

Unnatural disasters

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We've had all too many natural disasters in New Zealand in the last 15 years. We can do a lot to limit the impact of the natural disasters. It is much harder to protect ourselves against the unnatural disaster in which over decades the whims and systematic distortions of central and local government have wreaked havoc with house prices and land use regulation.

I've written a couple of columns here on house prices and policies. Since the second of those columns in late 2021, house prices in Wellington have fallen a lot, but that fall has really just undone the extreme increase we saw over late 2020 and 2021, after interest rates were, with hindsight, left too low for too long. Wellington house prices here are still savagely high, in a modestly-sized city with an underperforming economy.

In well-functioning housing and land markets, interest rates don't make much sustained difference to house prices. When demand for housing increases, supply adjusts pretty quickly. But when it is hard to build, or hard to bring to market land on which building might occur, interest rates have a big effect. So do swings in immigration. Right now we are experiencing record inflows and those population increases are a recipe for fresh increases in house prices. And, indeed, despite interest rates now being at the highest levels for 15 years, we are starting to see house prices rising again.

I'm writing this column a couple of days before the election. It is widely expected that Labour will lose office. If so, it will be the fourth time in succession in which real (inflation-adjusted) house prices have been materially higher at the end of a government's term than they were at the beginning. That's a scandalous failure, a blight on our younger generations, especially those from poorer backgrounds and without parental support.

There has been some progress in the political debate. Both main parties' rhetoric emphasises the importance of supply. When demand for most goods and services increases firms respond pretty quickly by increasing production, and as a result we tend not to see much sustained change in prices. House and urban prices should be like that too, especially in a country with abundant land. There are large chunks of the United States, including big and fast-growing cities, that typically see those sorts of outcomes. Cities where real prices haven't changed much for decades, where good family homes can be purchased for perhaps NZ\$400000. But not in New Zealand.

There have been some policy changes too. Some helpful, others not (among the latter the bipartisan agreement not to allow building on so-called "highly productive land"). But it has been striking how little attention house prices have had in the election campaign. I listened to one finance debate in which the spokespeople for both parties talked in the abstract of house price to income ratios of 3 being desirable (something more like 8-10 has been the experience in Wellington and Auckland recently). But neither of them seemed interested in policies that might soon bring about much cheaper house prices.

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And the market certainly isn't persuaded that a new National government would be any better than the recent Labour government has been. Houses and land are assets, and asset prices trade on information and expectations. If people really believed a likely new government was offering policies that would really free-up and transform the housing and land market, we'd see prices falling sharply now. That would be especially so for land on the edges of our cities. In a well-functioning market that sort of land should be trading at about its value in its next-best alternative use (not much in hilly Wellington). There is simply no sign of that. As I've already noted, house prices are already starting to rise again.

The two sides of politics have recently been offering competing (if overlapping) visions of a better-functioning market. Labour and its allies tend to be reluctant to see increases in the physical footprint of our cities and they back the recent law change in which, for example, three-storey dwellings can be put up almost anywhere. They are keen on encouraging intensification, almost as an end in itself. For them single-family homes, with a backyard and garden, in our cities are some throwback to the 1950s, or a future preserve of the relatively wealthy. In and around greater Wellington, the regional council seems intent on further restricting greenfields development.

National, by contrast, is now offering a different model in which local councils can make choices: they have to zone enough land residential to cover 30 years of future housebuilding needs, but that can be done by focusing on intensification or by increasing the physical footprint of cities.

Neither seems to offer a path towards a well-functioning market characterised durably by much-cheaper prices for houses and peripheral urban land. Labour's approach might well increase urban intensity, but nothing in the international experience suggests that will lower house or land prices. National's approach will tend to increase the physical footprint of some cities - in others, probably including Wellington, a council with an ideological commitment to density will probably opt to stick with the Labour approach - but still falls far short of creating genuine competition, where owners of land in and around urban area are aggressively competing to attract developers and buyers, keeping down house prices (and, over time, rents).

We need to get councils out of the mix completely, and enable real choice and competition. On the one hand, allow any geologically-suitable land to be built on to any height, so long as the builders and developers face the costs of providing water services etc. If someone wants to - although it is hard to imagine - build a 20-storey apartment block on a big property in the Ohariu Valley there is simply no pressing public policy reason to stop them. But we also need to enable small groups of individual property owners (perhaps at the scale of a city block) to act collectively, and cheaply, to limit development on their own properties, but only on their properties, if that is their choice.

This model seems to have worked very well in big and fast-growing Houston, which has seen not only the expansion of the physical footprint of the city, but also a lot of intensification. Provide that option - akin to the covenants seen in plenty of new private subdivisions, allowing for the terms to be amended by supermajority (perhaps 75 per cent of owners) - owners can collectively make their own choices, at their own cost, about the development rules for their own blocks of land. Subsequent choices for more intensive development can also then be managed collectively.

We could, and should, do so much better. Renting and buying should be easy and cheap. The path to such outcomes - as in so many other sectors - is aggressive competition. Sadly, our councils and our main political parties aren't too keen on competition, and still think governments should get to determine the shape of developments. The young and the poor pay the price.