pensionbriefing

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How much do New Zealanders actually invest in residential rental properties?

RPRC *PensionBriefing* 2010-1

This *PensionBriefing* investigates a claim in the Tax Working Group's 2010 report that New Zealanders have $200 billion invested in residential rental properties.

In summary

It is frequently asserted that New Zealanders have too much invested in residential properties that are held for investment purposes. Apparently, the structure of the income tax system has incentivised New Zealanders to that 'over-investment' so it seems that the tax system may be changed in the next Budget (May 2010). Part of the reason for the expected change is that, despite the so-called over-investment, owners returned overall tax losses so it looks as though owners as a group are gaming the system.

A closer look at what is known about New Zealanders' real estate portfolios suggests that the amount actually invested in rental properties is somewhat less than claimed: perhaps less than half.

We need better information than what is available before far-reaching decisions are made to the tax system.

Background

During 2009, the Tax Working Group (TWG) took on a semi-official task of looking at aspects of the structure of taxation in New Zealand. It sponsored a number of papers on the different New Zealand collects tax with a view to proposing a more efficient, more equitable way of organising this. Part of the TWG's brief from the government was that any change had to be revenue neutral. If there were to be any cuts, for example, to the top tax rates, they had to be matched by tax increases elsewhere.

The TWG's January 2010 report placed considerable emphasis on the way New Zealanders had responded to 'signals' embedded in the tax system; and how they might respond to changes in that structure. One consequence of the current arrangement was that, apparently, New Zealanders over-invested in residential rental properties.

> "A consequence of the tax treatment of rental property investment is that the $200 billion investment in rental housing generated net rental losses totalling about $0.5 billion and approximately $150 million in tax revenue losses in 2008." (Tax Working Group, 2010, p. 26)

The TWG's report gave no source for the $200 billion investment – this *PensionBriefing* attempts to understand its origin.

Some statistics on the value of property ownership in New Zealand

Public policy debates require quality information so that the discussion of alternatives can consider all the possible implications of change. A closer look at the TWG's claim raises some possible questions. Data on New Zealanders' ownership of property include the following.

1. 'The 2002 'Household Savings Survey' or HSS

Statistics New Zealand and the Retirement Commission produced the most detailed account of what New Zealanders owned and owed (Statistics New Zealand, 2002).

Table 1 summarises the HSS numbers on property-related assets owned by New Zealanders in 2001. The summary excludes the value of farms, Maori assets, trusts and business assets. Values are based on the 2001 rateable value of the properties.

Table 1: HSS property-related assets

	Gross value in 2001[1] ($million)	Proportion of total gross assets
House lived in	$159,205	36%
Holiday home	$4,361	1%
Rental property	$18,887	4%
Overseas property	$4,194	1%
Commercial property	$7,343	2%
Other property[2]	$9,863	2%
Totals	**$203,853**	**46%**

The HSS numbers are now nine years old (and were not 'market value' at the time) but:

- In 2001, the total gross value of all *residential* property owned by households was $182.5 billion (46% of all gross assets owned by households[3]).
- Of that total, 'rental property' investments (not commercial) were $18.9 billion or 10.4% of the total housing assets.

According to the Real Estate Institute of New Zealand[4], house prices rose between September 2001 and January 2010 by 202%. The adjusted total value for all residential property would, on that basis, be $369 billion and the adjusted value of just 'rental property' investments would be $38.2 billion.

2. The Reserve Bank of New Zealand's *Household Financial Assets and Liabilities*

Each year, the Reserve Bank looks at the assets and liabilities of New Zealand households as a whole. This is a 'top down' look at what New Zealanders own and owe, based on readily available statistics. The RPRC has looked at this survey in a previous *PensionBriefing* (Retirement Policy and Research Centre,

[1] Based on rateable values, rather than market values
[2] "Includes empty sections, partially built residential property, and any other residential property"
[3] The 46% proportion of all household assets in all types of residential real estate in 2001 is a somewhat smaller proportion than many might expect.
[4] http://www.reinz.org.nz/reinz/public/housing-price-index/reinz-monthly-housing-price-index_home.cfm

2008a). There are some acknowledged gaps in the data so the RBNZ survey gives an incomplete picture of households' total assets (but, probably, not liabilities).

The last annual survey was carried out as at December 2008[5]. The following summarise the key statistics[6]:

Gross value of all 'housing' owned by households: $568 billion

Net value after allowing for housing debt: $405 billion

Gross value of all assets measured[7] $769 billion

The Reserve Bank's survey defines the measured 'housing stock' as follows:

> "The 'housing stock' value (excluding chattels) illustrated includes all private sector residential dwellings - detached houses, flats and apartments, 'lifestyle blocks' (with a dwelling), detached houses converted to flats and 'home and income' properties - more than 1,450,000 as at December 2005."[8]

The survey offers a breakdown by housing type (but not by value) as follows:

> "Property categories are based on criteria set by the Office of the Valuer General. Every property is assigned to a category by the [Territorial Local Authority], allowing statistics to be generated for specific types of property. For the purposes of this report, categories were chosen to capture the main residential properties. The categories used and number of dwellings in each category as at December 2004 are shown below, for number of dwellings rather than assessments (which are fewer because of multiple dwelling properties)":

Table 2 summarises the RBNZ's data. It includes 'life style blocks' with a dwelling but excludes all other farm dwellings.

Table 2: RBNZ - Categories of dwelling - as at December 2004 reference date

	Number in category	% of total
Residential Dwellings (houses, units, baches)	1,015,000	70.5%
Residential Flats	213,000	14.8%
Properties Converted to Flats	17,000	1.2%
Home and Income Properties	22,000	1.5%
Rental Flats (purpose built)	75,000	5.1%
Lifestyle Improved – lifestyle properties with a dwelling	98,000	6.8%
Total	**1,440,000**	**100.0%**

Source: RBNZ[9] adapted

[5] http://www.rbnz.govt.nz/statistics/az/2989614.html
[6] The RBNZ bases property values on Quotable Value New Zealand data.
[7] For the reasons described in *PensionBriefing 04/08* (Retirement Policy and Research Centre, 2008a), the Reserve Bank's survey does not include assets like business investments, directly owned commercial real estate, farms and some overseas investments. The true gross value of all household's assets is likely to be somewhat higher than the cited $769 billion at 31 December 2008.
[8] As explained here: http://www.rbnz.govt.nz/keygraphs/Fig4.html
[9] http://www.rbnz.govt.nz/keygraphs/1697998.html

Based on Table 2, 21.1% of properties seem to be for tenants. However, for present purposes, Table 2 is not very helpful. All of the properties are owned by 'households' but the categories, despite their descriptions, do not differentiate between owner-occupied and tenanted. A proportion of 'Residential Dwellings' will be investment properties and, equally, a proportion of 'Residential Flats' will be owner-occupied. This distinction is not significant for the Reserve Bank's measures but matters for understanding what proportion of all these household-owned properties are held as investments.

3. National Accounts data

Some indirect indication of the proportions of housing that are (and are not) owner-occupied can be obtained from the National Accounts[10].

The National Accounts analyse the value of improvements measured on current prices, net of depreciation. Tables 3A and 3B show, first, the total improvements of all 'residential buildings', then separately, the total value of 'owner-occupied dwellings'. Not too much emphasis can be placed on the dollar values because they cover just improvements to the properties on a depreciated basis. Of interest is the proportion of improvements to owner-occupied by comparison with all residential properties. In 1972, 58% of the value of all improvements related to owner-occupied dwellings. That proportion has grown steadily over the 35 years to 2007. Since 1999, the proportion has been more than 70% and, for 2007 (the latest year) stood at 71.1%.

In summary, the National Accounts indicate that, for 2007, only 28.9% of the value of housing improvements related to dwellings that were not 'owner-occupied'. Not all of those dwellings would be owned by households, for example, state houses.

Commentary – conflict of data

The data from the HSS and the National Accounts seem inconsistent with the TWG's cited $200 billion invested in residential rental properties.

It is unlikely that the house-price adjusted 2002 HSS number ($38.2 billion) would have grown to $200 billion in only nine years. There may have been an increase (anecdotal evidence supports that) but a 523% increase (20% a year, compound) seems implausible.

Again, by reference to the Reserve Bank's gross housing numbers in 2008, if the TWG's $200 billion were correct, then 35.2% of the value of all housing assets ($200 billion on $569 billion) would be rental property investments. There are two likely problems with that proposition:

a. The 2002 HSS found that only 10.4% of all housing assets in 2001 were residential rental investments. It seems quite unlikely that the proportion of rental properties in households' balance sheets would have increased from 10.4% of all housing assets to 35.2% in only nine years.

b. Secondly, if the 2002 HSS proportion of 10.4% were applied to the Reserve Bank's total housing investment in 2008, the implied value of rental properties in 2008 would have been $59.2 billion. That seems more consistent with the 2010 adjusted value of the HSS number arrived at above ($38.2 billion). If both those numbers are

[10] *National Accounts:Year ended March 2009 – Tables* available here.

correct, that would indicate a 55% increase in the real value of investments in residential rental properties over the nine years since the 2002 HSS data were collected. That is a more credible increase than the 523% referred to above.

What was the source of the $200 billion?

However, the 35% number ($200 billion on $569 billion) is a clue to where the TWG probably obtained its widely cited statistic.

The RPRC asked the Inland Revenue for the source of the TWG's $200 billion and was referred to a paper used by the TWG in its consideration of taxes associated with property ownership and investment. Here is the relevant reference:

> "We also use census data to provide a pro rata estimate of residential land and property that is investor-occupied." (Coleman & Grimes, 2009, p. 30)

Table 3 of the report (2009, p. 53) suggests that the total of 'investor-owned residential' property on this basis was $213 billion in 2006 (37% of the total value of all 'residential' property).

The report's comment was made in the context of a study that looked at different ways of taxing land and their likely distributional and efficiency impacts. It made no further analysis of the $213 billion total. However the report did qualify its comment in a footnote as follows:

> "The remaining housing is owned by an owner-occupier either directly or through a family trust. This calculation assumes that owner-occupied and investor-owned properties are, on average, of equal value. If owner-occupied homes average a higher value, our pro rata estimate of investor-owned housing will be an over-estimate." (2009, p. 30)

The acknowledged difficulty with average values is only part of the problem with this way of calculating the amount New Zealanders have invested in rental properties.

There have been long-run and significant difficulties with using Census data to make any definitive judgement regarding the proportion of homes that are owned by their occupiers. These issues were canvassed in some detail by the RPRC (Retirement Policy and Research Centre, 2008b). In summary, the difficulties are created by:

- The presence of family trusts and the uncertain way in which the 2006 Census questions attempted to discover that;
- The failure of Censuses since 1991 to measure accurately unoccupied housing: whether that is holiday accommodation, vacant rental housing or unsold properties;
- The inconsistent way in which retirement housing is classified.

With those qualifications, we suggest where the Coleman and Grimes obtained the $213 billion total, in the next two tables.

Table 3 shows the relevant Census 2006 results.

Table 3: 2006 Census data[11]

Census 2006 - Table 62		
	Tenure of Household *for Households in Private Occupied Dwellings, 2006*	
Category		Number of Households
10	Dwelling Owned or Partly Owned by Usual Resident(s), Mortgage Arrangements Not Further Defined	26,529
11	Dwelling Owned or Partly Owned by Usual Resident(s), Who Make Mortgage Payments	405,267
12	Dwelling Owned or Partly Owned by Usual Resident(s), Who Do Not Make Mortgage Payments	312,159
20	Dwelling Not Owned by Usual Resident(s), Rental Arrangements Not Further Defined	6,312
21	Dwelling Not Owned by Usual Resident(s), Who Make Rent Payments	388,272
22	Dwelling Not Owned by Usual Resident(s), Who Do Not Make Rent Payments	57,378
30	Dwelling Held in a Family Trust by Usual Resident(s), Mortgage Arrangements Not Further Defined	13,386
31	Dwelling Held in a Family Trust by Usual Resident(s), Who Make Mortgage Payments	72,828
32	Dwelling Held in a Family Trust by Usual Resident(s), Who Do Not Make Mortgage Payments	81,711
77	Response Unidentifiable	22,323
99	Not Stated	68,013
Total		1,454,175

Table 4 summarises the main categories.

Table 4: Census data categorised

Census 2006	
Tenure of Household *for Households in Private Occupied Dwellings, 2006*	
(Grouped by category)	% of all households
1. Dwelling Owned or Partly Owned by Usual Resident(s) (Categories 10, 11 and 12 in Table 3)	51.16%
2. Dwelling Not Owned by Usual Resident(s), Rental Arrangements Not Further Defined (Category 20)	0.43%
3. Dwelling Not Owned by Usual Resident(s), Who Make Rent Payments (Category 21)	26.70%
4. Dwelling Not Owned by Usual Resident(s), Who Do Not Make Rent Payments (Category 22)	3.95%
5. Dwelling Held in a Family Trust by Usual Resident(s) (Categories 30, 31 and 32)	11.55%
6. Response Unidentifiable	1.54%
7. Not Stated	4.67%
Total	100%

Source: author's calculations

It seems that Coleman and Grimes added the 'owned or partly owned' categories (item 1 in Table 4: 51.16%) and the various categories of family trust ownership (item 5 in Table 4: 11.55%) and applied the total of 62.71% to the Reserve Bank's 2008 total value of $569 billion. They assumed that all the rest was rental property held for investment.

There are several difficulties with that assumption.

First, of the other four categories in Table 4 (totalling 12.59%), all could fit into the 'owner-occupied' if only the Census had been able to establish the true ownership position. To illustrate:

- **Item 2** (0.43% of occupied dwellings): if the private dwelling were not owned by the 'usual resident' but the 'rental arrangements [were] not further defined', that could describe a family trust style of ownership.

[11] Available here.

- **Item 4** (3.95% of occupied dwellings): if the private dwelling were not owned by the 'usual occupant' but by an unrelated party, why would they not be paying rent? More importantly for present purposes, why might that be regarded as a dwelling held as a rental investment? It is possible that the house was provided rent-free as part of employment remuneration arrangements but that is less likely to be the case now than in the past.
- **Item 6** (1.54% of occupied dwellings): it seems difficult to understand why a response might be "unidentifiable" and, again, why that might qualify the dwellings as residential rentals.
- **Item 7** (4.67% of occupied dwellings): This is the "not stated" category. Again, given the choices available, it seems difficult to understand why the answers were not provided for 68,013 homes that were actually occupied on Census night in 2006. Regardless, that again means they are probably not residential rental investments.

These four cases illustrate an important issue: respondents to Census questions on the way the family home is owned might reasonably be expected not to reveal information they wanted to keep confidential. The detail of the Census questions on this issue allowed respondents unnecessary 'freedom' as to the answers they gave.

As the *RPRC Submission on the 2011 Census Questionnaire* concluded:

> "Unfortunately, the questions in the 2006 Census form did not help to finally resolve the gap created in the data by family trusts....
>
> In our view, the obvious gaps in the questions asked has left unnecessary doubts inherent in the final results." (Retirement Policy and Research Centre, 2008b, p. 3)

The confusing and porous nature of the 2006 Census questions almost certainly contributed to the relatively large number of failed responses (6.2%) detailed in items 6 and 7 above.

Finally, the Census data in Table 3 exclude holiday homes and other dwellings (not necessarily rental investments) that were empty on Census night. The 2006 Census identified 159,276 dwellings in this category.

The total number of *occupied* dwellings on Census night was 1,454,175 (see Table 3). Adding the *unoccupied* dwellings means that total dwellings in 2006 were 1,613,451 of which 9.9% were unoccupied.

The Census no longer collects data on why homes were unoccupied. The last data were in respect of 1985 and 1991. Over those two Censuses, the average proportion of unoccupied dwellings that were holiday homes was 37.5% and the usual occupier was away in respect of a further 30.5%. So about two-thirds of unoccupied homes on census night in 2006 (59,700 dwellings) may have been owned by households but were probably not rental investments, as the TWG report described those.

From the total of all dwellings, we need to extract the total of known rental dwellings that were not owned by households. In 2010, there are about 69,000 state houses or 4.3% of all dwellings[12]. In 2007, another 14,000 (0.9%) were owned by local authorities (Centre for Housing Research, 2007). These are both in respect of different years from

[12] Housing New Zealand cites that total here.

the census (2006) but the numbers are unlikely to have changed much over the intervening year or so.

In summary, the 2006 Census showed that occupants were paying rent in respect of 23.7% of all dwellings. We do not know whether the amounts paid were market-related rents so even that statistic does not necessarily mean all 23.7% were owned at arms-length from the occupiers.

About 5.2% of all dwellings were owned by the government or local authorities. That leaves at least 18.5% as apparently owned privately in the form of rental investments. It is likely that there were more rental investment properties than that on Census night (for example, empty properties between tenants) but the total proportion of rental investment properties is more likely to be closer to 20% than the TWG's assumed 37.3%. Given that, as noted by Coleman & Grimes (see page 5 above), the average value of rental properties is likely to be somewhat less than the average value of all privately owned housing, the proportion by total value could easily be less than 20%.

The TWG's 2010 report has apparently taken what can only be described as a very rough estimate of the value of 'investor-owned residential' property of $213 billion and rounded it down to the cited $200 billion.

Based on the data analysed in this *PensionBriefing*, that seems an over-simplification.

Can we safely draw conclusions from the TWG's number?

The value of 'rental investment in housing' is likely to be somewhat less than the $200 billion cited by the TWG. As described above:

- The inflation-adjusted, 2002 *Household Saving Survey* total would be about $38 billion in 2010.
- If the 2002 HSS proportion held in investment properties were applied to the Reserve Bank's 2008 total value of all privately owned housing, the amount would be about $59 billion.
- The 2006 Census-based calculation could amount to as much as $114 billion (20% of $568 billion) but could be less.

However, we do not really know.

These smaller numbers put into a more useful context the somewhat dismissive comparison made by the TWG with the total value of all listed shares in New Zealand of 'only' $55 billion (Tax Working Group, 2010, p. 17).

The difficulties with the $200 billion number need to be considered in any potential changes the government is contemplating in relation to the tax treatment of residential property investments.

New Zealand needs better quality information than was offered by the TWG on this apparently crucial point.

If the true number is between, say $60-$100 billion, New Zealand can start a discussion about that level of investment. If it is 'inappropriate' then perhaps we need to consider changes to the income tax system that apparently encouraged that over-investment. If the true number is in fact 'appropriate' then changes to the income tax framework might not be needed on that account alone.

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