IPTI Xtracts

Property Tax and Assessment News from Around the World

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"The worm seems to have turned for property values in the main centres"

Property values could be at a turning point and may be heading for a 5%-7% fall, according to property data company CoreLogic.

The company's latest Market Pulse report says its quarterly housing value index declined 1.5% nationally in the second quarter of this year, with larger falls seen in Auckland (-2.4%) and Dunedin (-2.5%) with smaller falls recorded in Hamilton (-1.1%), Wellington (-0.4%) and Christchurch (-0.4%), while Tauranga went against the trend and was up 1.39%.

In regional centres the biggest declines were in holiday hot spots Queenstown (-7.2%) and Thames-Coromandel (-5.3%) with a mix of falls and rises in other centres (see the graphs below).

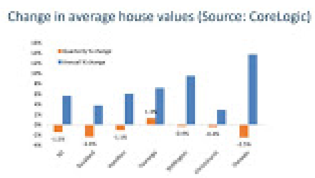
The decline in values is unsurprising, given that housing market activity was severely restricted for much the second quarter and the broader economic repercussions that followed, but the CoreLogic report suggests the Q2 figures may mark a turning point for the market.

"The overall message is that the worm seems to have turned for property values in the main centres," the report said.

"Given that we are in recession and that unemployment is rising, it's no surprise that property values have started to face some downwards pressure.

"Overall, property values seem to have reached a turning point and we estimate that the national average could ultimately fall by 5-7%.

"That would obviously be unwelcome for any property owner, although a bonus for would-be buyers, but it would be a smaller fall than the figure of 10% during the GFC," it said.



Postponement of Auckland Council 2020 revaluation

All councils in New Zealand are required to revalue properties within a three-year period.

Earlier this year, Auckland Council commenced its latest revaluation exercise that would result in updated capital values being available on all properties in early November 2020. These valuations are one component in helping determine what portion of the region’s total rates an individual property owner pays.

COVID-19 and the lockdown have made it difficult to conduct a reliable revaluation this year. Property valuations are generated using recent sales data of comparable properties and other relevant market evidence such as rental levels. That sales data is currently limited, as COVID-19 has caused a significant drop in both the volume of property sales and the quality of rental evidence.

As a result, the Valuer-General has agreed to Auckland Council’s request to defer its 2020 general revaluation for one year because of difficulties caused by COVID-19.

Impact on rates

Rates will continue to be generated based on the current (2017) values in the same manner as the 2019/2020 and 2020/2021 rates have been.

Impact on property prices

Rating valuations are not intended for market use. They are a mechanism to allocate rates among property owners.

Property prices: Lockdown sees growth rate decline in 13 New Zealand cities

The effect of the COVID-19 lockdown is starting to show in New Zealand's housing market with 13 of the 16 major cities showing a reduction in the rate of growth since May.

Despite the lockdown, Auckland and Wellington are still experiencing strong growth, while Christchurch has experienced "modest" growth.

Quotable Value (QV) house price index data for June shows that over the past three months, the national average house price increased by 1.3 percent to $738,018. This growth rate is down from 2.4 percent in May. The year on year increase was 7.4 percent, down slightly on annual growth of 7.7 percent last month.

QV general manager David Nagel said this indicates that the heat in the pre-lockdown market is gradually dissipating.

"A combination of pent up demand following lockdown, plus vast numbers of returning expats over the past few months has contributed to strong attendance at open homes, auctions and tenders in most locations throughout New Zealand," Nagel said.

"Record low-interest rates have also helped to ensure prices have held up well so far with an active buyer pool dominated by investors and first home buyers."

But Nagel said the worst is still ahead with homeowners expected to be under financial pressure when the Government's wage subsidy ends.

"Many homeowners that sought relief from banks with mortgage holidays are likely to feel some financial pressure heading into summer, the worst is still ahead of us."

"We're seeing some early signs of value stress with the QV House Price Index in Queenstown declining by 1.5 percent for the three month period to June. This is the first fall in quarterly values for a major urban area that we've seen this year," he said.

However he noted that drop was expected because of the city's heavy reliance on tourism and short term rental accommodation.

Nagel said the housing market will be relying on returning Kiwis over the next few months in order to fill the void.

"Market resilience over the coming months will be reliant on a continuation of returning Kiwis feeding demand as both buyers and tenants. Grounded Kiwi's unable to embark on their OE will also help to fill the void of migrants coming into the country. "

He also noted that a return to lockdown protocols would be "catastrophic to market confidence".

But Nagel said this comes off of strong growth for the past year and will just be a "passing aberration" for some.

"Our earlier projections that the market will experience a correction of 5-10 percent by Christmas time from the pre-COVID high of January to March 2020 is still looking likely."

"While some parts of the country will be harder hit than others, any fall in value should be put into context. Most parts of New Zealand have experienced value growth in excess of 5-10 percent in just the past 12 months, so for those that can weather the storm, this is simply a passing aberration", he said.

Auckland house prices up 5.4 percent year-on-year, North Shore highest

The average house price in Auckland is now valued at $1,082,54, an increase of 5.4 percent year on year and 1.5 percent over the last quarter.

The North Shore had the highest annual growth with an increase of 5.9 percent followed by Auckland City at 5.8 percent growth, and Manukau at 5.7 percent.

Quarterly growth figures from the past three months show that houses in the Rodney area increased by 0.8 percent, while North Shore values went up 1.2 percent, Waitakere was up 2.0 percent and Manukau at 1.9 percent. Values in the Papakura area went up by 1.8 percent over the same period.

QV senior consultant Rupert Yortt said a lack of listings and low interest rates are driving demand.

"The pent-up interest from the lockdown period is starting to ease as the market is showing a more accurate story of what is going in the Auckland residential market," Yortt said.

But he warned that the region is experiencing mixed results with some open homes struggling to attract potential buyers.

"Most auction rooms are seeing good numbers and good prices being achieved while at the same time, there are some properties receiving little interest at all."

He said houses at the lower end of the market are being impacted more than others.

"The hit to Kiwisaver balances is being felt at the lower end of the market with multi-offer situations often falling down to only one or two offers remaining on the table when it comes to the crunch time.

Yortt noted that developers seem more likely to negotiate because of the uncertainty in the market.

Wellington house prices up by 10.4 percent, Hutt City leading

The average house price in Wellington is now $783,655, an increase of 10.4 percent year on year and 0.4 percent in the last quarter.

Hutt City had an annual growth of 15 percent, while Upper Hutt and Porrirus also saw growth of 13.6 percent and 15.5 percent respectively.

Quarterly growth shows Hutt City increased by 0.4 percent with an average price of $686,283. The average house price for Upper Hutt and Porirua are now $639,489 and $691,176 respectively.

QV senior consultant David Cornford said that Wellington market is continuing to show resilience with plenty of buyers.

"Wellington continues to be a sellers' market and this likely will not change unless more listings come onto the market," Cornford said.

"Despite the economic outlook, buyers have shown they are still prepared to continue with their purchasing decisions, relatively undeterred."

He said houses under $800,000 in Lower Hutt, Upper Hutt and Porirua are most in demand.

Christchurch sees 3.7 percent increase year-on-year

Housing prices in Christchurch are experiencing modest growth with an increase of 3.7 percent over the last 12 months and a 0.8 percent increase in the last quarter. The average house is now worth $518,369.

QV senior consultant Kris Rogers said while there hasn't been a substantial drop, the lockdown cooled a growing market.

"To date there has been no substantial reduction in value levels noticed across Christchurch post lockdown."

"COVID-19 has however served to cool a market that was starting to develop some momentum prior to the lockdown."

Rogers said prior to the past six months, Christhucrh had limited growth for around 30-36 months in contrast with the rest of the country.

"It is anticipated that this preceding period of little to no growth will help minimise any potential effects any market downturn will have on value levels across the region moving forward."

Hamilton prices remain stable

House prices in Hamilton City have remained fairly stable with the average median one month change showing a -0.2 percent decrease. There were 468 sales in June, with the average median price for the city now at $627,777.

Tauranga increases 6.7 percent year-on-year

Tauranga saw a 6.7 percent increase in house prices in the past year with a 2.8 percent increase in the last three months.

The average house price is now $794,000. Since the previous market peak of 2007 there has been a 64.9 percent increase in house prices in the city.

Rotorua house prices increase 10.1 percent year-on-year

Houses in Rotorua are now worth just over $520,000 after a 10.1 percent increase in the last 12 months. Over the past three months house prices increased 0.9 percent. This is 77.2 percent above the last market peak which was in 2007.

Hawke's Bay see modest growth

House prices in Napier and Hastings increased 10.1 percent and 12.6 percent respectively over the last 12 months. Napier increased 2.6 percent over the last quarter while Hastings values increased 2.0 percent over the same period. The average value for Napier is $614,322, while Hastings sits at $587,931.

Palmerston North house prices experiences strong growth year-on-year

House prices in Palmerston North increased by 415.3 percent over the last 12 months and 1.8 percent over the last quarter. The average value is now $509,859

Nelson/Tasman house prices increase 5.9 percent

Nelson house prices increased by 5.9 percent over the last 12 months and 0.6 percent over the last quarter. The average value is now $661,345.

Dunedin house prices see strong growth

Dunedin house prices increased by 18.9 percent over the past year and 1.8 percent in the last three months. The average value is now $547,531.

Queenstown sees slight growth year-on-year, 1.5 percent fall in last quarter

Average house prices in Queenstown increased slightly by 1.6 percent in the last 12 months but fell by -1.5 percent over the last quarter. The average value is now $1,192,613. Since the last market peak in 2007 values have increased by 73.4 percent.

Invercargill

Invercargill house prices increased by 18.6 percent over the last 12 months and 2.6 percent over the last quarter. The average value is now $355,952.

Auckland Council looks to delay house capital valuation process until 2021

Its triennial revaluation of properties was due to take place this year, but the council has asked the Valuer General if it can hold off assessments until 2021.

Chief Financial Officer Kevin Ramsay said the process has become impractical because of Covid-19, with insufficient market data available.

The council is expecting an answer next week.

Changes to CVs can significantly affect those looking to sell, but also influence how much a homeowner pays in rates.

Real Estate Institute chief executive Bindi Norwell said Auckland homeowners should not to worry about a delay in CV assessments.

She said the delay could have positives.

"The benefit is that they may not have increased rates so much, but it really is one part of the equation so it really shouldn't impact the sale of their property."

Norwell said CVs are based on an algorithm that may not pick up property renovations, so it is better to get an independent assessment.

Auckland Council's economists investigate the idea of changing the rating valuation process to focus solely on land values

• The covid-19 pandemic has impacted employment and preferences about where people choose to live or work.

• Auckland Council has requested that the three yearly revaluation of properties be delayed a year to allow the re-establishment of the market. At current low sales volumes post-pandemic it is extremely challenging to show the medium-term trajectory of the market or credibly revalue properties.

• Auckland currently uses a capital value (land value plus improvement value) based ratings system to collect property rates. The variable component of the rates bill is based on the capital value of the property.

• Given the accelerated change in how people live and work, the challenging financial environment that councils are in from the covid-19 shutdown, the timing of the property revaluation process, and the incentives to more efficient use of land that a switch would provide, one option may be to switch to a land value based rating system.

• A land value based system would see around 59% of Auckland households pay less in rates.

Auckland's changing patterns

The lockdown, aimed at preventing further spread of the covid-19 virus, brought much of the city to a halt. Up to 40% of economic activity could not occur under Level 4. At the same time, thousands of office workers who had previously faced the daily commute into the city centre suddenly had no option but to work from home. Technological deficiencies were unearthed and dealt with as a matter of urgency.

With open homes cancelled, people staying in their bubbles, and less job security, house sales plummeted by 70% in April compared to a year ago and remained down almost 50% in May. This makes it hard to infer any medium-term patterns from these sales data, much less infer the value of the entire housing stock.

Back at Level 2 and Level 1, workers travelling into the city centre have reduced. Many office based businesses have chosen to adopt a model that includes more working from home and a smaller office footprint. Workers' preferences for warmer drier homes will also likely strengthen now that they are spending many more hours in them.

These potential changes mean it makes little sense to undertake a property revaluation today; leaving this until we have a better understanding (and more data) on the new economic realities is likely to deliver more credible valuations.

But the impacts of the covid-19 lockdown are widespread. Auckland Council is not immune from these challenges, with an estimated hit to revenue of over $500 million. This means more than ever, pressure exists to deliver development that uses existing or new infrastructure capacity efficiently, and maximises the number of homes the region delivers to house Aucklanders.

Capital based vs land based ratings systems

Auckland's current property rates system uses capital values (CV) to determine the variable component of a property's rates bill. This approach, is widespread in New Zealand, but does not incentivise the most efficient use of land. Land owners who use land efficiently by developing on it, pay higher property rates, because the more improvements you add, the more you pay.

Another challenge with a CV based rates system is that because it does not incentivise land development, it creates less certainty about when development contributions and additional rates revenue will be received by councils. In times of financial challenge, the right incentives need to be in place to encourage uptake of new infrastructure soon after it is put in place.

In summary, a land value (LV) based rates system approach has several strengths:

1. It incentivises efficient use of land and doesn't reward those who do not develop their land.

2. It is easy to administer.

3. It is difficult to evade.

4. It doesn't distort production in the economy – land is fixed and a tax on it won't mean less of it is produced.

5. It better aligns timing between infrastructure provision and take-up of that infrastructure.

6. It is progressive. Those with more valuable land pay more.

Who thinks this is a good idea?

The economic advantages of an LV based system have been understood going back at least as far as Henry George, a 19th century economist.

In New Zealand, support from economists for an LV based tax is widespread because of its advantages. An LV tax was favoured by the Tax Working Group that the 2008-2017 National-led government instituted and is favoured by a wide range of academic and think tank economists from the left and the right.

Internationally, support is strong for an LV based tax as well. Here are a few quotes:

• The Financial Times: "In theory, it is not just an excellent tax but the best of all possible taxes. Once the initial valuations have been done, it is phenomenally easy to collect and all but impossible to avoid. It also discourages speculation and stops in its tracks the endless cycle of investment in land and property purely to rent it out. It promises no more property boom and bust. But, as it is not collected on any improvements made to land or to buildings on land, it does not discourage productive activity. Instead, it encourages people to bring idle land into use, to improve land they own and to be as productive as possible."

• Mirrlees Review of the UK tax system published in 2011: "Taxing land ownership is equivalent to taxing an economic rent—to do so does not discourage any desirable activity. Land is not a produced input; its supply is fixed and cannot be affected by the introduction of a tax."

• Lincoln Institute of Land Policy: "After surveying the experiences of taxing jurisdictions around the world, we conclude that LV taxation is more than an intriguing and attractive idea. It is a form of taxation that has actually worked since the nineteenth century at national, state and local levels of government… Proposals to tax LVs more heavily than improvement values can find support in both historical experience and economic theory."

If it's so good, who uses it?

Several jurisdictions overseas have adopted a rates system based on LVs. In fact, more than 30 countries have some experience with separately estimating LV and taxing it, including New Zealand.

In New Zealand, LV rating was used to some extent in the former Auckland councils of Waitakere, North Shore, Rodney, and Papakura. On amalgamation, a requirement was put in place that until the 2012/13 year, CVs were to be used.

Overseas, a number of developed economies use an LV based tax system to varying extents.

Pure land tax systems

• Denmark
• Singapore
• Taiwan

Land taxes with other objectives

Some Australian states have used land taxes. e.g. NSW and Victoria. The objective appears to be to tax speculative investment on multiple properties, rather than encouraging the best use of all land. In both NSW and Victoria, the primary residence has been exempt from an LV based tax.

Mixed land value – capital value tax systems

In Pennsylvania in the United States, several municipalities use a mixed tax that applies a higher rate of tax on land, and a lower rate of tax on improvements, the so-called "two rate" system. This mix appears to be a compromise, with the tax rate on land being 1.6 times to 44 times higher than on improvements, with most in the range of four to seven higher than on improvements.

The biggest challenge to greater uptake appears to be political. The Economist magazine puts this well:

The bigger barrier is political. LVTs would impose concentrated costs on today's landowners, who face a new tax bill and a reduced sale price. The benefit, by contrast, is spread equally over today's population and future generations.

In Pittsburgh, for example, after a review of LVs that saw strong increases in the value of some land, political controversy ensued. The entire land tax was disestablished after lobbying from those with valuable land. New Zealand councils are fortunate in having a well-established revaluations process, and a robust process for those who wish to contest property valuations.

Is there proof that a LV tax works better?

Theoretically, the argument in favour of an LV system over a CV system is easy to make. But can we show that an LV system encourages more of the much-needed development than would be the case if CVs were used within the same jurisdiction?

The Pennsylvania experience is helpful here. A study of 15 municipalities with two-rate systems and 204 municipalities without, found that two-rate systems had higher rates of construction.

A separate study of Pittsburgh and economically similar cities nearby showed that Pittsburgh experienced a sharp rise in building activity relative to comparators despite its falling population in the 1980s. One factor explaining this difference was the introduction of an LV oriented tax.

But Auckland is not Pennsylvania

LV oriented tax systems have worked well in a US state that experienced slow growth over the 14 years analysed – just 0.2% per year on average across Pennsylvania during that period. Meanwhile, Auckland grew by around 2% a year over 17 years.

If anything, this implies that an LV ratings base would likely be more effective in encouraging efficient land use in Auckland than in Pennsylvania. Growth in residential LVs has likely been higher in Auckland given its relative growth rate, and certainly much faster than growth in improvement values. This makes the skewing of the current tax system in favour of under-used land all the larger, which a switch would overcome.

The Pennsylvania study also provides some scale to the question of how much incentive a switch to an LV based system might offer. Notwithstanding the earlier comments that the incentives to develop under-used residentially-zoned land through switching to an LV based rating system are likely to be higher in Auckland than in Pennsylvania, that study does provide some sense of the scale of the likely change. In Auckland, a further 650 dwellings could be consented each year, on top of the average of 14,800 consented in the year to April 2020, assuming the supply elasticity of a change in tax regime estimated in the Pennsylvania study. This would be an increase of 4.4% in dwellings consented each year in Auckland.

Two further idiosyncrasies in Auckland

In Auckland today, those who use residentially-zoned land for farming purposes are given a discount of up to 20% off their residential zone rates. The rationale is that these land holdings don't use the services that developed properties do. But the infrastructure services have to be there regardless of whether the land owner chooses to use them.

Further, residentially-zoned land in more rural oriented (as opposed to rurally-zoned areas) areas receive a 10% discount on their rates, the argument being that they don't have access to the same level of services that urban residentially-zoned areas do. Economics counters that while it is undoubtedly true that land in rural-oriented residential areas have access to a lower level of services than those in urban residential areas, this is already reflected in lower land values.

In Auckland, the largest 0.1% of properties zoned for residential use but used in less efficient ways (farming or lifestyle) accounted for almost 8% of available residentially-zoned land in 2020.

What a switch would mean for Aucklanders

We analysed the impact of switching from the current system that uses a mix of uniform general rates and CV based rates to a scenario that:

1. Assigns all rates based on LV
2. Removes the 20% discount for using residentially-zoned land for less efficient purposes
3. Removes the 10% discount for residentially zoned rural properties.

Our analysis was limited only to residentially-zoned properties used for residential or rural purposes and re-assigns the residential rates take for the 2019/20 year by applying the same rate per dollar value across all land parcels included in the analysis. Analysis was using the 2017 residentially-zoned property valuations.

Key findings

• 59% of Auckland residential ratepayers would pay on average $476 less a year.

• A further 12% of ratepayers would receive a rates bill increase of no more than $200 (less than 10%) a year. On average, their increase would be less than $2 a week.

• Many retirement villages and apartment complexes would see their rates fall as they are using their land efficiently.

• The 5% of properties that would receive the biggest dollar increases have LVs of $2.85 million on average, but improvements are typically only 12% of the property's value. This compares to 29% across all residentially-zoned properties in Auckland. These high LV but low improvement value properties are being used inefficiently.

• In contrast, the 5% of properties that would receive the biggest dollar rates decreases have improvements worth over 57% of the property's value – they are being used quite efficiently.

Would this be hard to implement?

First, it’s important to point out that the any switch to an LV oriented system would require consideration of a wider range of factors than those encompassed here to meet obligations of the local Government Act. But an LV oriented system would be administratively relatively easy and cheap to implement. We were able to calculate the revised rates bills for each property in a few hours after receiving the current valuations and rates bills, for example. These figures could then be easily uploaded for use in bill notifications.

Introducing a step-change in a year in which new valuations are implemented would make the task administratively easier as a review is being done anyway.

One way to overcome upfront challenges could be to introduce a gradual switch to an LV based system, perhaps over five years as set out in the example table below.

	Contribution to rates bill calculation	
	Land value	**Improvements value**
Current system	100%	100%
Year 1 of change	100%	80%
Year 2 of change	100%	60%
Year 3 of change	100%	40%
Year 4 of change	100%	20%
Year 5 of change	100%	0%

The benefits of this approach would be:

• It would still be relatively easy administratively.
• The suddenness of the change would be reduced, meaning those with under-used land would have the opportunity to consider their options.
• The change would occur across at least two three-yearly revaluation process, which would provide an opportunity for those who dispute the value of their property to have their say through a routine process.

On the cost side, this gradual approach would mean one of the key benefits of a switch to an LV based tax – increased housing production – could be delayed for a few more years.

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