tenancy bond and tenancy mediation services.
- Tighter specification on what a residential rental property is, and has, and requirements for landlords to maintain some form of quality assurance certification such as a building warrant of fitness.

Encouraging private sector investment into rental housing

While the prospects for further private investment in rental housing do not look bright, some of this pessimism is due to the nature of the current investment models. These, for the large part, rely on small-scale individualised investments that are motivated more by capital appreciation than by long-term income growth. The United Kingdom has had some success in promoting alternative private investment models—such as 'build to rent' developments—and these are worth considering in New Zealand. The challenge for New Zealand is to build a private rental sector that is less reliant on small-scale 'mum and dad' landlordism and based more on trustworthy, transparent and value for money corporate investment models.

Subsidising home ownership

Current home ownership support programmes make up only around 8%⁴ of all housing subsidy budgets, and there is no evidence that these programmes are lifting rates of first time home ownership.

The unwillingness of Government to include a generous subsidy programme into its KiwiBuild programme will mean that it is only accessible to wealthier middle-class households who most likely could have accessed home ownership through the market. The opportunity costs of capital tied up in KiwiBuild and related programmes will exceed \$100 million annually, yet the programme appears to be another form of middle-class welfare and continues the gentrification of state house communities, which was started by the previous Government in Tamaki.⁵

Extended home ownership subsidy programmes—perhaps through well-funded equity share schemes—will extend the reach of KiwiBuild and, if it is of sufficient scale, unleash private sector development to cater for a market that to date has not existed. Indeed, the Government should focus more on supporting modest income households (earning around the median household income not twice it) to achieve home ownership through subsidy programmes rather than facilitating small-scale residential developments and balloting off houses.

More social housing

Previous work on demand for social housing has suggested that New Zealand requires at least another 2000 extra state and social houses each year for the next decade.⁶ The Government's present commitment to building 1600 per year for the next four years is clearly inadequate, as witnessed by the growing waiting list which more than doubled in two years.⁷ Further extensions of the waiting list appear likely as the private rental housing market proves unable to meet demand due to high costs and low yields. Furthermore, while the Government has promised 6,400 additional public and social houses over the next four years, where these will be built is unknown, given recent announcements around the redevelopment of state housing suburbs that are clearly favouring gentrification and KiwiBuild.

Reform of rental subsidies

It seems likely that rents will continue to rise faster than wages, salaries and benefits and that these increases will stretch household budgets, even with the recent increases in AS entitlements. It is not useful to continue to prime the AS pump in the short-term hope of alleviating housing-related poverty of poorer tenant households. Rather, attempts should be made to radically reform the AS, perhaps by integrating it with other income support programmes—such as Working for Families and New Zealand Superannuation. This integration may promote higher take-up amongst working poor households, and will reduce the high abatement rates which confront beneficiary households as they become more active in the labour market. The basic flaw in the AS is that it does not offer entitlement to housing, but rather a subsidy should a household be fortunate enough to secure housing with the income and other entitlements they have. This means that the AS does not necessarily secure people against homelessness or even poor quality housing and this flaw needs to be addressed in any reform of housing subsidies.

Endnotes

- 1 Johnson, A. Howden-Chapman, P. and Eaquib, S. (2018). *A Stocktake of New Zealand's Housing*, p.28.
- 2 The social housing waiting list grew by 127% between June 2016 and June 2018, while the waiting list for highest priority applicants (Priority A) grew by 162% between these dates. See Ministry of Social Development (2018) Housing Quarterly Report—June 2018. Available at <https://www.msd.govt.nz/documents/about-msd-and-our-work/work-programmes/social-housing/housing-quarterly-report-jun2018.pdf>
- 3 See Budget and Fiscal Update 2018, p.129. Retrieved from <https://treasury.govt.nz/publications/efu/budget-economic-and-fiscal-update-2018>
- 4 Housing New Zealand's *Financial Products Report*, reports total allocation of HomeStart grants for the year to 30 June 2018 at \$81 million; against this the 2018 Budget (BEFU 2018) estimated 2017/18 spending on the Accommodation Supplement of \$1.208 billion and on income-related rent subsidies of \$889 million.
- 5 For example: a Newshub report of 12/3/17 'Tamaki housing scrap "They're shifting out the poor"' notes that the Tamaki Regeneration Project will see the demolition of 2,500 state houses replacing them with the same number and building a further 5,000 dwellings around half of which will be sold at market prices. Retrieved from <https://www.newshub.co.nz/home/new-zealand/2017/03/tamaki-housing-scrap-they-re-shifting-out-the-poor.html>
- 6 Johnson, A. (2017). *Taking Stock: Demand for social housing in New Zealand*, pp.2–4.
- 7 Ministry of Social Development (2018). *Housing Quarterly Report—June 2018*, p.10 (reports the priority social waiting list of 3,549 in June 2016, rising to 8,704 by June 2018.