26 October 2022

Committee Secretariat
Finance and Expenditure Committee
Parliament Buildings
Wellington

By email: fe@parliament.govt.nz

<u>TAXATION (ANNUAL RATES FOR 2022-23, PLATFORM ECONOMY, AND REMEDIAL MATTERS) BILL (NO 2)</u>

Please find attached the written response of the New Zealand Property Investors' Federation Inc to the above Bill.

The Federation is happy to provide policy advisors or Members of Parliament with any further information they may require and wishes to be heard in person in support of this submission should verbal submissions be held.

Yours sincerely

Andrew King
President

Submission to the

Finance and Expenditure Committee

On

Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2)

26 October 2022

Andrew King
President
New Zealand Property Investors' Federation Inc
PO Box 20039, Bishopdale, Christchurch
Email: Andrew@NZPIF.org.nz
Mobile: 021 216 1299

New Zealand Property Investors' Federation

This submission has been prepared by the New Zealand Property Investors' Federation Inc (NZPIF) in response to an invitation to provide feedback on the Residential Tenancies Act Review.

Established in 1983, the Federation has seventeen affiliated local associations situated throughout New Zealand. It is the national body representing the interests of over 7,000 property investors on all matters affecting rental housing.

Our philosophy is to be an industry advocate. This means we take a balanced role in considering the rental industry as a whole, which includes the requirements, rights and responsibilities of both tenants and rental property owners.

Industry Background

There are approximately 270,000 landlords in New Zealand. There are no corporate or institutional residential landlords.

There are approximately 546,000 residential rental properties[1], housing over 1,500,000 tenants[1], and worth around $171 billion[2].

Private landlords are the largest providers of rental accommodation in New Zealand. 87% of tenants rent from a private landlord or trust[3]. The average length of a tenancy has increased from one year and four months in 1995 to two years and three months in 2017[3], meaning tenants' security of tenure has improved.

Median weekly rent for all accommodation is $550[4]. The amount spent on rent each week is $121 million and annually this is $6.3 billion.

Most property investors (57%) have been engaged in the business for 10 or more years[5], which dispels the myth that people are investing in property to make a "quick buck". Instead, property investors are using their rental income business as a mechanism for saving for retirement and are professional and committed long-term service/accommodation providers.

The rental property industry paid tax on net rental income of $1,444,000,000 in the 2016 financial year[6].

---

1 2013 Census data
2 NZPIF Calculation. 475,000 private rental properties multiplied by the February 2018 REINZ lower quartile house price.
3 Regulatory Impact Statement: Prohibiting letting fees under the Residential Tenancies Act 13/04/2018
4 Tenancy Bond Centre statistics, August 2022
5 ANZ NZPIF Annual Survey 2006
6 IRD Data, April 2018

SUMMARY

The NZPIF submission only covers the parts of the Bill that impact on the rental property industry, namely issues on the intention to reintroduce interest deduction in perpetuity for institutional Build to Rent (BTR) developers.

The NZPIF is fundamentally opposed to mortgage interest on rental property not being considered a tax-deductible expense. This reduces the ability of people to provide rental property to tenants at a time when Government is spending a million dollars a day on inappropriate emergency housing, the waiting list for social housing has ballooned to 27,000 and rental prices have increased more than they would have done without the introduction of this tax increase.

However, we agree with IRD officials that despite being against the original interest limitation rules, it is not appropriate to exempt large BTR developers from these new rules. The IRD have correctly stated that “there is nothing inherent in BTR that makes it different from other residential rental property, apart from scale” and that to exclude them from the new rules would be “Inequitable” and “undermine the purpose of the rules”. The NZPIF agrees with the IRD that “reintroducing depreciation deductions only for BTRs would reduce fairness and efficiency within the tax system, as well as the overall coherence of the tax system”.

The objective of removing interest deductibility was to improve affordability for first home buyers by reducing investor demand for existing housing stock. While the new rules have reduced demand from rental property buyers, the objective of improved affordability for first home buyers has not been achieved. Instead, the shortage of rental property has been exacerbated, leading to higher levels of homelessness, reduced availability of rental property and higher rental prices. In short, it was a well-intentioned policy that has not achieved its aims but has caused a high level of distress and financial hardship for tenants.

Instead of exempting large corporate rental property owners, all rental property owners should be allowed to claim mortgage interest as a tax deduction.

It is unlikely that large BTR developers will build the type of rental properties that most tenants will actually want to rent. This is much more likely to be achieved through small scale BTR providers.

A key part of allowing large BTR developers extra benefits is requiring them to provide tenants with long term security of tenure. However this could also be achieved by developing a new long term tenancy option in addition to the existing periodic and fixed term options currently available. This option would also be more widely available to tenants who would value better tenure security.

Discussion

<u>Inconsistent objectives</u>
When looking at the matter of reinstating mortgage interest as a tax deduction for large corporate BTR developers, we must look at the three original objectives of the policy, which is covered in the IRD regulatory Impact Statement.

Executive Summary

Problem definition

The Government's three key housing objectives are to:

a) Ensure every New Zealander has a safe, warm, dry and affordable home to call their own – whether they are renters or owners.
b) Support more sustainable house prices, including by dampening investor demand for existing housing stock, which would improve affordability for first-home buyers.
c) Create a housing and urban land market that credibly responds to population growth and changing housing preferences, that is competitive and affordable for renters and homeowners, and is well planned and well regulated.

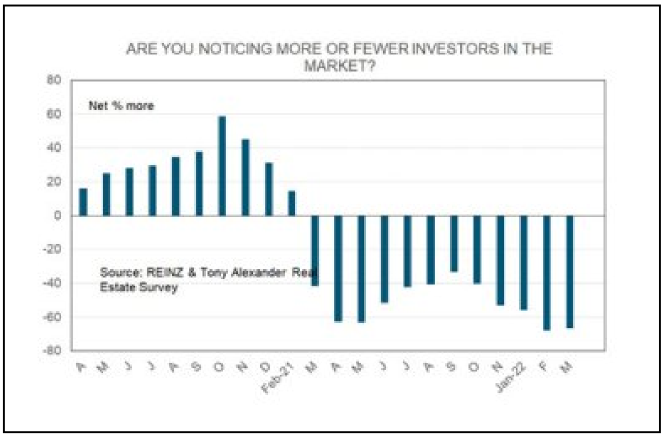
Renters are mentioned in two of the three government housing objectives. The Government wants tenants to have safe, warm, dry and affordable rental homes, plus a housing market that responds to population growth, is competitive and (again) affordable.

However objective B goes against the other two objectives as it reduces supply of rental accommodation, making rental properties less competitive and less affordable. Objective B is solely aimed at benefitting first home buyers at the expense of tenants.

<u>Failure to achieve objective</u>
The Government's decision to remove mortgage interest as a tax-deductible expense was announced in March 2021.

The objective was to reduce demand by rental property buyers to improve affordability for first home buyers.

Demand for rental property dropped immediately. The following is a graph from a Tony Alexander survey asking real estate agents if there are more or fewer investors in the market. It shows that there was an immediate reduction in people looking to buy rental property and this has continued for the rest of the year.



Despite a large fall in people buying rental property, house prices continued to grow for the rest of 2021, only slowing down when interest rates started to increase.

Records from QV show that house prices increased from $884,447 in March 2021 to $1,063,765 in January 2022. That is an increase of $179,318, or 20.3% in the 10 months following the announcement of mortgage interest no longer being tax deductible.

This data shows that the assumption that rental property buyers were the main cause of house price inflation was wrong and that reducing the number of rental property buyers did not improve affordability for first home buyers.

Lack of support for removal of mortgage interest deductibility

In the IRD regulatory Impact Statement on limiting interest deductibility on residential investment property, they said the following:

> "Inland Revenue has advised against any of these options to deny or limit interest deductions and prefers the status quo to all options. It considers that additional taxes on rental housing are unlikely to be an effective way of boosting overall housing affordability. While they will put downward pressure on house prices, they will put upward pressure on rents and may reduce the supply of new housing developments in the longer-term. The benefit of increased housing affordability for first-home buyers is outweighed by negative impacts on rents and housing supply, high compliance, and administration costs for an estimated 250,000 taxpayers, and the erosion of the coherence of the tax system".

Even if the policy change achieved its objective of putting downward pressure on house prices (which it ultimately didn't) the IRD outlined a comprehensive list of reasons why the policy should not be implemented.

Treasury supported the policy, but only because it "addresses the Government's demand-side housing objective of moderating prices". As we can see above, the policy failed to do this.

However, Treasury did not support any exemptions for new builds. They said they are "of the view that there should be no new build exemption, and that if there is one it should be as short as possible". This position supports rejection of the current policy calling for large BTR developers to be exempt.

The third Government department to provide advice on implementing the policy was Housing and Urban Development. Like the IRD, they opposed outright the implementation of the policy. HUD policy advisers opposed the policy "because of the negative impacts it is likely to have on rents, rental churn, the provision of emergency, transitional and public housing, and the feasibility of purpose-built rentals".

All these forecasted and negative impacts have occurred. Rents have increased, tenants have been displaced because they couldn't afford the rental price increases, overcrowding has increased along with demand for emergency, transitional and social housing.

Logically, rental providers and tenants would be opposed to the policy as it directly and negatively affects them through higher taxes for providers and higher rental prices for tenants.

In a possibly surprising occurrence, first home buyers (the beneficiaries of the policy) were also against the policy. The First Homeowners Group could see that rental prices would increase, making it harder for would-be first homeowners to save a deposit.

In a wonderful show of unity, the NZPIF, Tenants Protection Canterbury and the First Homeowners Club wrote a joint letter to the Government, asking them to reconsider implementing the policy.

The letter said that "we believe this policy will not achieve the desired effect of increasing the supply of houses. We believe it will somewhat reduce the supply of rental property, will increase rental prices and make it harder for aspirational first home owners to save a deposit".

The letter was signed by Lesley Harris, First Homeowners Club; Penny Arthur, Tenants Protection Association; and Andrew King, NZ Property Investors' Federation. It was presented in person at a meeting in the office of the honorable Grant Robertson, but was rejected.

Inconsistent treatment of taxpayers

While our previous comments refer to the overall policy of removing interest deductibility for rental property, the following considers the current proposal to exempt large corporate BTR developers.

The IRD Regulatory Impact Statement says that the problem that this policy is attempting to address is a shortage of good quality, affordable rental properties in New Zealand.

The Governments also has stated aims to increase the supply of homes in New Zealand, both owner occupied and rented. To that end they have provided incentives for rental property providers to build new rental properties.

There are certain questions that need to be answered. These include do tenants want to pay the extra rental prices that new properties require? should large BTR developers be the only BTR operators to have the exemption?; will large BTR build the type of rental property that a majority of tenants will want?, will these rental properties be affordable?, and are there better options to achieve the desired outcomes?.

Cabinet has defined the BTR asset class as:

a. 20 or more dwellings in a single development;
b. A single owner;
c. Tenants are offered tenure benefits and/or rights greater than those provided for under the Residential Tenancies Act;
d. Tenants are offered lifetime tenancies;
e. Continuous use as a build-to-rent since they were constructed.

There is no explanation as to why, all else being equal, a development of 19 dwellings cannot claim mortgage interest as a tax deduction while one of 20 can.

The IRD recommends that Government not allow large BTR developers to be exempt, saying "there is nothing inherent in BTR that makes it different from other residential rental property, apart from scale".

Not restricting exemption to developments of 20 or more dwellings opens the potential for the development of far more BTR rental dwellings.

If it is good policy to encourage new build rental dwellings that offer lifetime tenancies, then it shouldn't matter whether one or twenty dwellings are provided.

<u>Will large corporate build-to-rent developers provide the right type of property</u>

Large developments tend to be apartments with one or two bedrooms. There is definitely a need for one- and two-bedroom rental dwellings, but there is also a need for four and five plus bedroom rental properties.

The aim of the proposal is to increase the supply of good quality, affordable rental properties. New properties are good quality, however they are expensive to build and therefore expensive for tenants to rent. Most tenants prefer established properties that, even being of a similar quality, have a lower rental price.

In addition, large BTR developers produce high end properties as these are more profitable for the developers. This makes these properties attractive to only a small proportion of tenants who are willing and able to pay top rental prices. Large scale BTR Developers also target these tenants as they know they are easier to manage and therefore aren't as affected by changes to the Residential Tenancies Act which makes it harder to end the tenancies of problematic and antisocial tenants.

Small scale rental providers have lower overheads than large corporate rental providers and produce rental properties that a large proportion of tenants actually want. It follows then that small scale BTR developers are more likely to build and provide the type of rental property that is most need in New Zealand.

<u>New build rentals not required to increase housing supply</u>

Part of the aim in exempting large BTR developers from interest deductibility restrictions is to increase the overall supply of housing in New Zealand.

While this is an admirable aim, it ignores tenants who do not generally want new rental properties and the higher rental prices that come with them. In addition, you do not require new build rentals to increase housing supply.

While it is true that physically building a property is a requirement to increase supply, you do not necessarily have to build a new rental property. This is due to the cycle of home ownership.

Typically, first home buyers and tenants want low-cost homes to own or rent. Building in New Zealand is expensive and factors such as development contributions make it unfeasible to build smaller low-cost housing. Therefore, most first home buyers and tenants prefer low cost established homes.

Homeowners looking to upgrade their homes are more likely to build a new home than first home buyers. To do so, they first need to sell their existing home which is likely to appeal to first home buyers and tenants.

By buying the older and established low-cost property, first home buyers and rental providers allow the homeowner to build and move into their new home.

There was an enormous level of low-cost new builds in the 1970’s to accommodate baby boomers reaching the age of home ownership. As their circumstances allowed, baby boomers built new and bigger homes, leaving their smaller lower cost houses for subsequent generations.

So, while there will always be some requirement to build low-cost housing, it isn’t absolutely necessary to do this in order to increase the overall stock of housing.

Is there a better option?

Officials from the IRD plus Housing and Urban Development did not support removing mortgage interest as a tax deduction for residential rental properties.

They advised that this policy would reduce supply of rental properties, increase rental prices, increase homelessness, and increase the requirement for social housing. This is precisely what has happened.

We have a shortage of rental property in New Zealand which has got worse since this policy was announced. Rental prices have increased more than they otherwise would have. Many tenants have increased the number of people they have in their rental properties leading to overcrowding. The lack of supply has forced tenants to accept rental property that is in areas they do not want to live in and is of a quality that is not what they want. These tenants have pushed out more marginal tenants that used to live in these properties, leading to a four-fold increase in homelessness and extremely high demand for emergency housing. The Government is now paying one million dollars a day in emergency housing as a consequence. The social housing waiting list has increased from 5,000 to 27,000 over the last 5 years.

It costs the Government (and therefore taxpayers) much more to provide state housing and social housing than it does to provide support for low-income families renting in the private sector.

The small-scale private providers have been much maligned over the last few years. However they generally provide good quality and appropriate rental accommodation at reasonable prices and this is less of a burden on government funds.

If less money was being spent on emergency housing, it could be spent on education. If we increase the number of state and social houses, then we have less to spend on healthcare.

We have a rental crisis in New Zealand and small-scale rental providers are the solution to this crisis. Rather than putting roadblocks in the way of private providers, we need to encourage them to provide more rental accommodation.

The NZPIF is not asking for any special treatment to accomplish this. We would point out that some of the policies introduced over the last five years have not achieved their purpose, but they have caused the rental industry, including tenants, severe harm.

If the policies of interest deductibility, ring fencing and the bright line test were reversed then providing rental property would be much easier and cheaper. If rental properties were easier to manage, then more people would be willing to provide them.

A key desire for the proposal to exempt large BTR developers from interest deductibility rules is better security of tenure for tenants. However, this can be accomplished in a much better way by establishing a new and additional long term rental option.

A model for this new tenancy type is detailed in the NZPIF plan to fix the rental crisis. This new tenancy type could be provided by any rental provider, not just large BTR developers and would therefore be more widely available to tenants that desire and would benefit from longer term rental security. A summary of the NZPIF plan to fix the rental crisis is on the NZPIF website where you can also see a full report of the NZPIF plan.

Conclusion

Removing interest deductibility for residential rentals goes against established tax principles and is discriminatory. It is inconsistent with other Government aims to provide tenants with safe, warm, dry and affordable rental homes. More importantly, it has not achieved its aim but has exacerbated a rental crisis in New Zealand. The undesirable outcomes of the policy, pointed out by various Government policy advisors, have proven correct.

While BTR is appropriate for New Zealand, new rental properties are expensive to build and for tenants to rent. The majority of tenants do not want to pay a rental price premium to live in a new rental property. Build-to-rent is not the key to solving New Zealand’s rental crisis.

Large BTR developers are a small proportion of all BTR providers. They do not provide the type of rental accommodation required by a majority of tenants and should not receive extra incentives to operate.

In addition, it is inconsistent and irrational to treat rental providers differently solely because of their size. Why should a development of 20 dwellings be able to claim mortgage interest as a tax deduction while one of 19 cannot? If it is good policy to encourage new build rental dwellings that offer lifetime tenancies, then it shouldn’t matter whether one or twenty dwellings are provided.

If improving security of tenure for tenants is desired, there is a better way to achieve this, by establishing a new long-term tenancy option for all providers and tenants to access.

Recommendations

The NZPIF recommends that:

1. The decision to remove mortgage interest as a legitimate tax deduction for residential rental properties be reversed for all rentals.

2. If recommendation one is unachievable, then all BTR providers are treated equally and the requirement for having 20 dwellings be removed.