Lots of action, but none that will fix the housing market

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Even before Covid, house prices in much of New Zealand were very high. Over the last year or so they've again risen sharply almost everywhere, putting home ownership further beyond the reach of most, and underpinning rising rents. This dreadful situation, transferring resources (wealth) from the relatively poor and young to the relatively rich and the risk-takers, is utterly unnecessary and deeply unjust.

In a well-functioning market, times like these should be a renter's dream. Purchasing a house should never have been cheaper, and rents should be lower (in real terms) than ever.

That's because interest rates are at record lows. The New Zealand government's 20-year inflation-indexed bond currently trades at about 0.8 per cent. 25 years ago the comparable rate was about 5 per cent. Basic finance theory suggests that when rates of returns on one long-term asset fall so will those on other long-term assets. And in a well-functioning market, rents are the main source of return to the owner of the rental property.

But a well-functioning market is one in which it is easy to bring to market and develop new land and new houses. In that sort of market, developing the new land (building the new houses) would now be easier and cheaper than ever. It takes time to develop a subdivision and build houses, and finance costs are one of the major costs those in that business face. New Zealand has abundant land, that could readily be converted to urban uses. So, of course, does Wellington, and much of the land surrounding Wellington isn't worth much in alternative uses. But if regulations make land artificially scarce, then lower interest rates (or other sources of higher demand) can translate quite quickly into higher house/land prices.

The alternative isn't just some theoretician's dream. When I wrote here six months ago, I highlighted Little Rock, Arkansas, as one example of the many growing, pleasant and highly-affordable US cities. Real house prices in Little Rock hadn't changed much in 40 years and median house prices appeared to be about NZ$300000. Interest rates are at least as low as those here. Check any website and you'll easily find modern townhouses to rent in Little Rock for no more than NZ$1000 per month. Try that in Wellington.

In a well-functioning market, when interest rates fall and prices look like beginning to rise, owners of land (whether existing sites in the city or new areas at the periphery) should be falling over themselves to get new land, and then new houses, to market, and owners of rental properties should be competing aggressively to get and keep tenants. The alternatives would be a vacant property (earning nothing) or money in the bank (earning little more).

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But this is New Zealand where, absent a well-functioning market, house/land prices have surged again, where rents have been rising, and where price to income ratios - which should be less than 4 in well-functioning markets - are now more like 10.

There has been all manner of policy announcements this year, some substantive and others little more than rhetorical. The government has extended the "bright-line test", so that investors selling properties within 10 years will pay a sort of capital gains tax, and – in one of the more bizarre moves - is legislating to stop businesses owning investment properties deducting their interest costs against taxable income. A select committee is looked into new resource management legislation. And, of course, some councils - including Wellington's – are moving to allow some more intense development in some parts of the city. Bureaucrats have got in on the act too, with renewed loan-to-value (LVR) restrictions from the Reserve Bank and the threat of more restrictions to come. And the government has insisted that the Reserve Bank should talk more about house prices.

But there are two pointers that none of this amounts to much more than performative display. The first is that government ministers - from the Prime Minister down - refuse to express any interest in lower house prices. Instead, they talk repeatedly about just lowering the rate of increase. Councillors, and Opposition parties, are rarely much better.

The second clue is that prices have kept on rising, and at best are perhaps expected to fall back just a few percentage points over the period ahead (despite the huge increases we've seen). If people - smart people with lots of money at stake - really thought that the policy changes already made (tax rules, access to finance) or those in the works (such as the replacement for the RMA, or the National Policy Statement on urban development) were going to make an enduring difference, we'd see to see it in the prices of the assets already. That is how asset markets work, whether stock markets, foreign exchange markets, or (a little more murkily) land markets. But there are no signs or reports of substantial falls, whether for existing properties or potentially-developable land.

This year's measures aren't designed to fix the broken housing market, just to throw some sand in the wheels, be seen to be doing something, and perhaps to buy a bit of temporary relief. Nothing done or promised is likely to make very much sustained difference at all, because none of it gets to the source of the problem.

Some put a lot of hope in provisions allowing for greater urban density - even as our cities are already quite densely populated by New World standards. They are probably wrong to do so. Increasing density has already been a feature of the last few decades - think of all the infill housing a decade or two back – and, of course, the physical footprint of our cities has also expanded. But in the face of rapid population growth - likely to resume once Covid passes - these grudging changes have only been enough to avoid house prices rising sooner to even more outrageous levels.

Without a radical freeing-up of land use at the periphery, creating aggressive competition between development options in cities and those at the margins, simply allowing a bit more densification will not bring land prices down. It may even bid up the prices of some sections, now able to be developed more intensively. A lot of houses are being built right now, but there is no prospect of enduringly much lower prices unless or until owners of vacant land, on the peripheries of our city, are free to bring that land into housing and other urban uses.

New Zealanders should be able to count on a well-functioning housing/land market and ready access to finance. Increasingly we have neither; just more complexity, more inefficiency, and more-unaffordable house/land prices.

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