BC2946

December 2013

Housing Matters

Chief Economist's Newsletter

Auckland Council
Te Kaunihera o Tāmaki Makaurau

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Auckland Economic Quarterly—a roundup of Auckland's economy next edition January.

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Welcome to the first edition of Housing Matters, a comprehensive roundup of Auckland's housing market. We have chosen to dedicate an entire publication to Auckland's housing market because of its unique role to the future economic success of Auckland. The most fundamental purpose of any city is to allow people to live and work in close proximity to one another. Such concentration does not come without costs however; and one such cost is rising house prices. Auckland's residential housing stock constitutes around $246 billion or approximately two thirds of the city's capital value[1]. Managing rising housing costs is of critical importance to the ongoing success of Auckland, but with a ranking of 313 out of 337 global cities[2] for housing affordability, there is perhaps no greater headwind to Auckland's growth.

1

Auckland's median house price stood at $582,000 in October 2013, 9.8 per cent higher year-on-year and 25 per cent higher than October 2011.

The Reserve Bank introduced restrictions on high loan-to-value (LVR) lending on 1 October. The LVR limits are directed at preventing a build-up of highly interest rate sensitive debt which could pose a risk to financial stability. We have already witnessed a marked slowdown in national housing approvals, which is likely to translate into slower house price growth through 2014. However, the Reserve Bank still expects to raise the official cash rate through 2014 from the current lows.

2

The number of building consents issues in the 12 months to October was 5690, up from 3330 over the previous 12 months. An extended period of under-building relative to population growth has resulted in some pent-up demand for housing and a tight rental market in Auckland. There is no definitive estimate of the housing shortage, but it's likely to be between 1 and 2 years worth of supply at current levels of consenting activity.

The Reserve Bank announced on 10 December that all qualifying new residential construction loan applications would be exempt from the LVR restrictions from 1 October which is good news for housing supply.

3

Inflation in Auckland's rental market remains fairly contained given that the rental vacancy rate has been falling steadily since 2007. Average weekly rents for the 12 months to October 2013 were 3.5 per cent higher year-on-year, while annual median house prices were 11 per cent higher.

The widening disconnect between rents and house prices suggests there has been a considerable debt-financed speculative element to the latest run-up in house prices.

4

The Council and the Government have announced the first tranche of Special Housing Areas (SHAs) identified for fast-tracked development, with the second tranche to be announced on 18 December.

Resource consent lodgments for land supply and subdivision have already grown strongly over the past 12 months, including for major greenfield developments. This includes a pick-up in resource consent applications for major apartment builds and major subdivisions.

As always, if you have any feedback or comments on the content of this publication, please don't hesitate to get in touch with us.

[1] Auckland Council, draft Annual Plan 2014/15, forthcoming.

[2] Demographia, 2013, '9th Annual Demographia International Housing Affordability Survey'

Solid demand for housing in Auckland

Auckland's housing market regained momentum through 2012, following an extended period of weakness trigged by the 2008/09 domestic recession and prolonged by the coinciding global economic recession.

During this period the number of houses being built was below that required to meet demand from additional household formation growth, and as a result there is now significant pent-up demand for housing.

The combination of pent-up demand for housing, constrained supply and favourable credit conditions set the scene for a further period of strong house price growth over 2012 and into 2013.

Auckland has not been building enough houses to meet growth in household formation...

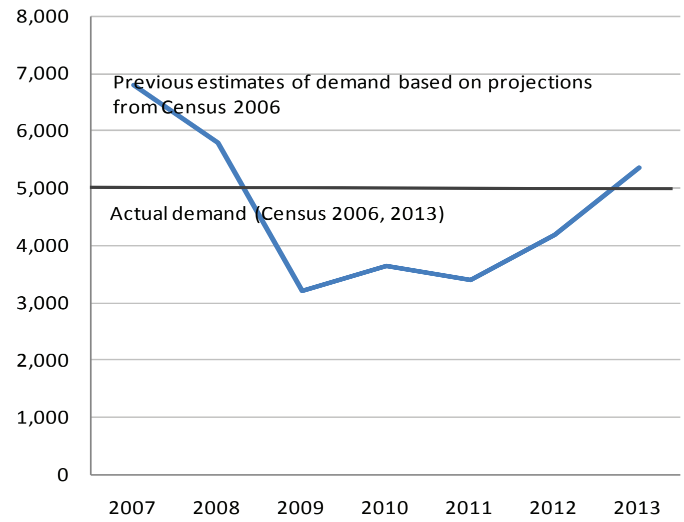
Building consent numbers started trending upwards over the second half of 2011, however the rate of increase has eased back in recent months—consents averaged 490 in the three months to October, down from 563 in the three months to July. While the negative impact of recent strong house price growth on both housing affordability and rental yields could be starting to weigh on demand, the upswing in consents over the past two years has not been uniform, so it's also possible that the latest slowdown is temporary.

Some 5,690 dwelling consents were issued in Auckland over the 12 months to October 2013, an increase of 28 per cent over the previous 12 month period and the highest annual figure since June 2008.

Although consent activity has strengthened over the past two years, it's still tracking below the level of household formation. According to the latest Census data, there were 469,500 households in Auckland as at March 2013, up from 434,268 in March 2006. That equates to an average of 5,033 additional households a year, compared to an average of 4,631 new building consents over the same timeframe.

There is no definitive estimate of the housing shortage in Auckland, but it's likely to be between 1 and 2 years worth of supply at the current levels of consent activity.

Annual household formation vs annual building consents



Source: Statistics New Zealand

...but situation not as bad as initially feared, with population projections below expectations

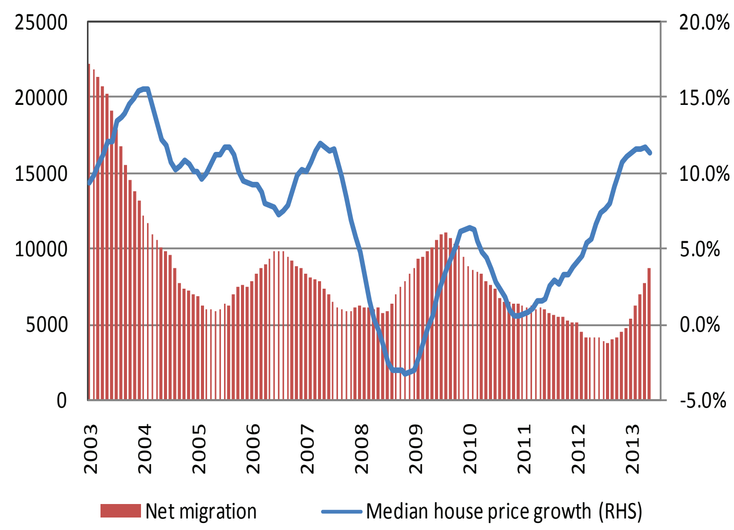
The housing shortage could have been worse if the post-2007 downturn in consenting activity hadn't coincided with a slowdown in population growth. Census figures show that average annual population growth slowed from 2.4 per cent between 2000 and 2006, to 1.2 per cent between 2006 and 2013.

The slowdown was a result of weaker net migration flows: on average, net migration contributed an additional 11,000 persons a year to Auckland's population between 2000 and 2006, but the figure slowed to around 7,000 a year between 2006 and 2013.

This chart shows that there has historically been a strong relationship between large swings in net migration and house price growth in Auckland, but this was not the key driver of the run-up in prices through 2012.

However, we have seen a significant pick up in net migration through 2013 as a result of a sharp slowdown in outbound flows to Australia—net migration for the year to October 2013 was 8702 persons, up from 4070 from the previous 12 months. This equates to the potential for an additional 1500 households (based on a average 2013 household size) looking to rent or buy a house, or 27 per cent of dwelling consents issued over the 12 months to October 2013.

Annual net migration vs annual median house price growth



Source: Statistics New Zealand, REINZ

Auckland's housing market is ranked as 'severely unaffordable' in international rankings

The median Auckland house price stood at $582,000 in October 2013, 9.8 per cent higher than a year earlier and 25 per cent higher than the 2007 peak.

Auckland was ranked as 'severely unaffordable' in the 2012 Demographia International Housing Affordability Survey with an index of 6.7. Across the Tasman, Sydney and Melbourne were also rated as severely unaffordable with indexes of 8.3 and 7.5, respectively.

The table below shows that only 4 suburbs were ranked as affordable in October 2013, where affordability is defined as a multiple of median household income to lower quartile sales price of less than 3. These four suburbs are Papakura South, Grafton, Auckland Harbourside and Auckland Central East. With the exception of Papakura South, these suburbs have a high proportion of one and two bedroom units and this goes some way to explaining their relative affordability.

Excluding Canterbury, house price growth outside of Auckland has been fairly muted over the past couple of years and prices in real terms remain around 20 per cent off their 2007 peaks. These regions are not regarded as having a demand-supply imbalance, so the fact that they experienced strong price growth prior to the 2008/09 downturn highlights the role that financial conditions and expectations have played in driving house price growth. Auckland's housing shortage has kept a floor under prices, but the affordability problem is not purely a supply-side phenomenon.

Auckland Housing Affordability

Affordability	Threshold	Number of suburbs	Percentage
Severely unaffordable	> 5.1	313	89.0 per cent
Serious unaffordable	4.1- 5.0	33	9.3 per cent
Moderately unaffordable	3.1 - 4.0	6	1.7 per cent
Affordable	< 3	4	1.1 per cent

...however, the rental market remains affordable and rental inflation contained.

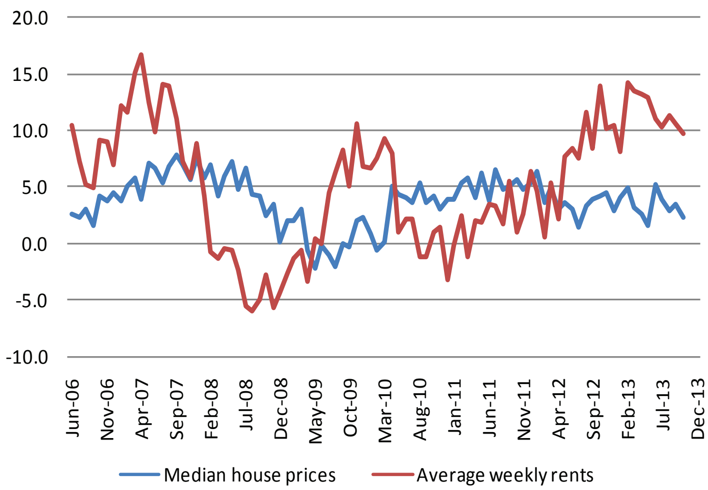
Inflation in Auckland's rental market has remained surprisingly contained considering that the rental vacancy rate was estimated to stand at just 3.3 per cent in September 2013.

Average weekly rental inflation in October 2013 was running at 2.3 per cent, compared to median house price inflation of 9.8 per cent. Consequently, gross rental yields have been under pressure.

Going forward, the relative affordability of renting compared to buying, together with the LVR restrictions and low rental yields, should dampen demand for house purchases and house price growth. Conversely, additional demand on an already tight rental market, and a strengthening labour market, should put upward pressure on rents.

However, it should be noted that the decision whether to buy or rent is based on a time horizon of a number of years, taking into account expectations for house price and rent increases, housing costs (set-up and ongoing) and tax implications, among other things. Moreover, the rental and homeownership markets are not perfect substitutes and homeownership is a key aspiration of New Zealanders, making up the lion's share of households assets. Property has also looked attractive to investors in a low yield environment.

Annual rent vs house price growth



Source: Statistics NZ, REINZ

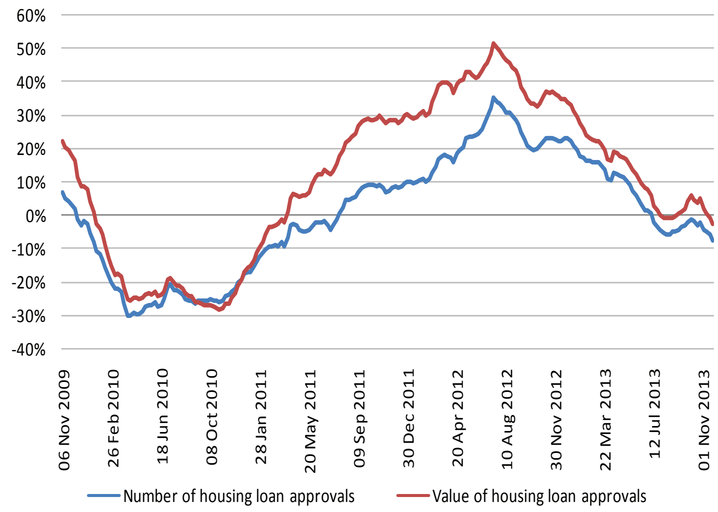
Share of low-equity lending slows sharply following introduction of restrictions

The Reserve Bank introduced restrictions on high loan-to-value ratio (LVR) home lending from 1 October. Registered banks are required to restrict new residential mortgage lending at LVRs of over 80 percent to no more than 10 percent of the dollar value of their new housing lending flows.

Some categories of lending are exempt from the restriction, including loans made under Housing New Zealand's Welcome Home Loan scheme, refinancing of existing high-LVR loans, bridging finance, and loans made to borrowers who are moving house but not increasing the size of their mortgage. To mitigate the impact on first home buyer demand, the government adjusted KiwiSaver and the Welcome Home Loan scheme to make it easier for people to buy their first home.

Recently released Reserve Bank figures show that the level of High-LVR lending (excluding exemptions) fell to 11.7 percent of total new mortgage lending in October, down from 25.5 percent in September and 30 percent earlier in the year. There has been some anecdotal evidence of low equity borrowers circumventing the LVR restrictions through the non-bank lending sector, but this is yet to show up in official data.

National annual growth in housing approvals



Based on growth in the most recent 13 weeks of data to the same 13 weeks in the previous year

Source: RBNZ

Even with their assumptions around the dampening impact of LVR restrictions on credit growth, the Reserve Bank is projecting that the official cash rate will stand at 3.0 per cent by the June quarter 2014 and 4.6 per cent by the December quarter of 2014.

The LVR limits are directed at preventing a build-up of highly interest rate sensitive debt which could pose a risk to financial stability. Without LVR limits in place, interest rate increases would likely have been required sooner to address a build up of inflationary pressures and this would have increased debt servicing costs, reduced affordability and jeopardized an already fragile national recovery.

In response to feedback from banks and the building industry since LVR restrictions came into effect, the Reserve Bank announced on 10 December that all qualifying new residential construction loans will be exempt from the LVR restrictions from 1 October 2013.

The pipeline of supply is growing and includes a number of large-scale land developments

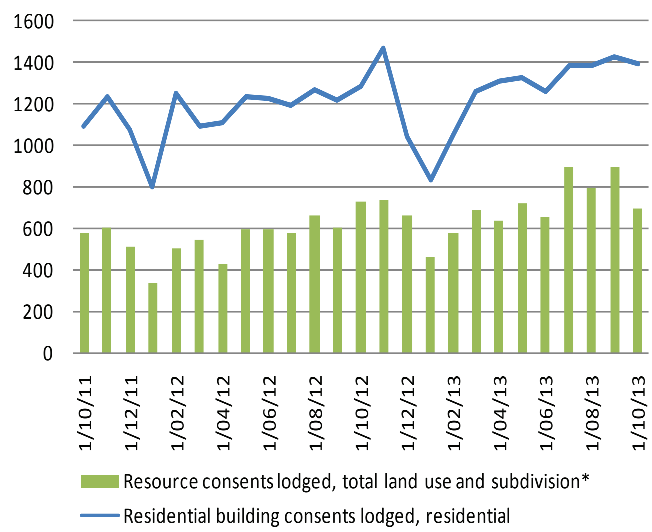
Aside from a small dip in October, applications for resource consents for subdivisions and land use had previously been growing at a faster pace than building consents. Most resource consents have a 5-year timeframe in which to implement or take effect to the consent, while a building consent lapses if the building work does not start within 12 months. The strong run of resource consents applications therefore bodes well for future development.

In the six-month period between May and October 2013 there were resource consents for over 21,000 units/lots in progress or approved, and over 10,000 units/lots at the pre-application stage. Recent land use/subdivision applications granted include:

- Panama Road Mt Wellington—application for 429 units on a 10 ha site (former quarry)
- Manukau Golf course—subdivision into 479 residential lots

Since amalgamation, there has been a significant improvement in timeliness with regards to issuing consents. Legacy councils achieved an on-time processing rate of 92 per cent for building consents and 89 per cent for non-notified resource consents; while the comparative figures for the year to June 30th were 96 per cent for building consents and 95 per cent for non-notified resource consents.

Consenting activity: resource consents vs building consents



Source: Auckland Council

*Includes consents for commerical use

One of the most encouraging developments of 2013 has been the upswing in apartment consents. In the 12 months to October 2013, 878 building consents were issued for flats and apartments, up from 729 in October 2012 and four times higher than the 12 months to October 2010 (note this includes aged care facilities).

Large scale apartment developments have also been prominent in recent resource consent applications. Recent consents granted in the CBD include:

- 17 Wakefield Street – 273 apartments
- 39-47 Union Street –182 apartments
- 5 Howe Street – 143 apartments
- 145 Nelson Street – 757 apartments (staged development)

The apartment building sector was constrained by the collapse of finance companies pre-GFC and then the impact of the GFC itself. However, there have recently been some signs of non-deposit taking mezzanine financiers becoming more active.

First tranche of Special Housing Areas announced, with second expected by year end

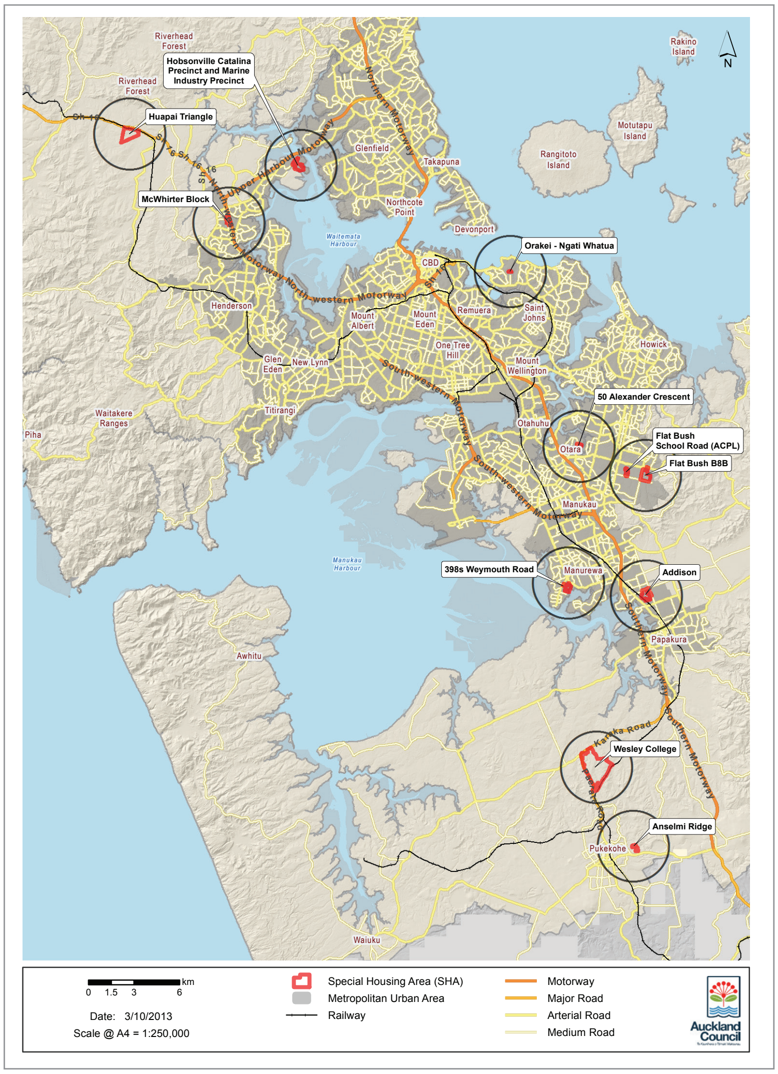
The Auckland Housing Accord between the council and the government aims to increase housing supply and improve housing affordability in Auckland in the interim period until the Auckland Unitary Plan becomes operative. Through the Accord, Special Housing Areas (SHAs) are currently being identified for fast-tracked development.

The Accord will be in place until the Proposed Auckland Unitary Plan becomes operative in 2016, although this could be extended. The target is for 39,000 new homes and sites to be consented over the three-year period—9,000 in the first year, rising to 13,000 in year 2 and 17,000 in year 3.

The council and the government announced the first tranche of SHAs on 9 October 2013 (see figure). The likely yield for this first batch of SHAs is approximately 2,000 new homes and sites in the next three years, but there is capacity for more than 5,500 new homes and sites over time. These numbers are dependent on how quickly property developers and builders establish new homes and sites within these areas. There may be some displacement from sites which otherwise would have been developed, so the net impetus to house building could be lower.

A second tranche of SHAs has been recommended to the Minister of Housing, with an announcement expected on 18 December. The third tranche is likely to be released around May 2014. The second and third tranches are expected to include more brownfield developments.

Areas with SHA status will benefit by having the Notified Unitary Plan zonings apply within them. They will also benefit from an integrated Auckland Council-council-controlled-organisation fast-track consenting process and limited notification and appeals.



The lack of productivity and small scale of the construction sector is a threat to growth

Auckland isn't the only region where housing activity has been running hot: in Canterbury, the loss of dwellings as a result of the earthquake has resulted in a classic demand-supply imbalance, with an acute shortage of stock underpinning strong growth in both rents and house prices.

Annual construction costs in the Canterbury region have been growing at double digit rates since the December quarter of 2012, but we haven't seen much of a flow-on to other regions to date.

The residential construction sector is quite localized, reflecting the fact that it's made up of a large number of small firms—there aren't many large players in the market which would actually compete for business directly with companies in other regions.

In Auckland, there were 5091 businesses registered as operating in the residential construction sector at February 2013. The employment count was 27 per cent lower than the peak in February 2008 and there were only 13 businesses registered with an employment count greater than 20. Skilled shortages have been a major constraint for the Canterbury region—the Ministry of Business, Innovation and Employment's national construction skilled vacancies index stood 25.3 per cent higher in October 2013 year-on-year.

The small scale of the construction sector affects its ability to respond swiftly to a significant pick up in demand, while its lack of efficiency and flexibility also fuels cost pressures. Residential consenting volumes in Auckland are some 50 per cent off their 2004 levels, while non-residential and civil construction activity is currently subdued. However, activity is expected to strengthen across all three sectors in the medium term: there is significant pent-up demand for housing, non-residential markets are tightening and there is a major round of civil construction projects waiting in the wings. With the Canterbury rebuild expected to stretch towards the end of the decade, there is a risk that we will see the emergence of significant cost pressures through the second half of the decade.

Auckland Housing Scorecard

Consents			10 yr trend	Q3	Quarterly Change	Q3-on-Q3 (previous year)
Total dwellings approved	Number		2,001	1,548	↓	24.4 per cent
Detached dwellings approved	Number		1,469	1,271	↑	37.9 per cent
Apartments approved	Number		532	277	↓	-14.0 per cent
Housing Demand						
Real median house price	$	1	485,072	565,143	↑	9.8 per cent
Real average private rents	$/ week		424	447	↑	2.5 per cent
Real average private rents, 3 bedroom	$/ week		454	477	↓	2.4 per cent
Rental vacancy rate	per cent	2		3.3 per cent	↓	-2.9 per cent
Households						
Employment	Number(000s)		663	747	↑	8.0 per cent
Unemployment	per cent		5.5 per cent	6.7 per cent	•	
Real wages	$/week (average)		1,080	1,145	↓	2.3 per cent
Net migration	Net annual flow		7,481	7,680	↑	160.0 per cent
Financials						
OCR	per cent	3	4.9 per cent	2.5 per cent	•	no change
Effective mortgage rate	per cent	3	7.2 per cent	5.5 per cent	↓	-5.1 per cent
Consumer confidence	Index	4	113.9	115.1	↓	10.1 per cent
Annual CPI inflation	per cent		2.6 per cent	1.4 per cent	↑	
Annual Housing CPI inflation	per cent		4.1 per cent	3.2 per cent	↑	
Residential Building Industry			**10 yr trend**	**As at Feb 2013**		**Feb 2013 on Feb 2012**
No. of businesses			5290	5091		0.6 per cent
No. of employee counts			3588	3250		10.9 per cent
Census Data			**2006**	**2013**		**5 Year CAGR**
Population	Number		1,304,961	1,415,550		1.2 per cent
Number of households	Number		434,268	469,500		1.1 per cent
Occupied dwellings	Number		439,701	473,448		
Household size	Number		2.97	2.99		
Vacancy rate	Number		7.00	6.60		

Notes:

All data is from Statistics New Zealand and is not seasonally adjusted, unless otherwise specified. Other sources of data: Reserve Bank of New Zealand (3) ; Real Estate Institute of New Zealand (1); Westpac (4): Ministry of Business, Innovation and Employment (2).

Data presented with the asssistance of the Research, Investigations and Monitoring Unit, Auckland Strategy and Research Department.