

House Affordability Project

General Observations

New Zealand is a country with at just over 4 million one of the smallest populations of any country in the world. It has a generous land mass but this is tempered in its potential by the large amount of unusable mountainous and earthquake susceptible territory it has and the fact that the two main islands are not linked. Little can be done about the first of these issues, and tackling the second would be technically difficult and surely costly. I observe that NZ is really two countries, with quite different cultures. The likelihood is that each part will continue on a pathway of separate development unless the issue of linking the islands is tackled, or the decision is made to join with Australia, which already controls much of the country's banking and retail activity. Then different considerations would apply. Kiwis living in Oz outnumber Australians living in NZ by 5 to 1, but as Australia's population is about 5 times that of NZ, it is probably a safe bet that the two countries have sufficient in common to be able to merge and enjoy good mutual benefits from a union. That option is enshrined in the constitution and it will be returned to time and again, and probably eventually be exercised. I cannot tell when that might be.

It is also true that because of its' small population NZ has suffered in having inadequate political leadership down the years – it is to state the obvious to say that the pool of excellence that is available here is much smaller than the equivalent pool available in countries with large populations, and idiosyncratic developments have taken place here that would not be seen in other Western countries with a larger population – two obvious examples are the odd democratic process where terms are too short for governments to make real achievements, and the peculiar ACC system, which elsewhere would be swallowed up within a national health care system and coupled less restrictions on the laws of Tort.

The country has been quite remarkable in what it has achieved in the world. It has a spotless international reputation as a place where fairness and decency abound, a green image (probably largely unmerited!), a tradition of participation in helping those in distress, doing its' bit in international affairs where military intervention is appropriate, and of course it punches well over its' weight in sporting activity.

There are of course downsides – NZ is too dependent on agriculture, has failed to integrate the Maori population which represents about 8% of the total numbers but 60% of the prison population, and as a poor (but certainly not poverty stricken) nation has too big a gap between the “haves and have nots” with far too many “haves” as a percentage of the total number of residents. Most importantly it is not growing and using its natural resources to maximum effect, because the Green lobby carries too much unmerited influence, and a sensible balance between use of resources and conservation is still a long way off. It needs professional standard immigration to drive commerce forward.

Of recent times the country's currency has become far too strong, and the tradition in NZ of being a high investment income and high borrowing cost economy will count against it severely unless it mends its ways.

The country's education system and traditional high quality family values produce well rounded young people who travel the world and settle elsewhere because the opportunities overseas are so much more exciting and rewarding than in their home country. This starves the two island nations (that New Zealand has become) of talent. The potential for enormous wealth generation here is largely ignored. If the country were to invest in green (ish!) electricity generation by harnessing and increasing the high altitude lakes it has, and supplementing these with wind power off the South Island to push water up to constantly refill those lakes, and then supplement these with a vast barrage of hydro schemes, with the huge excess of electrical generation resource available, scientists would flock here from all around the world to research and create world leading transport systems based on renewable energy, and modern lightweight energy storage techniques. The existing Aluminium smelter on the South Island would be a valuable tool in this process, as would be the gas and oil deposits round the country's shores. Given dynamic leadership the potential for this country is vast. These notes are not about developing NZ's infrastructure and society, but about housing cost. They are an Obiter Dictum that sets a background to the issue. We need to be aware of the history, the present difficulties both social and economic, and of course mindful of the huge opportunities here that at present are unexploited when framing structures for housing the country's people. It is within this framework and thoughts that I make the suggestions below.

Taxation

Before moving to the detail of housing affordability and making proposals account needs to be taken of the nations need to raise taxes. In a country with such a small population the tax burden on the individual is high. There are costs in running a state that exist dis-proportionately to its population. One could envisage that if our nations' working population were to increase by 30%, then the individuals personal contribution to the state in taxation outgoings might fall, obviously not by 30%, but possibly by 10% - 15%. It needs some economic research to be carried out to calculate what percentage of population increase results in what decrease in individual taxation so that a valid and practical target for population growth can be arrived at. These notes will endeavour to hint at how much revenue will be lost by the taxation impact of what is proposed, and also to indicate what steps might be taken to restore the tax income that may be lost. Intelligent use of taxation should be a tool that can be employed to the mutual benefit of all.

The proposals made herein will be a big ask on the government and it will be a *sina qua non* that there be a balancing and sustainable tax raising proposal. The proposals I will make would involve a short term reduction revenue for the government, with a greatly enhanced return to the state over the term of a mortgage.

What are the component costs of residential housing?

Residential housing costs split into six clear areas:

- a/ Land cost
- b/ Consent cost
- c/ Material cost
- d/ Building (architect, engineering labour and builders profit) costs
- e/ Taxation Burden
- f/ Ongoing costs: Borrowing, energy, local taxation, structural

In the proposals I make, I am addressing the factors relating to construction, maintenance and costs of a two storey house of approximately 200 sq. metres set on a section valued at about \$180,000. Typically this will be 500-600 sq. metres

I have discovered an anomaly that exists in New Zealand that I cannot explain. On a cost per square metre basis a two storey house should cost less than a single storey house – there is half the amount of foundation needed, half the amount of roof, and about 30% less timber framing material. Counterbalancing this is the additional provision of a staircase, the costs of timber flooring and joistwork for the upper floor and some additional costs in scaffolding during the construction process. Builders tell me that on a square metre basis, two storey costs more here than single storey, and there is no clear rationale for this. I therefore propose to disregard this myth.

Across the country, based on current costs the total consumer price paid is likely to be around 400,000 for a house of a typical family specification. I make the assumption that about 25000 such houses are built each year in NZ. This number will fluctuate from year to year – at present immigration is quite low as the NZ Dollar is very strong and world conditions mean that incomers may have problems finding work here. There is little retirement to NZ, indeed, there is not yet a specific immigration category for this, and the government needs to review its policy on silver haired residency. They may be missing an opportunity. Again a fresh policy here would impact on housing matters

a/ Land Cost.

Presently if a typical section cost for a 500-600 metre plot is around \$180,000, if buyers could be persuaded or induced to accept smaller sections, cost per plot would fall. A plot of about 300 metres is in line with European sizes, and allowing for additional

marketing and legal costs, the plot cost could be almost halved. It must be remembered that whilst there is a strong Kiwi tradition of having a plot large enough to support a family's vegetable consumption or provide a good children's play area, there are many people for whom this is inappropriate. This will include first time buyers many of whom would happily trade the burden of having to tend a large patch for a reduction in plot size and a reduction in price, some elderly who cannot physically cope with a garden and retired second homers who might want to spend part of their lives in another country, usually that of their birth, and for whom a large garden represents a bind.

In addition building plots here in NZ are subject to a local development land tax, which seems to average 10% of value. My proposal is that this be scrapped, and replaced by a tax of 33% on the capital gain made on land sold for development. The consequence of this would be that a plot of land with a purchase cost of say \$200,000 by a speculator, could be split into three sections, each selling at around \$120,000. This would yield a profit of \$160,000 for the speculator, on which after his legal costs he would pay a tax bill of about \$50,000. Eliminating the development charges and replacing them with a profit or capital gains tax would free up land for sale, as the owners would not have to front up development taxes, and act to depress the sale price of building plots, especially when this is matched with a market acceptance of smaller sections.

As a counterbalance to this, a yearly rates premium of, say 10% should apply to plots exceeding 400 metres, rising to 20% on plots over 1000 metres. This may more than compensate Councils for the loss of development tax income.

For the buyer of our illustrative house above, the cost of his house would fall by about \$90,000 - \$100,000, and government income might actually rise by a lump sum, whilst council income falls from development cost falls, but is offset by the penalty rates charge on larger sections.

b/ Consent Costs

Consent costs in NZ are disgracefully high. On our house described above, in Canterbury they would be around \$6500. In the UK, consent fees are fixed at around £350 per house, regardless of how much "work" the council choose to do in processing the application. Councils here will argue that the consent process needs to be self funding. I respond that this is a flawed and foolish argument. The applicant is seeking to build a house, in consideration of which he will be allowed to pay rates in future, giving the councils a future income. My proposal would be that consent costs be fixed at a maximum of \$1000 per house.

Councils will scream with rage at this, as they see it as important that they carry out numerous technical assessments in order to be able to comply with legislation. Every house building proposal is allegedly researched to ensure that it meets requirements, but also to ensure that no liability for subsequent failure falls on the council. This system needs to be changed. Two levels of consent should be available. The basic one is a consent in principle which gives the developer a certainty that he can build on a piece of land. This consent can place certain aesthetic stricture such as size, shape and number of storeys on a developer for a given site, but makes no technical stipulation. This should take no more than 3-4 hours work, and cost a maximum of \$500. It gives the developer the certainty that he can build on the site, and he will have an understanding of what will be allowed to be built there.

The detailed plans would be only accepted if submitted by a certified architect or architectural technician, who I will call the “designer” It will be a legal requirement that the designer carries professional indemnity insurance, and he must supply evidence of this with each application. The designer will sign a warranty for each application that it meets current legislation, and will identify and request consent for any deviation from the legislation that needs discretionary consent by the council. Thus the council, knowing that they are covered against the event that the design either malfunctions or is outside permitted standards, can consider the detailed plans for a house solely in the light of the areas development designation and aesthetic presentation – things like how it sits on the landscape and its impact on traffic and safe access to the site. A fee of a maximum of \$700 per house would be appropriate, or if a piece of land with no ruling were subject to a detailed proposal from scratch which seeks to gain consent in principle with consent in detail then the fee should be set at a maximum of \$1000.

This removes the multitude of planning consent levels from a council, which can then reduce its’ planning workforce, whilst retaining control over development in general, but not needing to worry about technical detail. The councils would lose development charges, but for each development site have the option to either let the developer provide the infrastructure such as roadways, drainage and lighting, or to “adopt” the roads and infrastructure, giving a specification to the developer for each site which he must meet himself and pass on to the home owner or builder. The council would accept responsibility for it thereafter, otherwise it would remain a private road, with house owners having to fund the infrastructural upkeep

If our sample house above were one of say three houses on the site, then the infrastructural costs might be quite modest – maybe only a few thousand dollars. If the site were say 50 or 100 metres off a main road, that would change things, but people

would have more choice, with the cost of their infrastructure related directly to their personal environment.

Excluding infrastructural issues, but allowing for an increase in architect fees for the extra insurance needed by the designer, then the cost of consent would fall for a typical house to around \$1500. The council would need to inspect the work as it progresses as a matter of due diligence, with perhaps inspections at foundation setting, framework, roofing, mechanical services and finally site presentation, which should be about \$1000, making the total consent and inspection bill no more than \$2500.

This would be a major change in NZ consent philosophy, but major change is called for in this situation, and the powers that councils have will be less open to abuse and exploitation.

c/ Material Cost

I would like in this section to focus on one issue only. It is a vast area, but my own personal experiences and knowledge may provide some enlightenment. I would like to relate my own experiences here to illustrate my arguments and proposals.

When I came to NZ in 2008, I bought two sections totaling 1440 sq metres in the Port Hills area. The land was quite flat except for one end where there was a significant fall of about 3-4 metres. We decided that 700 metres was grossly excessive as a plot size, and discounting the part of the site where the land fell away, we split, or “subdivided” the land into three distinct freeholds. We built a house which we sold on one section of about 500 metres, retained a second section of 400 metres to provide a home for our retirement, intending when my wife retires to be “Ping Pong Poms” spending half our life in each country. On the third section of about 540 metres we built the house we presently live in, and will sell when we are in a position to proceed with the smaller house on the vacant section – that will not be until the aftershocks cease.

The house sold was built to a typical Kiwi specification. It had a steel roof, aluminium windows, was about 235 metres and was clad on the bottom with stack bond blocks and on the upper level with linea. There is a generous balcony giving views over Lyttelton Harbour and the Port Hills.

Our own house was quite a different design. Because it is on a hill, it is split over three levels – a basement with a garage, a middle floor consisting of a living area and the master bedroom, and an upper floor with three bedrooms, each with en suite bathroom.

The house was designed to be energy efficient, without being conspicuously “green”. It occupies 240 metres and has a balcony at the rear giving good views. We built the lowest storey in steel re-inforced block, and we have a 2 metre deep foundation in the ground filled with tailings. Above this, the two upper floors are clad in polystyrene and rendered. The roof is steel. Our structural insulation is of a high order, exceeding a factor of 3.2 on the NZ national scale. We employed NZ sourced UPVC double windows and external doors. Heating is provided by two heat pumps, three fitted electric wall heaters in the bedrooms and a couple of electric column heaters for the places where the heat pump doesn't quite work. We also have a built in electric flame effect fire in the lounge. Our hot water is provided by an over capacity gas combi boiler giving hot water on demand, and which also provides power for the cooker hob. The main cooker is an electric double oven.

With this degree of insulation, and the vast barrage of heating equipment we have, our energy bills over the eighteen months we have been here average just over \$110 per month, when the winter period is added in. Summer months bills are about \$70 - \$80 per month. The defining characteristic, which gives us such a modest energy cost is the use of UPVC windows. We refused to use Aluminium windows and doors because they are outmoded and inefficient. My calculation is that over a fifty year life cycle, the running costs of the house will be \$50000 - \$75000 less, without considering inflationary savings than if we had used aluminium. I will write about running costs in a little more detail later.

The house cost \$490,000 to build, a cost over just over \$2000 a metre, but the specification is high with four bedrooms and four bathrooms in total and some above average cost internal fittings and doors. Built to a more normal NZ spec it would probably have cost \$370,000 - \$400,000.

The windows came from a New Zealand supplier, and it was not realized by us at the time that these cost \$33000, about 60% more than we would have paid for a UK manufactured equivalent.

We have now been planning to build the last of the three houses, and are trying to implement some of the lessons we have learned from building the first two. The lessons relating to windows and doors have proven quite instructive.

For the new house locally sourced UPVC windows and doors made to a late 1980's specification will cost around \$35000. Locally bought Aluminium windows and doors will cost \$22000, and \$28000 if I elect to use a type with a partial thermal break. UPVC windows and doors sourced in the UK, but made to the latest EC specifications will cost

\$17000. It should be a no brainer. I approached CCC and they have told me that I cannot use the UK sourced ones, even though they comply to the worlds' highest standards. The explanation is that there is no NZ standard for UPVC windows and European standards are not recognized. I could possibly use them if I had them certified and tested by a company called "Branz" but that will cost \$100,000!

My UK producer is interested, if the conformity issue could be resolved, in setting up a production unit here. This would create jobs here and enable home buyers to benefit from superior technology which costs less, and reduces energy bills. Most interestingly he makes the point that if New Zealand architects could be persuaded to use a range of standard sizes for windows and doors, the prices here would reduce by up to a further 25%. This would put world class windows in standard sizes into the showrooms of people like Placemakers and Bunnings in almost the same way that bathroom furniture is marketed.

The savings on the house model outlined above here would surely be of the order of at least \$8000 maybe more, with increased insulation qualities and hence lower energy bills.

d/ Building Costs

I am not intending to offer any comment on this aspect, save to note that if the other proposals I make were accepted, then there would be an increase in architects costs

e/ Taxation Burden.

I begin by commenting that in the UK new build houses are not subject to VAT. Renovations and Extensions are. A house that costs \$220,000 to be built in NZ, in the UK would sell for \$183,000 in the UK, although in reality this UK price would be higher for other reasons unrelated to the matter in hand.

I would estimate the average GST content of an average house here, costing perhaps \$300,000, at your 15% GST rate will be about \$39,000. If this were indeed the NZ average, then if my information about 25000 new houses being built here is correct, then the loss to the government of GST on new houses would be just short of a billion dollars a year, a substantial sum. But I would like to propose that this be done, and I will demonstrate below how, over the years, this will prove cash generative for a government

One of the characteristics of NZ economics is that like the rest of Australasia the country is a high interest rate economy. This is a factor that will inevitably change.

Europe is a powerful determinant of western style global economic policy, and currently base rate in the EC is 1.5%, and in the UK it is 0.5%. In Germany and Scandinavia houses are very expensive by comparison with both Britain and NZ. Incidentally the European rented sector is also much bigger than that in the Anglophone world. European interest rates on mortgages are much lower than ours, generally around 2.5% - 3%, and then mortgages are frequently issued on a generational basis, with some having terms of up to 75 years. This goes at once to affordability, and very expensive properties become very viable when there is a regime of low rates and long repayment terms. This is not a model for NZ to contemplate yet, as the culture change would be too great for NZ to handle at present, so we need to look at means by which the monthly repayments made by home owners can be controlled whilst delivering to government the revenue it needs.

I would like to advocate a structure which is a combination of fixed rate long term mortgages, and tax free returns for those who invest in mortgages over a long term. This is how it would work –

I propose that the government be asked to issue a “Housebuilder” bond, and also to authorize other financial institutions to issue their own versions of the bond, and interest on the bond will be paid annually at 4%. The interest on the bond will be free of withholding tax, and income shall be tax exempt and non declarable. Mortgage providers operating the bond will loan to homeowners at a fixed rate of 5.25% on new houses. The interest rates may be reviewed every five years, but the 1.25 difference between interest and borrowing cost shall remain in perpetuity. This should be a workable margin. Normal lending criteria shall apply. The bonds would need have a defined lifetime, and have to be tradable. In addition where issued by financial institutions, they will be government guaranteed.

All mortgages granted on residential property shall be subject to GST on repayments. This will have the effect of reclaiming the GST forgiven on the initial purchase, but replacing it with a staged repayment over the term of the mortgage

f/ Ongoing costs

Affordability is a concept that extends beyond simple capital cost. My experience of life in NZ has taught me that the elements of utility that need to be added to mortgage repayment costs are far from insignificant, and affordability needs also to incorporate realistic month to month costs.

A typical house owner of our \$400,000 house will be faced with monthly outgoings that look something like this when averaged through the year:

Rates	\$200 – high by UK standards
Energy	\$200
Broadband, phones	£110 – expensive by Euro standards
Insurance	\$ 70
TV signal delivery (Sky)	\$ 70
Total	\$650

This is in addition to his mortgage. A reduced energy bill through good window and insulation planning can take between 40% and 45% off that part, lower property cost can reduce insurance costs by a modest sum, say \$5 - \$10 per month, and a lower rateable value through having a smaller plot could be worth further \$40 a month. Savings on ongoing utilities could be of the the order of around \$100 a month at least, maybe more. Savings of this calibre will make the extra GST burden I propose more viable.

Conclusions and Recommendations

Let us try and draw together what impact the changes proposed have on housing costs and ongoing viability whilst preserving the need for national tax revenue generation.

Firstly let us look at what would happen to the cost of our \$400000 house if the proposals I make were carried out:

Land Cost	
Reduce plot size to 400 metres plus removal of council development charges	\$112,000
Consent Fees	\$ 1,000
Additional design fees for PI insurance - say -	\$ 1,000
Building cost, less GST, removing consent fees to adjust for figure included above	\$186,000
Deduct cost of better windows and doors	minus\$ 6,000
Add for upgraded insulation	\$ 2,000
Total cost	\$308,000

This would be a total reduction in house cost of around 25% coupled with a major upgrading in insulation to impact on future energy outgoings

This comes at a price in terms of government revenue. Let us look at how this would pan out -

GST on house build cost	\$27,000
Development tax from local council	\$15,000
Loss to local council on consent fees	\$ 5,500
Total	\$37,500

Let us now look at what happens in terms of the housebuyers tax burden. Let us assume that the mortgages granted are all subject to a deposit. And that typically this will be 20%. It may be necessary to define a minimum deposit to make the scheme work.

House cost	\$ 308,000
Less 20% deposit	\$ 246,400
Monthly payments on 25 year term	\$ 1,475
GST on repayment	\$ 220
GST payable over 25 year term	\$66,000

In addition, the government would collect a form of capital gains tax on the sale of the plot, depending on what the developer paid for the land, and this would be an almost immediate sum here of maybe \$18,000 - \$20,000

Payments on a house valued at \$400,000 under present regime, at a normal local rate of 6.5%, where GST has been paid on the house become \$2160 per month

The advantage of a scheme like this is that it cuts the price of the house substantially, and also reduces the borrowers payments by a third. The government for its' part loses \$37500 in revenue initially, but recovers nearly twice that over the term of the mortgage plus the income it receives at once on the capital gains tax on the development land. Even allowing for the tax concession on the "Building Bond" that I propose, over the term of the mortgage, the government would be significantly better off than under the present scheme

It may not be practical or desirable to extend this scheme to all properties, but as a scheme to encourage home ownership of new homes with high insulation standards on plot sizes that are right for the 21st century it would work very well for all involved -

The house buyer gains by having a house with lower mortgage repayments and better insulation, at the price (which for many may be an advantage) of having a smaller garden. He will have in addition lower utility costs

The builders' position is largely unchanged, but the cost per unit falls and demand may increase as a result creating more business

The architect has the burden of carrying extra insurance, but this is passed on fully. If the project stimulates growth, then he will have more work

From a national point of view, house prices will be lower and members of the public will have more money to spend on other things that benefit the economy.

For the immigrant, first time housing becomes very affordable, and the country becomes attractive to immigrants again, which will help ramp up economic activity

Investors will have a secure tax free return on pledging savings for a specific period

Lenders will be able to raise funds to lend more easily

The government and councils will over the long term, have more taxation income from this project that they might otherwise have. Local councils in particular will benefit from higher income from the proposed large section surcharge, which I have indicated here, but not costed, as I am not privy to the numbers in terms of plots sizes.

If steps like this increase inward migration, then the individual tax burden will reduce

I see a strategy like this working to benefit almost everyone in the country