A MULTI PRONGED ATTACK

KEY POINTS

- The past week has seen material policy shifts on the part of both the RBNZ and Government to more explicitly target the demand side of the Auckland property market.

- The RBNZ is tightening loan-to-value ratio restrictions on Auckland residential investor loans and the Government has now announced measures targeting speculators and non-resident buyers. A passive capital gains tax regime is being replaced by a more active one within a two-year window and resources given to IRD to monitor. Offshore buyers will require a NZ bank account number and IRD number too.

- Uncertainty surrounds the precise impact – there are a number of moving parts. But we suspect the impact will be stark given the extent of house price movement of late. We believe sentiment could turn on a dime. We will be paying particularly close attention to the number of property listings over the coming months, which could rise sharply as sellers try to beat the 1 October introduction of the new measures.

- Importantly, this shift in housing market performance will be occurring when other challenges such as dairying are intensifying and inflation is low. The risk profile facing the economic outlook continues to shift.

- As such, the new measures reinforce our view that the OCR is heading lower, and sooner as opposed to later. We retain our expectation that the RBNZ will cut in both June and July. We also retain a bearish slant towards the NZD.

FIGURE 1. REGIONAL HOUSE PRICE GROWTH

Source: ANZ, REINZ
Housing Policy Changes

Key Points

Policy-makers have the Auckland property market in the cross-hairs. There have been a number of material announcements made over the past week, which will take effect from 1 October.

- Residential property investors (which the RBNZ is now defining as any property that is not owner-occupied – although the precise definition is yet to be firmed up), will require a deposit of at least 30% if the property is located in Auckland.

- Speculators who buy and sell property within two years (with some exceptions) will be subject to paying tax on any gains – at the seller’s normal income tax rate. New Zealand does have a “capital gains tax” of sorts at present but it’s a soft-edged one that is dependent on one’s “intent” when purchasing. Intent is now simply assumed to have been capital gain if you sell within two years. That moves the passive capital gains tax regime of present into a more active mode.

- The IRD is receiving additional funding in the Budget to more actively enforce the “passive” nature of the current regime – so that selling a property after two years and one day is still likely to be tested against the “intent” yardstick.

- Non-resident and New Zealand property investors buying and selling any property other than their main home will need to have a New Zealand IRD number and provide this as part of the usual land transfer process.

- Non-resident buyers and sellers will need to provide their tax identification number from their own home country, along with identification such as a passport.

- In order to obtain a New Zealand IRD number, non-residents will need to have a local bank account. No more flying under the radar. Such steps hint of targeting the “grey” channels.

- The rules may have the effect of dissuading foreign investment in NZ residential property. Not only are the bureaucratic/ transparency requirements heightened; a withholding tax on all foreign investors selling property was explicitly mooted as a possibility down the track (mid-2016). This appears to be designed to force foreign investors into the tax net at the outset (i.e. when the sell) – they can then seek to recover any withholding tax by filing a NZ tax return (where they will effectively have the burden of proof that they are not in the “speculators” camp).

- There are also mooted changes to immigration rules. While not confirmed yet, the Government is considering giving even more points to immigrant investors, entrepreneurs and skilled migrants who are willing to settle outside of Auckland.

Comment and Assessment

The precise economic impact of all these changes is difficult to disentangle. There is a lot of uncertainty surrounding the precise application, and there are a number of moving parts. However, we can make some brief observations, focusing on the spirit:

- The initiatives don’t apply until 1 October 2015, and that may distort behaviour in the meantime. Some sellers may rush to get out while the going is good. Some would-be investors may also try to skirt the borrowing restrictions by getting in now, but on the banks’ part we expect to see behavioural shifts straight away. The RBNZ has already made it clear that it expects banks to work within the spirit of the changes immediately and we are sure it will be monitoring bank behaviour closely. On net, then, it seems likely the changes could tilt the balance in favour of supply over coming months, further reinforcing the impact on sentiment and house price expectations.

FIGURE 2. REGIONAL CPI RENTAL INFLATION
**HOUSING POLICY CHANGES**

- **More active investor demand management won’t fix the real shortfall of houses relative to Auckland’s population**, but the subdued nature of rental increases in Auckland (CPI rents were up just 2.6% over the 12 months to March) tells us the supply shortage thesis is not the only game in town; demand has also been fuelled by unrealistic expectations of ongoing price increases.

- **The Auckland market is primed to soften.** Prices have risen by a third in two years. That’s a pretty stretched base to keep accelerating off, especially with major sources of buyer “demand” now being targeted. At the very least sentiment will be negatively affected and sentiment is a crucial element of any asset market.

- **We will be paying particularly close attention to the number of property listings over the coming months – we may see a rather sudden rebalancing of demand and supply if sellers race to beat the 1 October deadline** for the introduction of the new measures. Ultimately, we suspect this marks a turning point for the Auckland housing market.

**FIGURE 3. REGIONAL PROPERTY LISTINGS**

![Graph showing regional property listings](image)

Source: ANZ, Barfoot & Thompson, realestate.co.nz

- **It is telling that we have seen such a breadth of policy responses in such a short space of time.** We can point to the obvious financial stability justification (RBNZ) or politics (housing affordability, foreign buyers, the debate on whether we need a capital gains tax etc) but let’s not forget the currency too, with Auckland property one factor keeping the OCR higher than would otherwise be the case. Given commodity price falls, New Zealand needs a lower currency and only interest rate cuts will do that. You can’t simply dangle the possibility or cuts if you really want the currency down. Auckland property was a big hurdle standing between the Reserve Bank and a lower OCR.

- **It’s not only about financial stability and housing affordability concerns.** Given its size and importance, any action aimed at the Auckland property market has real implications for the broader economy and monetary policy. **New Zealand is often perceived as a three-shot wonder growth-wise:** Auckland housing, Christchurch’s rebuild, and dairying. Strictly speaking we think the story is broader than those alone, but each is still significant. Right now, dairying is facing a cash squeeze that will last until 2017. Christchurch’s rebuild is ongoing but the boost is waning and with the housing market cooling and rents starting to recede in the region, the inflationary risk here is turning into a deflationary one. And now we have the Auckland property market under a multi-pronged policy-maker attack. The aeroplane is progressively losing engines.

- **We suspect there is enough economic muscle across the wider economy to cope with these additional headwinds, but it adds to the shifting risk profile. Importantly, the RBNZ must be wary of economic risks around their central projection when it comes to setting policy.**

- **There looks to suddenly be much more coordination between officials when previously it appeared as though they were at loggerheads.** In mid-April, the Government made some comments on interest rates that, while not necessarily undermining the RBNZ’s independence, certainly made it clear what their views were. Arguably in response, RBNZ Deputy Governor Spencer made reference to the need to use the tax system more to target the demand for housing and create some form of registry for non-resident buyers. Certainly there was a bit of tit-for-tat rhetoric going on. But it is uncanny how these recent announcements close the gap in views. **Obviously the RBNZ and Government have been liaising and it all hints of things moving fast of late.**

**THE UPSHOT**

These changes all reinforce our view that the OCR is heading lower, and sooner as opposed to later. June is in play. We can’t see why the RBNZ should wait to assess the impact of such demand management tweaks when core inflation is closer to 1% than 2% and the risk profile across the economy is clearly shifting.
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