

HOUSING AFFORDABILITY INQUIRY, DECEMBER 2011 - PRODUCTIVITY COMMISSION

1. Summary

This submission addresses matters raised in the *Housing Affordability Inquiry* Report December 2011.

I have several concerns about the **research framework** contained in the Report, the information and analysis used, and some of the **conclusions and recommendations** which have been drawn from the findings.

2. Relevant Experience

I am James Douglas Marshall Fairgray. I am a principal of Market Economics Limited (M.E) an independent research consultancy. I have a PhD in Geography (University of Auckland) and 32 years' professional research experience (900+ projects) in urban and economic issues for public and private sector clients, and on many occasions as an expert witness in the Environment Court, as well as the High Court and the Supreme Court. My research experience includes a wide range of studies into housing demand and supply, segmentation of the housing market, urban growth matters generally, and the operation of the economy, in the context of urban sustainability and efficiency (RMA) and economic, social and societal wellbeings (RMA and LGA).

This submission presents an independent view. It has not been commissioned or encouraged by any third party.

3. Key Concerns

Issue 1 – The Research Framework is Weak

The Report considers a good range of important factors which affect housing affordability. However, the overall research framework is weak because it remains fragmented, and does not examine how the relevant factors **together** affect affordability. Nor does it seek to establish the degree to which each factor has contributed to observed shifts in affordability over the study period. As a consequence, the Report offers information about several factors which do affect housing affordability, but it has not been able to establish the **relative** influence of each factor – individually and in combination with others – in contributing to changes in affordability.

The lack of a comprehensive research framework is apparent in the Report structure. There are sections on important factors such as taxation, urban planning, infrastructure charges, regulations, construction costs and so on. However, it does not contain a section which then attempts to draw together all the relevant factors, as a basis for recommendations.

Given the objectives of the study, there are three logical and standard steps for a methodology:

- i. **Stage 1** – define the components of affordability, provide a comprehensive situation review (recent past to current), and identify the key factors which affect housing affordability and how they interact, and;
- ii. **Stage 2** - use this knowledge to examine how in combination these factors have contributed to shifts in affordability in the long term and recent past, including their relative importance, and the manner in which these factors can be expected to affect affordability in the future;

- iii. **Stage 3** - draw from this evidence base to reach conclusions and make policy recommendations.

The Report as drafted focuses on Stage 1 and Stage 3, but has largely omitted Stage 2.

Many factors influence housing affordability. The final or direct components – the prices of land, materials, and construction for new dwellings, the price of existing dwellings, relative to consumers ability or willingness to pay – are themselves influenced by a range of direct and indirect influences, including supply of land, supply of materials and construction resources, existing owners' willingness to sell, market sentiment, income levels, wealth levels, availability and cost of finance, expectations of economic growth or decline, and so on. These factors and their interactions are reasonably well understood, including the knowledge that they work in combination to affect housing market conditions. However, the inter-relationships are not yet well quantified in the New Zealand market.

The Report identifies and addresses the main factors but focuses on each individually. That is quite appropriate as long as this consideration is then complemented by assessment of the key drivers together. That combined assessment is necessary because that is how the real market operates. However, there is no assessment to show the **relative contribution** of each factor to the changes in housing affordability in the New Zealand market.

This is a very important gap, because the relative contribution to declining housing affordability should be the basis for prioritising initiatives to improve affordability. The obvious risk is that any policy initiatives will not be effective because they target less important factors, and/or fail to address the key factors in combination.

By way of illustration, the decline in affordability has been generated by housing prices rising above the market fundamentals – that is, rising faster than would be expected given general economic conditions. This issue is not evident only in the New Zealand market. Similar patterns emerged in the 2000-2005 period in many economies around the world, as identified in the Report (Section 3), and by other studies¹. The important implication is that the decline in affordability was not just a New Zealand issue, and not just an Auckland issue. The New Zealand economy is not insulated from the global economy, and it is clear that the New Zealand housing market has been influenced by global factors including the *'financial laxity that emerged during the 2000s...'*(p32). ***The key matter in relation to the Report is that the influence of global factors needs to be identified and separated out from the factors which have specific effect in the New Zealand market and/or in the Auckland market over and above the global influences. There is no evidence in the Report that this has been attempted.***

I note that there is a range of research in the literature which sets out comprehensive analyses of the housing markets in other western economies, including the relative importance of different factors for housing affordability².

Issue 2 – The information and analytical base is limited

Information

The second concern relates to the relatively limited and higher level information which has been drawn on in the Report. Research into such an important issue demands careful consideration of

¹ OECD Economic Outlook 78: Recent House Price Developments – the role of fundamentals. OECD 2005

² For example, *New House Price Modelling* BRANZ Study Report 196 (2008) identifies some 20 factors which directly and indirectly affect new housing prices (Figure 1, p13).

matters affecting affordability, and how these have individually and in combination, over time, contributed to the current situation. In short, it demands a solid **'evidence base'**.

While the Report contains a great deal of good information, a number of the indicators and analyses presented are relatively simple and high-level, and others are notably absent. In part this reflects the research framework. Because the assessment does not drill into the more complex inter-relationships, the focus is on the individual factors for which relatively simple information – such as time series indicators - is appropriate. However, because the market is complex and there are many feedbacks and flowbacks in the economy which contribute to affordability, these relatively simple measures (such as the *Demographia* median data, p 44) are able to tell only part of the story. While many are certainly useful and relevant (especially for Stage 1 of the broad framework above) they do need to be examined alongside other indicators.

Similarly, the consultation and stakeholder input is very important, but it needs to be complemented by solid statistical information. For example, Section 4 of the Report considers housing affordability differences variously by region, and by age group, and by ethnicity, and by income levels (pp 42-45). This is valuable, but the Report does not go the next logical step and provide information on the extent of the affordability issue – which could have been readily done in terms of numbers of households in the most affected segments of the market, and their distribution across different regions.

As another example, there is reference to the price of land now accounting for 60% of the total cost of a new dwelling in Auckland, though it is not clear whether this is based on comprehensive data, or is simply anecdotal.

There is limited use of Census data, although this is a core source of data on dwelling ownership, and how this varies among household types, across income levels, and across regions – all important aspects identified in the Report. Although there is no data for 2011, the Census does provide information on changes in dwelling ownership patterns in the 2001-06 period, when affordability showed substantial decline.

Analysis

In similar vein, the analysis is not detailed, and does not always reflect the key processes which affect the housing market, including the extent to which affordability affects the operation of the market. To illustrate, the Report acknowledges that the period since 2000 has seen two markedly different market situations – pre- and post-GFC. However, the distinction between the two market situations is limited. It is very important to distinguish between affordability issues, and the wider market conditions, in order to understand the interactions. For example:

- i. ***Housing Affordability*** declined very significantly from 2000 to 2007 (-8.8%pa nationally according to the Massey University data), but since 2007 has improved significantly by +9.9% pa over the 2007-2011 period. By November 2011, affordability was just -2.2% lower than in November 2000³;
- ii. ***Housing Market Activity*** was relatively strong in the period to 2007, as affordability fell, but has been persistently sluggish since 2007, especially in the construction of new dwellings and the development and release of residential land. That is despite the improvement in affordability throughout New Zealand. Simply, the improvement in affordability since 2007,

³ *Home Affordability Index, Massey University; December 2000; December 2007; December 2011.*

while important, is a necessary but not sufficient condition for recovery in the housing sector.

In my view, the Report does not make sufficient distinction between the two aspects of market operation.

As another example, it is relevant to understand the contributions of different factors. One of the important drivers of the increase in new dwelling prices has been the increase in average dwelling size – which grew by about 2.2% pa between 1999 and 2008. This was apparently an important contributor to the difference in dwelling construction costs between Auckland and the Rest of New Zealand. Table 1 below, drawn from BRANZ Study Report 196 on new house prices, shows that for the year to December 2007 – the peak year of the affordability decline – average new dwelling sizes were some 15% larger in Auckland than in the rest of the country, while costs per sqm were only 1% higher – suggesting that larger size was the dominant contributor to regional differentials in new detached dwelling costs.

Table 1 : Components of Detached Housing Costs 2007 – Auckland and New Zealand

DETACHED HOUSING BUILDING CONSENTS YE DEC 2007				
	Dwellings	Mean Size (sqm)	Cost \$/sqm	Cost per Dwg (\$000)
Auckland	4,786	229	\$ 1,255	\$ 287
Rest of NZ	17,863	198	\$ 1,241	\$ 246
New Zealand	22,649	205	\$ 1,244	\$ 255
Auckland as % RoNZ		115%	101%	117%
Auckland as % NZ		112%	101%	113%

BRANZ Study Report 196, 2008, New House Price Modelling (Appendix 2 Table 9)

Issue 3 – Focus on the Auckland Market

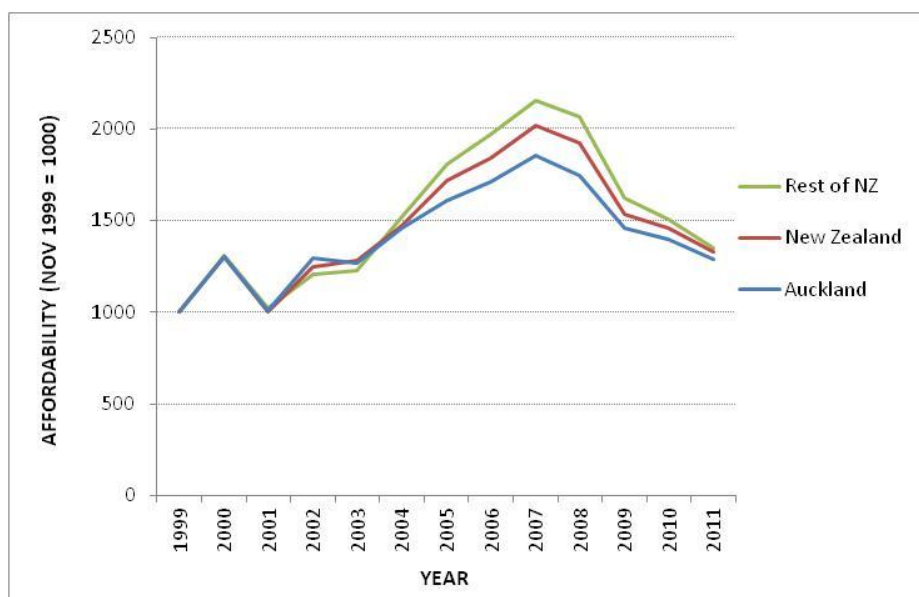
The report has very strong focus on the Auckland market, and the significance of affordability. Generally, a number of matters are presented as being specific to Auckland, or more significant in Auckland. It is important to place the Auckland market in the national context, especially in relation to the changes which have occurred since 2000.

First, housing affordability in Auckland is around 31% lower than for New Zealand as a whole (again drawing from the Massey Home Affordability Index, where higher cost means lower affordability), though this ranged from -39% in 2002 to ‘just’ -22% in 2008. Consistent with this, dwelling ownership levels (as measured by the Census) are lower in Auckland (59.5% in 2006) than for New Zealand as a whole (63.0% in 2006).

However, the shifts in affordability since 2000 are not unique to Auckland. Rather, affordability in Auckland has shifted in a pattern which very closely matched that across New Zealand as a whole. Affordability declined from 2000 to the price peak in 2007, and then improved to 2011 as prices relative to market conditions came back (Massey University Home Affordability Index series). Over the period November 1999 to November 2007, in Auckland affordability declined by -8.1% pa, a slightly slower decline than for New Zealand as a whole (-9.2%). Subsequently, in the period November 2007 to 2011, affordability improved by +8.8% pa in Auckland and +9.9% for New Zealand as a whole (see Figure 1 below). By November 2011, affordability for Auckland was about 1% better than in 2000.

While the Affordability Index is a broad indicator, it does identify important patterns.

Figure 1: Home Affordability 1999-2011 – Auckland and Rest of New Zealand



The key points of relevance to the Report objectives are that affordability is not just an Auckland issue, that shifts in the Auckland market have been part of national level shifts, and the affordability situation in Auckland has not materially worsened relative to the rest of the country in the past decade or so.

This raises the question of the extent to which factors specific to Auckland – including the effect of constraints to urban growth – have been influential over and above the national patterns.

In this regard, it is relevant to consider overall ownership patterns, and the extent to which these patterns may have been affected by the decline in affordability. The Census of Population and Dwellings (2001 and 2006) provides comprehensive information on one part of the picture, including dwelling ownership and rental status for households of each type and in each region as at March 2001 and 2006. Analysis of customised data from StatisticsNZ as to dwelling tenure (broadly, ownership without or with mortgage, and rental or other occupancy by non-owners) by household type by region for both 2001 and 2006 situations helps illustrate how the decline in affordability has had effect. Specifically:

- i. The dwelling ownership rate in Auckland region (% of households identified as owned, including through a family trust without or with mortgage payments) was some 3.9% below the national ownership rate in 2001, and 3.4% below in 2006;
- ii. Over the period 2001 to 2006, when housing affordability declined by some -19% in Auckland, and -28% for the rest of New Zealand, dwelling ownership rates declined across New Zealand. The observed shift was -1.5% for Auckland and -2.1% for the rest of New Zealand.
- iii. To place this in context, if the 2001 ownership rates had persisted to 2006, then there would have been around 39,000 more households in their own dwellings by 2006 than the Census recorded (after allowing for changes in the mix of household types).

While none of this is surprising, it is important to note that the ownership position in Auckland Region **improved** relative to New Zealand as a whole. This is evident in Table 2, which identifies the net shift in dwelling ownership across all regions between 2001 and 2006. Simply, Auckland was less affected by the decline in ownership than the country as a whole. Over the period, Auckland accounted for 39% of the total national increase in households, but 46% of the increase in households in their own dwellings (Census of Population, 2006).

Table 2 : DBH Estimated Building Costs 2011 – Auckland and New Zealand

REGION	2001 Owning Households	2006 Owning Households (Expected with NZ- wide Shift)	2006 Owning Households (Actual)	Net Shift	Net Shift Adjusted for NZ- wide Shift
Northland Region	32,470	34,320	34,010	- 1,890	- 310
Auckland Region	234,390	254,250	255,180	- 8,740	930
Waikato Region	81,170	85,880	83,940	- 5,680	- 1,940
Bay of Plenty Region	55,710	59,530	59,300	- 2,830	- 230
Gisborne Region	8,860	8,850	8,680	- 610	- 170
Hawke's Bay Region	33,320	34,190	34,570	- 1,190	380
Taranaki Region	26,290	26,460	25,910	- 1,800	- 550
Manawatu-Wanganui Region	52,280	52,330	52,590	- 2,310	260
Wellington Region	99,070	102,670	103,860	- 2,830	1,190
West Coast Region	7,900	8,240	7,850	- 840	- 390
Canterbury Region	126,340	133,030	133,470	- 5,570	440
Otago Region	46,060	47,230	47,970	- 1,480	740
Southland Region	25,000	24,520	24,330	- 1,420	- 190
Tasman Region	10,810	11,900	11,920	- 520	20
Nelson Region	10,280	10,780	10,900	- 400	120
Marlborough Region	10,410	11,270	10,990	- 760	- 280
Area Outside Region	1,620	1,320	1,300	- 130	0
New Zealand	861,980	906,770	906,770	- 39,000	-

The information above is relevant but again is only part of the picture. This does not indicate that declining ownership rates and affordability are not an issue in Auckland – far from it.

However, it does suggest that the Auckland situation is driven primarily by national level influences, rather than influences which are specific to Auckland.

Issue 4 – The ‘Evidence Base’ is not adequate to support key conclusions

The shortcomings in the research framework and the evidence base carry through to the Report conclusions.

In particular, there is a strong focus that urban planning approaches which seek compact urban form – particularly in Auckland – have had a major influence on the decline in housing affordability, and declining ownership. The Report recommends immediate release of more residential land, and a more liberal planning regime. This is based on the view that residential land supply has been artificially constrained and housing prices have been pushed up as a consequence.

However, the strength (and apparent enthusiasm) of these recommendations is not adequately supported by the evidence base in the Report.

This is where the shortcomings in the analyses and the research framework become most evident. Again by way of example, there is no indication of the degree to which the decline in affordability is

attributable to constraints in land supply, or the relative influences on land supply of the statutory planning context or land-owners' decisions as to release, or the implication for ownership, and so on. Nor is there any clear assessment of the wider implications of less compact urban form outcomes – for example, the trade-offs between dwelling cost and the costs of operating a household, including transport costs, value of time and other aspects of accessibility.

From a research methodology perspective, there is some 'dis-connect' between the information presented, and the recommendations drawn.

4. Conclusions

Accordingly, while the Report does bring together important material about housing affordability including stakeholder submissions, the evidence base it offers is not comprehensive and does not offer a sufficiently robust research framework to support some of its key recommendations.

The Report should be considered at best as a first stage assessment. The logical next stages are to extend the evidence base, and undertake sufficiently rigorous assessment in order to identify the relative influence of each main factor on housing affordability and how these factors have effect in combination, and then use this more comprehensive evidence as a basis for policy initiatives to enhance affordability for the community.

In conclusion, the information contained in the Report has not yet brought us to a point of having a sufficiently good evidence base about housing affordability, and the importance of the underlying causes. Consequently, it does not yet offer a sound basis for policy initiatives.

In particular, the recommendation is for a fundamental shift in the growth strategy of New Zealand's largest urban area. A change of such magnitude, and major long term significance, demands considerably more rigorous and comprehensive assessment than is provided by the Productivity Commission Report.

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10 February 2012