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Experts in property care and return

Welcome to your monthly update from Quinovic Merivale on property investment news and opportunities *23 April 2021*

Our good summer continues and so does the level of business so we are very grateful. Interest continues from both directions – new investors wanting us to manage their property and potential new tenants seeking quality properties across Christchurch. No suburb stands out as being in high demand.

What is wanted, which we are struggling to provide, are 3-4 bedroom houses. If you know of anyone looking at renting out a 3 or 4 bed stand-alone home please ask them to contact us. Demand being what it is this could most likely be let within just a few days.

Thank you to those who attended our recent seminar which was very well attended. Now that the Covid-19 restrictions are hopefully behind us we will resume holding these seminars at regular intervals. If there are specific issues that you as a landlord / investor want discussed please let us know. We will identify a qualified speaker to address these issues at future seminars.

Media attention over recent weeks has nearly all been around the recent Government interventions in the Residential Rental sector. There were two significant aspects to these announcements these being:-

- The extension of the Bright Line test from 5 years to 10 years (excluding on new builds). So, if an investor sells a property within 10 years they will/may be subject to tax on any difference between the buying and selling prices. Effectively the Government has in place a capital gains tax under a different name. We seem to recall them saying that under this Government no new taxes will be introduced and no CGT whilst this prime Minister was in office. Seems to have been forgotten. But this aside the extension will most likely not impact on many of our clients. Few investors buy property for the short term. Most property is held for more than 10 years. We do however acknowledge that some landlords are there by 'accident' – maybe unable to sell, maybe inherited property. Please speak with your financial advisors as there are some exemptions to the rules.

- The removal of the ability to claim interest charges on mortgage payments on taxes. Again, for many of our clients this will have little impact as their properties are either freehold or they have small mortgages. But for others however this will add a degree of additional cost to the economics and viability of being a landlord. For some we are aware that this may result in their having to 'top-up' mortgage payments from resources other than rent – this may not be doable. Rents may be able to be increased but there are limitations on this. Others will see a reduction in the positive cash-flow from their investment. It is essential that a cool-head is kept when working through this. Think of it this way. On a $300,000 mortgage @ 5% the interest paid is around $15,000. The tax on this amount varies but let's say its $5,000. With the current level of growth in the price of houses across the country and equally now here in Christchurch, this loss is well offset by the gain. And the gain is still much better than the return from some other investment options and certainly from the banks.
- Other changes announced included a program of land purchases, an increase in first home buyer's incentives and a Development Response fund.

However. A further intrusion into the sector was also alluded to. Limiting rent increases to once every 12 months. This wasn't new – it had been talked about before – but we are hearing 'gossip' that the impacts of this may be much more than anticipated.

- The limit of 'once every 12 months will apply to the property not to a specific rental agreement.
- Should for any reason a tenancy end with 12 months of a rent increase then you may not be able to increase the rent for an incoming tenant.
- But it may not end there. You may not be able to put the rent up within 12 months of the start of a new tenancy. If this cycle were to continue then it could be a long time before a rent increase can be undertaken.

We are not sure this was the intent of the Government when it considered this change but we have heard that Tenancy protection agencies have seized upon this and of course would support it.

We repeat that at this point in time this is just gossip and hearsay. We will keep you informed as more information comes top hand.

Another thing that needs to be clarified is the definition of 'family home'.

The Government has said that the family home is exempt from some of its recent announcements but we now hear that it means 'the prime place of residence' of an owner. We know of instances where the property owner may have moved to live with a family member. The only property they own is then rented out. Because it is no longer the 'prime place of residence' rumour has it that it will fall under changes such as the bright line test and the tax impacts on interest (if the property is not freehold). If you fall under this situation then you should speak with your advisors.

From the media:

- FOMO (the fear of missing out) is quickly being replaced by FOOP (the fear of over paying).

  Property prices continue to increase rapidly. The Government continues to grapple with the housing problem. Concern is mounting that should the Government find a successful solution then this may impact on house prices and they may fall. Coupled again with the fear that interest rates may start to increase potential buyers are reconsidering and delaying purchase.

  An understandable concern but perhaps not reflective of the New Zealand market. A 'fall' in New Zealand traditionally has meant prices stabilise or drop very slightly. We do not see the huge variations such as witnessed in the UK or USA.
- A survey of investors by independent economist Tony Alexander has shown that the Government may have been too quick to disincentivise rental property providers. The survey shows that both investors and first home buyers have become more cautious in their approach to the housing market. 46% of mortgage advisors report that they are fielding fewer enquiries from investors. In February that was only 5%. The survey results have led Alexander to conclude that 'had the Finance Minister had that information in hand he may have been less inclined to take the step of removing tax deductions from rental property revenue'.

  (it is believed that recent changes in the LVR was the cause of the drop in investor enquiries).

- The Government is quick to highlight that under them more state houses have been built than under any Government before them. A total of 3,840 new state houses have been built. Kaiinga Ora has also purchased or leased many existing homes. However, it has also demolished or sold nearly 2,000 state homes, seemingly continuing the much-criticised actions of the previous National Government.

- The NZPIF is calling upon its members to adopt a planned maintenance schedule. Recent changes such as Healthy Homes have forced many landlords into making considerable expenditure to bring their property up to standard. NZPIF believes that future maintenance costs may be reduced if landlords planned future maintenance and built a maintenance budget into their forecasts. Some issues are of course unseen but others could be addressed before they become serious and expensive. Rental property maintenance requires round vigilance (part of our job). Large jobs, such as repainting the exterior or re-roofing, can be funded over several years with payment going into a holding account until such a job is undertaken. This avoids having to find a substantial amount at one time. Regularly maintaining a property helps to lift the value of the property and the rental received.

From the real estate sector:

- Christchurch continues to rise in terms of increases in property values. Whilst still bottom of the list of major cities at 10.2% it is significantly up on the 6-7% of just a few months ago. Annual growth in Christchurch has not been in double digits since February 2014. Wellington leads at 16.6% followed by Dunedin at 15.3%.

- With the tightening of LVR’s and other controls on investors it is expected that these rates of increase will fall. This is NOT saying that house values will fall.

- There remains a severe shortage of property listed for sale.

- The number of houses across the country that sold for under $500,000 has decreased from 30.5% last Feb to 17.6% in Feb 2021. On the other hand, properties sold for more than $1 million increased from 17.1% to 30.7% over the same period.

- Christchurch remains a very attractive place for New Zealanders to live and this is drawing large numbers to the city. Good for real estate including for rentals as not all of these new-comers will be in the position of buying.

Finally for your information:

- Opinion- Economist Tony Alexander:
  The extension of the Brightline test from five to ten years was expected and does not really have any major implications. But let’s look at the announcement we did not expect: the removal of the ability of all new investor purchasers to deduct interest costs from this week, and gradual reduction in the ability of those already owning investment properties to deduct such expense over the next four years. I had expected maybe 10% of interest costs to no longer be deductible. For the 12% of people who buy an investment property with cash there are no implications. But for the 24% on average who do so with a mortgage this changes the equation. Whereas before rental income of $20,000 might be offset with $15,000 of interest cost to deliver taxable income of just $5,000, now that taxable income will stand immediately at $20,000 for new purchases, and eventually become that over four years for the many people already owning investment property. The tax bill will rise (at a 33% rate) from $1650 to $6600. What are the implications? My experience over the decades has been that many Kiwi

landlords have not raised rents to levels they know the market could bear because they empathise with their tenants and could await capital gain to slowly accrue (sometimes swiftly) over time. Now the cost of doing that is much higher and we are likely to see quite strong rises in rents over the next four years. Many people who were thinking about buying an investment property now will not do so. Some people owning them will sell. The third layer of people discussed above will shift back to buying in the future. This will place downward pressure on prices which have risen on average nationwide by a ridiculous 25% since June. In many months for the remainder of this year prices will fall, but in 12 months we will almost certainly still have prices well above where they were in March 2020. First home buyers will gain through having lower entry prices for a while and less competition at auctions. But their ability to save a deposit will be reduced by higher rental costs on average. There will be extra demand for new properties which may open up a price difference with existing residences, though some details still look like they need to be worked out regarding interest cost deductibility for new builds. Eventually we will reach a new equilibrium in the housing market – probably within 12 months. From that equilibrium prices will probably rise on average long-term by 4% to 5% per annum rather than the average 6.8% seen since 1992. House construction will be boosted, especially with the moves to help fund infrastructure. But the pace of supply growth will be limited by the Government's increasingly expressed determination to limit migrant inflow from next year when the borders full open again. That will be good for upskilling and lifting great numbers of Kiwis into the construction sector. But the trade-off will be less speedy construction growth than would otherwise be the case. Three final points: the news reduces the chances of the Reserve Bank raising its official cash rate before the end of 2022 – though it does not rule that out. The likelihood of debt-to-income ratios and restrictions on interest-only lending being introduced this year has fallen substantially. And prospects for renters at the low end of the socioeconomic spectrum have become decidedly worse and the news today will bring a rise in homelessness and extra blowout in the state house waiting list as the pool of rental properties shrinks and becomes more expensive.

Have a great month.

Sharon, Caroline, Sue, Matt and Tracy