NEW ZEALAND PROPERTY INVESTORS FEDERATION

Proud providers of rental homes

Submission to the Reserve Bank of New Zealand

"Debt Serviceability Restrictions"

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New Zealand Property Investors' Federation

New Zealand Property Investors Federation (NZPIF)

This New Zealand Property Investors' Federation Inc (NZPIF) welcomes the opportunity to provide feedback for the Reserve Bank on Debt Serviceability Restrictions.

Established in 1983, the Federation has eighteen affiliated local associations 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, which means we take a balanced role in considering the rental industry as a whole, including the requirements, rights, and responsibilities of both tenants and rental property owners.

Industry Background

There are approximately 1,267,100 owner-occupier properties and 628,800 rented, and 37,300 provided free.[1] (54.9% are rented).

There are approximately 290,000 landlords in New Zealand.

Rental properties house over 1,500,000 tenants[2]. (32.5% of NZ's population)

The national median price of a property is $880,000[3].

There are currently 74,825[4] public (State) houses. Of these, 64,211 homes are provided by Kāinga Ora, and 10,614 community houses are provided by 48 registered Community Housing Providers across New Zealand.

Private landlords are the largest providers of rental accommodation in New Zealand. 87% of tenants rent from a private landlord or trust.

77% of property investors own just one rental property [5]

Most property investors (57%) have been engaged in the business for 10 or more years[6], which rebuts 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.

At the time of the 2018 Census, New Zealand's homeownership rates were at their lowest since the 1950s.[7]

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[1] Statistics New Zealand 'Estimated number of private dwellings in New Zealand by tenure' 1991-2021.

[2] 2020 Statistics NZ – Housing in NZ 2020

[3] REINZ Monthly Property Report January 2022 REINZ.

[4] HUD Public Housing Quarterly Report September 2021

[5] MBIE

[6] ANZ NZPIF Annual Survey 2006

[7] Housing in Aotearoa 2020.

There were 25,887[8] people on the Public Housing Register in January 2022.

Statistics NZ has made a comparison of household expenditure from 2021 compared to 2020[9]:

- total rent payments (up 5.4 percent) to $392.30 per week from $372.30
- mortgage principal repayments (up 17.5 percent) to $273.40 per week from $232.60
- property rates (up 5.3 percent) to $61.20 per week from $58.10
- building-related insurance (up 5.7 percent) to $39.70 per week from $37.60.
- Mortgage interest payments decreased, down 14.9 percent to $203.20 per week from $238.70, compared with the year ended June 2020.

The rental property industry paid tax on net rental income of $1,444,000,000 in the 2016 financial year[10]

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[8] HUD Government Housing Dash Board, January 2022

[9] Statistics NZ

[10] IRD Data, April 2018

Executive Summary

Over the last few years there have been many changes to the industry for private rental home providers. We have seen a period of extreme growth of house prices due in part, to the Covid -19 stimulus package. This, in turn, has increased house prices at an alarming rate, reduced mortgage interest rates to levels never seen in this country and increased rents for tenants. 2021 was also a time when the Government changed its focus. The March '21 announcement "The Government's goal is to encourage more sustainable house prices, by dampening investor demand for existing housing stock to improve affordability for first-home buyers" Finance Minister Grant Robertson said. The main parts of this policy were to treat newly built properties differently from older properties with regard to the extension of the Brightline Test and the removal of the ability to deduct mortgage interest as a taxable expense.

New Zealand Property Investors Federation (NZPIF) does not believe that changing banking requirements to include a Debt-to-Income ratio in its calculations will help achieve the goals set out on March 2021. Any DTI requirements would only reduce the number of rental homes, increase rents, cause overcrowding which will have adverse health effects on tenants, make it harder for first home buyers to save for their own property, and would not encourage more investment in new build houses.

Discussion

<u>Why NZPIF do not think that DTIs should be introduced</u>

NZPIF does not believe it is necessary to introduce a DTI policy. New Zealand banks are extremely conservative in their lending and already have lending policies that do not willingly subject them to any potential losses from their customers.

Loan to Value restrictions are applied by both internal and external requirements, and the serviceability equations used by banks already ensure that banks do not place undue hardship on their customers.

Each bank has its own lending criteria and can make judgments as to what the risk profile they are prepared to make for each client. To oversee them in such a way as restricting who and what they lend to customers is both unnecessary and uncalled for.

The aim should be to do everything possible to increase the supply of houses.

Any additional finance restrictions will stop Mum and Dad investors from supplying much-needed rental houses.

<u>What the Labour Government said in 2016/17</u>

In 2016/17 Labour politicians stated that they don't think that DTI limits should be used. "We have concerns that blanket debt to income ratios will exclude even more first home buyers from getting into a home," finance spokesman Grant Robertson has said. "More than a third of lending to owner-occupiers in the year to May was at a debt-to-income ratio of five or more."

And they are right to point out that there are disadvantages to implementing a debt-to-income limit.

The United Kingdom DTI Restrictions

Debt-to-income restrictions are already used in the United Kingdom, where most owner-occupier buyers are restricted from getting a mortgage higher than 4.5 times their annual earnings. However, it is not widely appreciated and seldom mentioned that these restrictions do not apply to buy-to-let investors (i.e., rental property investors) under the current UK scheme. If you do want to control property prices, then this makes sense – first home buyers, driven by emotion, tend to bid prices up while investors, seeking a bargain and with one eye on their calculators, tend to hold prices down.

The UK limits were imposed in June 2014. House prices across the UK rose 6 percent in 2015. In May 2016, estate agents Stirling Ackroyd announced that most of London's property market has seen values rise by 8.2 percent during the past year. Of course, it could be argued that without the DTI, these price rises would have been greater, but no one could prove that either way.

Tenants

There are approximately 1,267,100 owner-occupier properties and 628,800 rented, and 37,300 provided free.[11] (54.9% are rented). Rental properties house over 1,500,000 tenants[12]. (32.5% of NZ's population). Information from Housing and Urban Development shows that only about 25% of tenants have the ability and means to buy their own house. Any restrictions to finance such as a DTI should not be at the detriment of these tenants being able to save and purchase their own properties if they choose to do so.

Current changes to regulations and policies have had a major impact on the number of rental houses available for tenants. There were 25,887[13] people on the Public Housing Register in January 2022, and the numbers are only increasing. Implementing another policy that reduces the number of rentals available for tenants would provide further impetus to this rate of increase.

Although private renting predominated for all age groups of tenants, almost one-third of renters aged 65 and over lived in social housing.[14] There is provision in the discussion paper for Community Housing Providers, these provisions should also be available for private landlords. Private landlords are more efficient and cost effective at providing houses for people than any corporate or Government could be.

A reduction in the number of available rental houses ultimately leads to an increase in rents, leading to overcrowding of dwellings, which will inevitably have negative health impacts on the tenants. It could also result in extreme hardship for tenants as rents increase as the obvious reaction to an even shorter supply. It is also noteworthy that as rents increase, the time taken for those tenants to save the deposit for a house also increases.

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[11] Statistics New Zealand 'Estimated number of private dwellings in New Zealand by tenure' 1991-2021.

[12] 2020 Statistics NZ – Housing in NZ 2020

[13] HUD Government Housing Dash Board, January 2022

[14] Housing in Aotearoa 2020.

Immigration

New Zealand has had a recent period of little immigration due to border closures and Covid-19 restrictions. Annual migration has changed from a net gain in 2020 of 36,800 down to a net loss of 3,900.[15] When NZ finally re-opens the opportunity for immigration, these people will require houses to live in. Many of these immigrants will be unable to purchase properties until they have been in the country for several years and their visa status allows them to. Therefore, they have no option but to rent. In the meantime, they require somewhere to live.

Property Investors have been incentivised by the recent tax changes to purchase new houses or to build new houses with the benefit of mortgage tax deductibility and modifications to the Brightline Test. Any DTI restrictions should not stop the building and supply of houses from filling the lack of housing supply.

In New Zealand, house prices have been rising faster than wages over the past five years. The Auckland median house sales price in mid-2020 was about 11.5 times the median household income[16] (Over the past 12 months, we have had additional increases in house prices, so this number would be even higher). To even introduce a DTI ratio at anything less, would not allow most people to purchase a property.

NZ as a nation is a country made up of many small businesses. These businesses should not be restricted in growth due to the inability to gain finance, whether from a personal loan to support their business or mortgage debt.

Overseas buyers should not be penalised or advantaged by any DTI regulations.

First Home Buyers

The aim of the current Government has been to get First Home Buyers into houses. A DTI, if implemented, should be intended to assist this sector of the market. However, reducing the number of rental properties available in the meantime will increase rents and thus increase the time it will take for anyone in this sector of the market to save sufficient funds to purchase a house.

As a DTI is imposed at a specific time in someone's life, it does not take into account the future earnings of a person. Someone who has recently graduated from university with a huge student loan, although struggling at the start of their career, may find that they have excess funds available as time progresses.

The housing market is challenging to predict. As such, any implementation of DTI restrictions must be timed to still encourage investment in the area to provide houses for those who either choose or cannot afford to buy their own property.

Owner-occupiers

Like many interventions, introducing a debt-to-income rule will have an impact initially. If like the CCCFA slows the market substantially, it must be removed.

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[15] Statistics NZ 2021
[16] Housing in Aotearoa 2020

Owner-occupied properties and landlord's rental properties should be treated differently by any DTI policies. An owner-occupier has many outgoings, including living costs, e.g., mortgage, rates, insurance, food, living expenses, house maintenance, water, clothes, etc. However, when purchasing an investment property, an investor only has the costs associated with the property, e.g., mortgage, rates, insurance, and maintenance. All other living costs lie with the tenant.

Limiting households' opportunities to borrow would also slow consumption and economic activity.

A debt-to-income limit entails that some households are forced to borrow less than they consider optimal. This means that the households' ability to smooth their consumption over the life cycle is limited, which in turn leads to the households achieving lower welfare than if they were able to borrow more.

For example, in general, young-person households have lower salaries at the beginning of their professional lives but often excellent salary potential. By applying a debt-to-income limit, the banks' possibilities of assessing the households' potential payment capacity disappear to some extent since it is current income that forms the basis for the credit assessment even though a mortgage has a term of many years. A debt-to-income limit can thus make it difficult for young households with good creditworthiness to enter the housing market. A debt-to-income limit is also more limiting for households in the higher income groups than, for example, limits to discretionary income.

By limiting how much households may borrow, a debt-to-income limit also entails a decrease in both consumption and GDP, at least in the short term.

People have different risks that allow them to borrow this also is the same in a person's ability to save when things get tight, and they need to.

Additional income methods, such as crypto currency need to be included in bank calculations.

<u>Private Rental Property Providers (Landlords)</u>

Private landlords are the largest providers of rental accommodation in New Zealand. 87% of tenants rent from a private landlord or trust, with 77% of property investors owning just one rental property[17]

Tenants need a place to live. Private rental property providers are the largest sector providing houses for tenants, and we still need to continue this vital role. Any DTI must not prevent this from happening.

A DTI by design doesn't necessarily take into consideration a person's equity. Landlords are often in a situation where they have substantial equity behind them however, they do not necessarily have the income to support growth of their portfolio. Those with larger portfolios do not necessarily work in paid employment, but manage their rental portfolios fulltime.

Banks have started using reduced rental incomes of about 70% in anticipation of the mortgage Interest tax deductibility. We are already seeing a reduction in the number of investors who can secure finances for a new rental property.

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[17] Ministry of Business Innovation and Employment

Any introduction of a DTI would have to be made for future purchases. Banks have allowed many investors to borrow large sums of money over the past few years, and to retrospectively go through someone's finances and now consider them unable to service a loan that they have been managing sufficiently for some time would be devastating.

Regional Changes

Homeownership percentages continue to be higher outside the main centres – for example, 8 out of 10 households in Waimakariri and Selwyn districts lived in owner-occupied dwellings.[18] Homeownership rates in our major cities in 2018 were generally well below the national average.

As the price of houses is higher in larger cities therefore, it may be necessary to apply a specific DTI ratio to a specific area. Continual investment and alternative housing opportunities must be available for people living and working in these areas.

Other finance options

New Zealand Banks are conservative by nature however, there are alternative finance companies (such as second-tier lenders) that can provide finance. If DTI restrictions are too stringent, borrowers will find alternative avenues for finance. These may not be the best solution for the country's financial stability and may lead to adverse outcomes for both lenders and borrowers.

Banks already have their unique method of setting floor rates. Too much bureaucratic meddling in how a bank runs its operation is not in the best interests of the bank, its management, and shareholders. Like any business, any bank does not set out to fail.

After introducing the CCCFA requirements in December 2021, property investors find that finance is getting harder to find and are looking for alternative funders.

Community Housing Providers

Even with the high levels of support, government and social housing providers cannot provide all the properties needed to accommodate all those tenants requiring a house.

The costs of Kianga Ora and other Community Housing Providers to supply a house for a tenant are considerably higher than that of a private rental property provider. The ongoing costs to the taxpayer of providing more social housing are substantial and will prove to be a heavy drag on the public purse.

Overseas buyers

The proposal of a DTI would appear to advantage overseas buyers who either have ready cash available or who could arrange access to loans outside the New Zealand banking system, as it would reduce competition from local buyers who would be affected by the restrictions.

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[18] Housing in Aotearoa 2020.

Unintended Consequences

Particular attention should be paid to the unintended consequences of any changes. We have seen a magnitude of changes to our industry, including the Brightline Test, the removal of mortgage interest tax deductibility, CCCFA, ring-fencing, deposits required, and Loan to Value restrictions, to name a few. All were implemented for a specific reason however the consequences of some of these legislative changes have many unanticipated broad and far-reaching effects.

Since the recent removal of mortgage interest tax-deductibility, many property investors have not had an opportunity to talk to their financial advisors. NZPIF believes once the impact of these changes are realised at the end of the financial year (in many cases March), many investors will take a good hard look at their portfolios. They may make the decision to sell down one or two properties or even leave the industry if they cannot foresee any capital gains in the near future.

Any further implementation of changes to macroprudential tools should not be implemented until we see the effects of these policies.

Final note

While a DTI could slow down the local market, it is still a band-aid solution to a bigger problem. There is an imbalance between the supply and demand of property, particularly in Auckland, where mortgages tend to be the largest in New Zealand. If you have 100 people who want to buy but only 99 houses available, then increasing supply rather than artificially throttling demand is the only sensible long-term solution.

The key question surely is not 'Can We Do It' but 'Does It Work?'