

CALEB HOUGHTON

Legal Entities and the New Zealand Housing Crisis:
Analysing Entity Usage and Competition in a Shifting Regulatory Landscape

LAWS521 Research Paper

**Te Kauhanganui Tātai Ture | Faculty of Law
Te Herenga Waka | Victoria University of Wellington
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Abstract

The New Zealand housing market is in crisis. New Zealand property has been experiencing some of the highest real price growth rates in the world, with prices becoming increasingly unaffordable for many New Zealanders. This paper begins with outlining this context, before arguing that these consistent increases in property value have contributed to the deepening wealth divide in the nation. The paper in section III and IV then turns to analyse how different ‘legal entities’ may be used within the property market and their increasing prominence in residential property markets globally. It will be seen that a substantial number of both owner-occupied and investment properties are held within different types of trust or company structures. Factors impacting entity choice are then discussed in section 6, and it is seen that this choice involves a number of trade-offs due to the legal characteristics of each entity. Importantly, the purpose sought to be achieved will be essential to this decision. In section VII, the paper looks at how entities may impact competition in the residential market. It is argued that no entity individually could exert substantial market power in any of the markets analysed, and that the entities legal structures themselves do not cause detriment to the market. While some entities which have substantial liquid assets can engage in conduct which negatively impacts the market, it is argued in section VIII that development regulations have been a far more significant driver of the housing crisis. Finally, how these regulations are changing to promote affordable housing development and to dissuade investors from the market, along with their relevance to the different ‘legal entities’, is analysed.

I Introduction

The New Zealand housing market is in crisis. Consistent increases in property prices has not only made it increasingly difficult to enter the market but has also deepened wealth inequality. This paper begins by outlining the context of this market and wealth divide before analysing the increasing prominence of trusts and companies being used in residential property investment globally. It then considers why investment in New Zealand property is so attractive, and how ‘overseas persons’ can continue to invest through entities despite prohibitions on their ability to personally invest in the market.

The paper then turns to evaluate the different reasons entities may be used by property investors, focusing on asset partitioning, financing access and the accompanying compliance regimes. It will be seen that the entity choice will largely be determined by the purpose for which the property is held. Throughout this section the paper considers that the protections available to, and the variety of, legal entities creates a complex property market landscape which allows most purposes to be fulfilled and ‘cooling’ regulations to be avoided, at least in part.

Next, the impact of these entities on the residential property market is investigated. The paper considers that none of the actors individually, or even collectively in most instances, could be said to have substantial market power within that market. There is little evidence that their existence and the legal protections available to them impact house prices meaningfully, although certain conduct, such as landbanking, may do just that.

Finally, the paper notes that changes to the law and policy regulating the residential property market continues to create a rapidly shifting environment for property-related entities, and, in particular, for entities used as property investment vehicles. These regulations include the bright-line test, reform of the Resource Management Act 1991 and changes to the tax-deductible interest rules. The impacts of these changes on different property entities is discussed, and importantly it can be seen that they may make development of affordable housing more profitable for development companies.

II Context: The New Zealand Property Market

The average home in New Zealand now costs more than \$960,000¹, with some reports suggesting it has already surpassed the million-dollar mark.² The doubling of the average national property value in less than a decade³ has put immense pressure on the market, postponing or preventing many New Zealanders from ever owning their own home. At the same time, commentators and global ratings firms fear that, if prices continue to rise as they have been, it will become increasingly likely that significant numbers of defaults and subsequently associated credit losses will occur within the next two years.⁴

For its size, New Zealand is a sparsely populated country. Nonetheless, its property market is currently leading the world in terms of ‘bubble indicators’.⁵ We have not only the highest price-to-rent and price-to-income ratios globally, but also experience the highest real price growth rates in the world – nearly double that of the UK, and more than four times that of Australia.⁶ Consequently, the market can only be described as being in a state of crisis.

COVID-19 austerity measures have exacerbated this issue. In response to the pandemic, and like many countries, New Zealand reduced the official cash rate (OCR) to the lowest level on record to encourage investment over saving.⁷ In turn, and following a decade of declining interest rates encouraging property purchases⁸, banks dropped mortgage interest rates to their

¹ Quotable Value “QV House Price Index” (August 2021) Quotable Value <<https://www.qv.co.nz>>.

² Catherine Masters “New Zealand’s average house price hits \$1m” (13 September 2021) OneRoof <<https://www.oneroof.co.nz>>.

³ Masters, above n 2.

⁴ Anne Gibson “Banks at risk of ‘disorderly correction’ if NZ house prices keep rising: S&P warning” (28 June 2021) NZ Herald <<https://www.nzherald.co.nz>>.

⁵ The five main ‘bubble indicators’ for residential real estate are: price-to-rent ratio, price-to-income ratio, real price growth, nominal price growth and annual credit growth.

⁶ Matt Burrows “New Zealand tops Bloomberg real estate risk rankings as OECD house prices reach ‘unprecedented levels’” (16th June 2021) Newshub <<https://www.newshub.co.nz>>.

⁷ Trading Economics “New Zealand Interest Rate” (July 2021) Trading Economics <<https://www.tradingeconomics.com>>.

⁸ Reserve Bank of New Zealand [*Monetary Policy Statement: November 2020*](#) (November 2020) at 28 to 29.

lowest on record – breaching the once immovable 2% rate.⁹ Crucially, those rates are for two-year fixed mortgages. Mortgagors will then have to re-fix their mortgages, most likely at an increased rate. Some banks have already begun to raise rates in anticipation of the OCR being lifted¹⁰, with some economists predicting the OCR could be raised three times within the next year.¹¹

For purchasers, who have just bought into the most expensive property market in the world, increases in those interest rates may make the mortgage incredibly difficult to service. For a property which cost \$950,000 and required a 20 per cent deposit, an interest rate rise to 4-5%, as predicted¹², would mean interest payments themselves would rise from \$15,200 to \$38,000 per annum, excluding payment of the principal. Therefore, experts have suggested that when that occurs, default rates could match those seen during the 2008 Global Financial Crisis (GFC), which led to immense ramifications on the global economy.¹³

III Property and the Wealth Divide

Analysing the housing crisis illuminates larger issues which are placing pressure on society. Of importance is the deepening wealth divide between those who own properties and those without. Between 2015 and 2018, the “gap between the net worth of the top 20 per cent and the bottom of 20 per cent of all New Zealanders increased by \$226 billion”, with that gap now being above \$1 trillion.¹⁴ This means the average household in the top 20 per cent has \$2.76 million more in assets than a household in the bottom 20 per cent.¹⁵

⁹ See Susan Edmonds “Mortgage rates 'as low as they will go': What's the best strategy?” (8th March 2021) Stuff <<https://www.stuff.co.nz>> and Reserve Bank of New Zealand “Mortgage Rates” (June 2021) <<https://www.rbnz.govt.nz>>.

¹⁰ Bonnie Flaws “Kiwibank drops two-year home loan rate as other banks raise rates” (16th July 2021) Stuff <<https://www.stuff.co.nz>>.

¹¹ Liam Dann “Reserve Bank cash rate rise will affect just about everyone, says Kiwibank chief economist” (15th July 2021) NZ Herald <<https://www.nzherald.co.nz>>.

¹² Dann, above n 11.

¹³ Gibson, above n 4.

¹⁴ Susan Edmonds “New Zealand's trillion-dollar wealth gap: Who are we leaving behind?” (9th September 2021) Stuff <<https://www.stuff.co.nz>>.

¹⁵ Edmonds, above n 14.

This wealth divide has been driven by property ownership and the significant rises in property values over the past three decades. Typically, the home a person lives in will be their most expensive asset, and the increases in the value of that home will also increase their net worth.¹⁶ Property is the largest source of wealth accumulation for New Zealanders¹⁷, and this wealth has increasingly gone to investors, rather than owner-occupiers.¹⁸ For example, “since the late 1980s, investors have increased the number of houses they own by 191 per cent, and owner-occupiers by only 37 per cent.”¹⁹ This is reflected in home ownership statistics, with only 64.5 per cent of homes in New Zealand being owner-occupied in 2020, the lowest rate since the 1950’s.²⁰

In fact, recently the value of properties in more than one hundred suburbs around the country have increased at a higher per hour rate than New Zealand’s median wage of \$27.76²¹.²² Both Auckland and Tauranga saw property values rise at more than \$32 per hour on average last year, with New Zealand’s average being \$24.20 per hour.²³ Already it becomes apparent that those without property will not only quickly fall behind in wealth but will also increasingly struggle to attain a property. However, more startlingly, the report which estimated these per hour figures was not referring to the standard 40-hour work week; the properties were

¹⁶ Statistics New Zealand “Property assets and debt drive changes in wealth” (14th December 2018) Statistics New Zealand <<https://www.stats.govt.nz>>.

¹⁷ Debrin Foxcroft “Home owners are becoming New Zealand's landed gentry, passing their wealth down” (11 December 2019) Stuff <<https://www.stuff.co.nz>>.

¹⁸ Rebecca Macfie “The Great Divide” (16th August 2021) *North & South* <<https://northandsouth.co.nz/2021/08/16/nz-housing-crisis-the-great-divide/>>.

¹⁹ Macfie, above n 18.

²⁰ Statistics New Zealand “Housing in Aotearoa: 2020” (8th December 2020) Statistics New Zealand <<https://www.stats.govt.nz>>. ‘Owner-occupied’ is a wide term as defined by the Reserve Bank of New Zealand. For examples of what is captured by the definition, see Reserve Bank of New Zealand “Definition of owner-occupied residential property” <<https://www.rbnz.govt.nz>>.

²¹ Statistics New Zealand “Labour market statistics (income): June 2021 quarter” (18th August 2021) Statistics New Zealand <<https://www.stats.govt.nz>>.

²² Catherine Smith “The NZ suburbs where houses earn more per hour than the average Kiwi” (7th September 2021) OneRoof <<https://www.oneroof.co.nz>>.

²³ Smith, above n 22.

increasing at that rate every hour of every day and night.²⁴ Using a standard 40-hour work week will make the comparison to average personal incomes more apparent; people cannot work non-stop. Doing so demonstrates that New Zealand saw property values rise on average by \$101 an hour last year.²⁵ While this is an average, and many regions saw lower price increases, the lowest was the West Coast, which still saw increases of \$7.42 per hour all year or \$31.25 per hour using the 40-hour work week method. Clearly, property is a driver of the wealth divide.

Other impacts of investors in the property market will be discussed shortly. Here, it is important to note that the wealth created by property is regularly passed down to following generations. Using the defensive partitioning functions of different legal entities such as trusts and companies, discussed in section VI below, helps ensure this wealth is maintained within the family and structured appropriately where a death or bankruptcy occurs. Holding property within a discretionary family trust, for example, will generally protect that property from an individual's creditors, with those creditors generally only being able to claim from the trust property through the trustee's indemnity, also discussed in section VI below.²⁶

This property wealth also enables the building of additional wealth. As commonly recognised, wealth begets wealth, and time enables fortunes to be built. As will be discussed in section VI below, property is generally the best security for debt financing, and in particular mortgages. As the property's price increases, the equity the individual has in the property increases concomitantly; that equity being the difference between the value of the property and the amount owed on it under the mortgage. The additional equity can then be claimed and a 'top-up' or 'cash out' loan applied for, which allows additional borrowing against the property based on the increased equity. The new loan can then be used as a deposit on a further property, allowing the cycle to continue. Through the use of trusts and companies, such a process can continue for generations.

²⁴ The fact that the report calculates the per hour rates in this way is observable by using the New Zealand average data as an example. The average increase in New Zealand property values between 2020-2021 was \$212,000. $365 \text{ (days in a year)} \times 24 \text{ (hours in a day)} = 8760$. $212,000/8760 = \$24.20/\text{hour}$, as reported.

²⁵ This calculation has been done as follows and takes data from the Smith article above, n 21. The average rise across New Zealand property values last year was \$212,000. $40 \text{ (hour work week)} \times 52 \text{ (weeks)} = 2080 \text{ hours}$. $212,000/2080 = 101.923077$.

²⁶ Trusts Act 2019, section 86.

A number of new rules relating to residential property investors have been introduced which reduce the attractiveness of continued property investment. They include loan-to-value ratio rules, tax-deductible interest rules and the bright-line test. Notably, however, these rules do not *prevent* investment in the market, and investors can avoid their impact. For example, there are new build exemptions to both the loan-to-value ratio rules and the tax-deductible interest rules which allow investors to avoid them. Additionally, the ‘capital gains tax’ under the bright-line test can also be avoided, simply by waiting the required 10 year period. These rules are discussed in greater detail in sections VI and VIII below.

Exploring the housing crisis thus helps highlight the increasing wealth divide within New Zealand and highlights a key driver of that divide. Further, the use of entities within the residential property market protects that wealth and enables it to grow at a rate unavailable to those without. From a social perspective, access to housing is considered a fundamental human right by the United Nations.²⁷ While New Zealand is under legal obligations to protect the right of its people to access adequate housing, it is under no such obligation to provide that housing.²⁸ Notably, a key factor in ensuring housing access is deemed ‘adequate’ is that it is affordable, although other factors such as security of tenure and habitability appear to have so far been prioritised.²⁹

IV The Increasing Prominence of Entities in Residential Real Estate

A Entities Within the Market

Much of New Zealand property is owned by some form of legal entity. It should be noted that ‘legal entity’ has been used throughout this paper to refer to both companies and trusts as a convenient shorthand, although technically a trust is not an entity, but rather denotes a legal relationship.³⁰

²⁷ *Universal Declaration of Human Rights* GA Res 217A (1948), [art 17 and 25](#).

²⁸ Human Rights Commission “The human right to adequate housing in New Zealand” (25th July 2017) Human Rights Commission < <https://www.hrc.co.nz> >.

²⁹ Human Rights Commission, above n 28, at 1 to 2.

³⁰ New Zealand Law Society “The Family Trust” (17th March 2020) New Zealand Law Society <<https://www.lawsociety.org.nz>>. See also Pey Woan Lee “Remedying the abuse of organisational forms: Trusts and companies considered” (2019) 13 *Journal of Equity* 211 at 212 to 213.

A company, as a separate legal personality, can purchase and dispose of property on its own accord. While the board of directors would generally be responsible for the purchase decision, the company would hold the property in its own name. A property purchase or sale could be a major transaction³¹, and so a special resolution³² may need to be passed by the shareholders. Still, the company itself would be the legal and beneficial owner.

As aforementioned, a trust is a series of relationships, rather than a separate legal entity in law. At first settlement, the settlor will hold title to the property before it is transferred into the trust. The trustee is then the legal owner, and the beneficiaries the beneficial owners, of that property. In accordance with the trust deed, the trustee may be able to acquire additional properties on behalf of the trust, or the settlor may transfer further properties into the trust.

‘Mum and dad’ investors, as they are colloquially known, were reported to own more than a third of New Zealand property in 2020, and much is held in a family trust.³³ These are small-time investors, who own a small number rental properties each, typically as part of their retirement plan. Further, the 2018 census reported that 219,555 out of 1,653,060 households in New Zealand were held in a family trust.³⁴ On a per capita basis, New Zealanders use significantly more trusts to hold property than people in jurisdictions such as the United Kingdom, Australia or Canada.³⁵ A trust structure is commonly adopted not because these investors are attempting to develop a property investment business, but because they are simply seeking to maintain the value of their assets.

Comparatively, ‘professional investors’ were reported to own roughly 17 per cent of New Zealand property in 2020.³⁶ Notably, in that report, ‘professional investors’ were defined as

³¹ A ‘major transaction’ is defined in section 129(2) of the Companies Act 1993 as relating to an acquisition/transaction/disposition of assets greater than 50% of the company’s assets.

³² A ‘special resolution’ is defined in section 2(1) of the Companies Act 1993 as requiring a majority of 75% (or higher, depending on the company constitution) of shareholders to pass.

³³ Kirsty Johnson “Part-time paradise: Mum and dad landlords own more than a third of property” (6th January 2020) NZ Herald <<https://www.nzherald.co.nz>>.

³⁴ Statistics New Zealand “2018 Census” (2018) Statistics New Zealand <<https://www.stats.govt.nz>>. The relevant data category is ‘Tenure of Household’.

³⁵ Law Commission *Review of the Law of Trusts* (NZLC IP31, 2012) at 1.28 to 1.29.

³⁶ Johnson, above n 33.

owning 20 or more properties, and it is highly likely that many people who could be considered professional investors would own fewer properties, particularly in the 7-20 property range.³⁷

In terms of entity ownership, roughly 15.1 per cent of properties were owned by companies with traceable shareholders, although data regarding further trust ownership is unfortunately masked by the lack of a trust register.³⁸ Additionally, another 8.1 per cent of properties were owned by companies which owned more than 20 properties, but whose shareholders could not be traced.³⁹ The bulk of this last category was made up by Kāinga Ora (Housing New Zealand), which owns more than 60,000 properties.⁴⁰

Professional investors also own a significant amount of *land* in New Zealand, whether personally or through a legal entity. In 2019, six of the 10 largest landowners, including the four largest, were foreign forestry companies.⁴¹ One such company, New Forests, has bought up more than 77,500 hectares of land since 2015 to become the third largest landowner in New Zealand.⁴² Again in 2019, roughly 4500 people owned half of New Zealand's private land.⁴³ For completeness, 28 per cent of New Zealand land is publicly owned,⁴⁴ which is comparable to both Australia⁴⁵ and the United States.⁴⁶

It is notable that the extent of institutional investment in residential property differs substantially around the world. Countries such as the United States and Germany have seen high levels of institutional investment in residential property, while it is rare in other countries

³⁷ Johnson, above n 33.

³⁸ Johnson, above n 33.

³⁹ Johnson, above n 33.

⁴⁰ Johnson, above n 33.

⁴¹ Newsroom Staff "Who owns New Zealand?" (7th October 2019) Newsroom <<https://www.newsroom.co.nz>>.

⁴² Newsroom Staff, above n 41.

⁴³ Newsroom Staff, above n 41.

⁴⁴ Newsroom Staff, above n 41.

⁴⁵ Australian Bureau of Statistics "1301.0 Year Book Australia, 2002" (25th January 2002) Australian Bureau of Statistics <<https://www.abs.gov.au>>.

⁴⁶ Congressional Research Service "Federal Land Ownership: Overview and Data" (21st February 2020) Congressional Research Service <<https://fas.org>> at 1.

such as the United Kingdom and Australia.⁴⁷ In part, this has tended to reflect factors such as the type of dwelling, the extent of social housing and how closely residential values follow inflation rates, although none are determinative.⁴⁸ In the US and Germany approximately 25 and 52 per cent (respectively) of residential housing are apartments, which are a greater initial investment but also more suitable projects for institutional investors.⁴⁹ Comparatively, only 12 per cent of residential housing are apartments in the UK and Australia⁵⁰, with these countries also having higher rates of social housing.⁵¹

B Impacts of Investment in the Market

Perhaps the clearest way to see how investment is impacting on the property market is through home ownership rates. As aforementioned, New Zealand home ownership has fallen to its lowest rate since the 1950's, with only 64.5 per cent of households being 'owner-occupied'^{52, 53}. At its peak in 1991, 73.8 per cent of New Zealanders lived in homes they owned.⁵⁴ This is a global trend, being more prominent in countries where institutional investors are able to easily purchase residential property.⁵⁵ Ireland, for example, has seen a decrease in home ownership from nearly 80 per cent in 1992 to 67.5 per cent in 2016.⁵⁶ That trend has been connected to institutional investment, primarily through private rental companies and Real Estate

⁴⁷ Lee C., Newell G., Kupke V "Australian Institutional Investors and Residential Investment Vehicles" (presented in the proceedings of the 20th International Symposium on Advancement of Construction Management and Real Estate Hangzhou, China, 23-25 October 2015).

⁴⁸ Investment Property Forum "Residential Investment in International Markets" (November 2014) Investment Property Forum <<https://www.ipf.org.uk/>> at 1.

⁴⁹ Investment Property Forum, above n 48, at 3.

⁵⁰ Investment Property Forum, above n 48, at 3.

⁵¹ Investment Property Forum, above n 48, at 2 states the social housing rates in these countries are as follows: United States 1%; Australia 5%; Germany 5%; United Kingdom 18%.

⁵² 'Owner-occupied' is a wide term as defined by the Reserve Bank of New Zealand. For examples of what is captured by the definition, see Reserve Bank of New Zealand "Definition of owner-occupied residential property" <<https://www.rbnz.govt.nz/>>.

⁵³ Statistics New Zealand "Housing in Aotearoa: 2020" (8th December 2020) Statistics New Zealand <<https://www.stats.govt.nz/>>.

⁵⁴ Statistics New Zealand, above n 53.

⁵⁵ Statistics New Zealand, above n 53.

⁵⁶ Department of Finance of Ireland "Institutional Investment in the Housing Market" (February 2019) <<https://assets.gov.ie/>> at figure one, page 6.

Investment Trusts (REIT's), which have become significantly more prominent since the GFC.⁵⁷

Similarly, the United States has recently been experiencing substantial institutional investment of its own. Multiple housing communities worth tens of millions of dollars have been purchased by institutional investors following the GFC, both through companies and REIT's.⁵⁸ It is estimated that a few consolidated firms now own \$USD60 billion in residential real estate in the country, with investment accelerating since COVID.⁵⁹ Nonetheless, some corporate bankers argue institutional investment remains a “very, very small percentage of the overall market”, representing an impact on the market of “low single-digit percentage points” currently and pointing to other factors, especially shortage of housing stock, as driving house price rises.⁶⁰ Notably, this is another clear driver of house price increases in New Zealand. There is evidence of residential building activity increasing, with the value of residential building activity growing 8.1% nationally comparing the December 2020 Quarter to the December 2019 Quarter.⁶¹ Nonetheless, the available housing stock has been decreasing substantially year-on-year since 2007, falling from approximately 50,000 to 15,000 in that period.⁶²

A potentially more worrying statistic is that from 1988 to 2018 the number of New Zealand renters who spend 30 per cent or more of household income on rent has risen from 20 per cent to 40 per cent.⁶³ This leaves very little room for discretionary spending after paying for other essentials of life. Beyond the social issues this causes, it also reduces the income available for productive enterprise, limiting economic growth and increasing the country's dependence on real property.

⁵⁷ Department of Finance of Ireland, above n 56, at 5.

⁵⁸ Bill Lindeke “A worrisome housing trend: non-local investment firms buying Minnesota properties” (20th May 2021) Minnpost <<https://www.minnpost.com>>.

⁵⁹ Lindeke, above n 58.

⁶⁰ Kevin Stankiewicz “Coldwell Banker CEO says investors snatching up homes is not a driving force in hot housing market” (29th June 2021) CNBC <<https://www.cnbc.com>>.

⁶¹ Statistics New Zealand “Commercial construction slows, residential holds up” (5th March 2021) Statistics New Zealand <<https://www.stats.govt.nz>>.

⁶² Vanessa Taylor “NZ Property Report: June 2021” realestate.co.nz <<https://www.realestate.co.nz>>.

⁶³ Statistics New Zealand, above n 53.

V Why is New Zealand Property Considered Such a Great Investment?

A New Zealanders love for Real Property

New Zealanders have an almost unparalleled attraction to real property. This is immediately apparent when considering the ‘rental-for-retirement’ model which has been widely adopted by maturing New Zealanders. Property has regularly been our greatest yearly investment⁶⁴, with this being owed, at least in part, to our common law origins. Common law nations consistently rank among the highest cost of housing countries globally, with their underlying preconceptions of property having evolved into remarkable protections.⁶⁵

Like most other common law countries, that law came to this land because of colonisation. The expansionary mindset of colonisers, and the resulting dependence on agricultural production for our economy (which is routinely a ‘top-ten industry’ contributing to the nations GDP⁶⁶) ingrained the importance of property. Today, ‘rental-hiring/real estate services’, ‘owner-occupied property operation’ and ‘construction’ tend to be the greatest contributors to our annual GDP.⁶⁷ These latter industries have evolved alongside the real property protections available, and in combination with the unprecedented population growth which has occurred over the past 40 years. Crucially, their importance to our economy has only compounded the significance of the real property protections.

B International Interest

Primarily, foreign investors look for security – something New Zealand provides in abundance. The exceptional real property protections, as discussed below, are a key legal driver of this. More generally, the political stability of our government⁶⁸, accolades such as “the least corrupt

⁶⁴ See generally David Hargreaves “Statistics New Zealand says investment in houses made up nearly a third of all kiwis’ investment in the past year - the highest share of total investment since records began 45 years ago” (19th December 2017) Interest <www.interest.co.nz>, and Buzz Channel *Attitudes towards New Zealand’s financial markets* (Financial Markets Authority, Investor Confidence Research, May 2018), which outlines New Zealander’s confidence in different investment types.

⁶⁵ Gibson, above n 4. There are some exceptions, such as China.

⁶⁶ Statistics New Zealand “Which industries contributed to New Zealand’s GDP?” (20th November 2020) Statistics New Zealand <<https://www.stats.govt.nz>>.

⁶⁷ Statistics New Zealand, above n 66.

⁶⁸ Immigration New Zealand “Stability & security” (17th March 2021) New Zealand Now <<https://www.newzealandnow.govt.nz>>.

nation on Earth”⁶⁹, isolation from major conflict⁷⁰ and our ‘friendly’ relations with many countries⁷¹ further strengthen foreign investment confidence.

Policy in this regard often shifts with government. As that policy shifts, it naturally impacts expenditure in the market. The Overseas Investment Act 2005 is the primary legislation regulating the area, with recent amendments in 2018 and 2021, the latter of which came into force on the 5th of July 2021. The 2005 Act aims to balance the benefits of permitting limited foreign investment with the policy aim of ensuring housing remains affordable. This is politically contentious as allowing foreign investment can increase economic growth⁷², but it is arguable whether that benefit offsets the concurrent harm to New Zealanders. With the housing crisis in the media spotlight, the recent amendments have been made alongside other rules for investors, having been introduced to make it more difficult for non-New Zealanders, or entities owned or controlled by non-New Zealanders, to invest in residential property. Clearly, the intention of all these changes is to reduce demand in the residential property market.

The 2005 Act creates limits through definitions of ‘overseas person’ and ‘sensitive land’ in sections 7 and 12 respectively. There are a range of different restrictions depending on the type of ‘sensitive land’ involved, the most notable for current purposes being a complete ban on purchases of residential land, and a 5-hectare limit on non-urban land.⁷³ The definition of ‘overseas person’ includes not only non-residents/citizens of New Zealand⁷⁴, but also entities (companies, partnerships/other unincorporated bodies, trusts or managed investment schemes) in which an overseas person controls or owns (legally or beneficially) 25% or more of voting rights or entitlements to the New Zealand based assets.⁷⁵ The most significant deviation from

⁶⁹ Radio New Zealand “NZ, Denmark named as world's least corrupt countries” (28th January 2021) RNZ <<https://www.rnz.co.nz>>.

⁷⁰ Immigration New Zealand, above n 68.

⁷¹ New Zealand Ministry of Foreign Affairs and Trade “Countries and regions” (2021) Ministry of Foreign Affairs <<https://www.mfat.govt.nz>>.

⁷² OECD “The Governance of Land Use: Country fact sheet New Zealand” (2017) OECD <<https://www.oecd.org>> at 3.

⁷³ Overseas Investment Act 2005, schedule 1, table 1.

⁷⁴ Overseas Investment Act 2005 section 7(2)(a).

⁷⁵ Overseas Investment Act 2005 sections 7(2)(c) to (f).

this is a managed investment scheme, wherein ‘overseas persons’ may own up to 50% of the fund’s asset value, provided they do not also control 25% or more of the schemes voting rights. It should also be noted that Singaporeans and Australians are excluded from the definition of ‘overseas persons’ under the Act, arguably a further indicator of the politics involved within this area.⁷⁶

Generally, therefore, foreign investors collectively may own up to 25% of a New Zealand entity which has invested in ‘sensitive land’, including residential property, without breaching the Act’s requirements. Additionally, although beyond the scope of this paper, standing consents may be granted for larger purchases of residential land where a person has applied for that consent under the ‘increased housing test’, ‘non-residential use test’ or ‘incidental residential use test’.⁷⁷ Furthermore, a variety of entities already exist which invest solely or primarily in real property, and which are open to foreign investment. For entities large enough to be placed on the NZX⁷⁸, breaching the Act’s requirements will rarely be an issue. Critically, the legal entities provided within New Zealand law allow foreigners to continue investment in New Zealand property, even where they cannot do so personally.

Leaving this route available to foreign investors could also be seen as a result of the underlying political tension between economic development and providing for New Zealanders. It reduces the demand foreign investors can place on the market, generally preventing them from it unless they are willing to form an entity which is controlled by New Zealanders. Theoretically, therefore, there remains room for them to contribute to economic growth through investment in residential property, but practically it appears they would be unlikely to. Such restrictions, especially relinquishing control, significantly detract from the investment’s security and concomitantly its attractiveness. The declining interest of ‘overseas persons’ in the residential property market following these amendments is evidence of this, and is discussed at the end of section VII, below.

⁷⁶ Overseas Investment Regulations 2005, rr 75 and 81.

⁷⁷ Overseas Investment Act 2005, schedule 4 contains the Standing Consent Applications.

⁷⁸ Such entities include Goodman Property Group, Precinct Property Limited, Argosy Property, Kiwi Property Group Limited, Auckland Real Estate Trust and Stride Property Limited among others.

C Why is Real Property Special?

Within the common law, real property creates unique legal relationships. The term does not just refer to tangible property, such as land and the structures affixed thereto, but also abstract concepts relating to that real property, such as easements. Land in particular is an asset with special attributes. It is irreplaceable, immovable, limited in supply and as a result its value is necessarily subject to changes in its surrounding environment. Control of such a resource is inherently intertwined with power, and the way in which property is conceived by different cultures will influence how that power is gained and maintained.

As New Zealand real property law is derived from the Western conception of property, the power to exclude is fundamental to it. While the subject is in constant debate, this traditional view, famously encapsulated within Blackstone's definition of property⁷⁹, remains the focus of our conception of property and that debate generally. This is distinct from many other conceptions of property, the most obvious in the New Zealand context being that of Tikanga Māori. Within that framework, a foundational difference is that mana is gained through providing access to use, rather than through exclusion.⁸⁰

That New Zealand real property laws derive from the Western conception has meant its protections have evolved in suit. Of primary importance, especially in ensuring investment value, is the principle of indefeasibility and the Torrens system which supports it. That principle provides significant confidence to investors, who are entitled to rely on the title provided on the register, with very limited risk of another having better title.⁸¹ Prior to the Torrens system, whether title was 'good' was a serious concern and continues to be so in relation to personal property, despite the priority rules and disclosure requirements contained in the Personal Property and Securities Act 1999.

⁷⁹ Henry E Smith and Thomas W Merrill *The Oxford Introductions to U.S. Law: Property* (Oxford University Press, New York, 2010) at 4. Blackstone's definition of property is "that sole and despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe."

⁸⁰ Waitangi Tribunal *Muriwhenua Land Report* (Wai 45, 1997) at 23 – 25.

⁸¹ For another to have better title, generally the purchaser must not be bona fide. See generally *Frazer v Walker* [1967] 1 AC 569 and *Breskvar v Wall* [1971] 126 CLR 376 (HCA).

That certainty, in combination with real property's unique attributes, means real property is often the strongest security for loans. For investors seeking to use the power of leverage to maximise their returns, such a security is vital. For example, where a land purchase requires a deposit of only 20%, the investor can receive returns (both income and capital gains) on 100% of the land's value, with the bank being content with the interest from the 80% of capital it provides under the mortgage and the reassurance of a claim to the land itself in the event of default. In effect, the investor can leverage its initial investment by a multiple of five in such a scenario.

Notably, with new loan-to-value ratio (LVR) rules being introduced this year, persons or entities purchasing residential property for investment will generally need a 40% deposit, rather than the 20% deposit used in the example above, available only to owner-occupiers.⁸² Nonetheless, substantial exemptions exist, perhaps most crucially being the 'new build' exemptions, where a borrower commits to the purchase of either a new building, a building at the early stages of construction or will purchase a building within 6-months of its completion by a property developer.⁸³

VI Purpose and Entity Choice

A Asset Partitioning

As noted in sections III and IV, a common reason the property is held in an entity is because of their asset partitioning function. Both trusts and companies provide asset partitioning which can frustrate creditor claims and prevent the loss of assets.⁸⁴ While property itself is commonly seen as a relatively safe and steady investment, there are risks of loss and creditors may nonetheless try to claim the property as payment for other debts. Furthermore, as aforementioned, a home is commonly an individual's greatest asset, and so protecting it from other claims is often the vital reason why owner-occupiers in particular will place it in a trust.

⁸² See Reserve Bank of New Zealand "LVR restrictions at a glance" (February 2021) Reserve Bank of New Zealand <<https://www.rbnz.govt.nz>> and Jenée Tibshraeny "RBNZ targets residential property investors with new high LVR restrictions: Most investors to need 40% deposits and most owner-occupiers 20% deposits" (9th February 2021) Interest <<https://www.interest.co.nz>>.

⁸³ See Reserve Bank of New Zealand and Tibshraeny, above n 82.

⁸⁴ Henry Hansmann and Reinier Kraakman "The Essential Role of Organisational Law" (2000) 111 Yale L.J. 387 at 393 to 396.

This function may be particularly useful within the current market for investors, who may purchase rentals using separate entities to limit their exposure to a market downturn. This is because if property prices fall, and the new property's mortgage is unserviceable such that the investor defaults on it, the mortgagee claims would generally be limited to that entities assets; the new property.⁸⁵ How that mortgagee may claim from the entity depends on its form, as soon discussed. Nonetheless, the profitable property from past investments, especially if itself kept within a separate entity, could rarely be claimed.⁸⁶

While both entity forms provide this function, analysing how they accomplish this reveals key differences between them. Firstly, for a trust, it would generally be the settlor who has received the benefit of asset partitioning. They have placed the property into the trust and thereby split the legal and beneficial ownership of it between the trustees and beneficiaries respectively.⁸⁷ The settlor themselves no longer has any claim to the property except either as trustee and/or beneficiary; indeed this is considered to be a fundamental tenet of trust law.⁸⁸ As a result, the settlors personal creditors are generally unable to claim from the trust property to fulfil payments owed to them, and the property is retained. Still, if the settlor is a fixed beneficiary then the creditor may have a claim through that beneficiary's beneficial right to a portion of the trust property.⁸⁹ Nonetheless, even this could still be frustrated through the use of discretionary trusts.

The separate corporate personality of a company is essential to its asset partitioning function.⁹⁰ Because they are a separate corporate personality, companies can enter into contracts and agreements on their own accord, and subsequently have their own creditors. As will be explained shortly, while a trust can also raise finance, the agreement is with the trustee (the legal owner); not the trust as a separate legal entity. As the company is separate from its

⁸⁵ Hansmann, above n 84, at 394 to 396.

⁸⁶ Hansmann, above n 84, at 394 to 396.

⁸⁷ Jeff Kenny and Jared Ormsby "Lending to Trusts" (2010) Wynn Williams & Co <<http://www.wynnwilliams.co.nz>> at 1.

⁸⁸ Lee, above n 47, at 22.

⁸⁹ Law Commission *Dividing relationship property - time for change?* (NZLC IP41, 2017) at 434-435.

See also, the Trusts Act section 123, which allows a beneficiary of a vested trust to request a transfer of the fixed share of trust property they are beneficially entitled to.

⁹⁰ Hansmann, above n 84, at 392.

shareholders, a creditors claim against the company does not generally extend to a claim against the shareholders. They have limited liability; that being, they are only liable to the extent of the share capital they have provided to the company. Concurrently, the personal creditors of the shareholders cannot normally claim from the company's assets.⁹¹ Therefore, where there is a business purpose for the property, which carries with it inherent business risk, having the property within a company will prevent the shareholders of that company being personally liable for debts which are incurred.

It should be noted that placing property in an entity for the purpose of avoiding a liability or defeating creditors' claims after they have been incurred will not be valid if done near bankruptcy or insolvency. Under the Insolvency Act 2005, the Official Assignee "may be entitled to recover from assets that the bankrupt has transferred before bankruptcy."⁹² A person is considered 'bankrupt' when they are adjudicated bankrupt in accordance with section 10.⁹³ Under the Act, irregular transactions may be cancelled⁹⁴ and the Court may then subsequently order the retransfer of property or the payment of value for them.⁹⁵ Irregular transactions include an insolvent transaction⁹⁶, insolvent charge⁹⁷, insolvent gift⁹⁸ or "a disposition of property to which subpart 6 of Part 6 of the Property Law Act 2007 applies."⁹⁹ Whether a transaction, charge or gift will fit the requirements of these sections depends on the time of bankruptcy and the third parties relationship with the bankrupt.

The phoenix provisions¹⁰⁰ of the Companies Act 1993 are also relevant here. These provisions have been inserted into the Act to prevent the situation wherein an insolvent company transfers business to a new similar-looking company so creditors and customers believe they are dealing with the same old company. Entering insolvency or liquidation will limit the claims of the

⁹¹ Hansmann, above n 84, at 394.

⁹² Insolvency Act 2005, section 7(1)(c).

⁹³ Insolvency Act 2005, section 3.

⁹⁴ Insolvency Act 2005, section 206.

⁹⁵ Insolvency Act 2005, section 207.

⁹⁶ Insolvency Act 2005, section 145.

⁹⁷ Insolvency Act 2005, section 198.

⁹⁸ Insolvency Act 2005, sections 204 and 205.

⁹⁹ Insolvency Act 2005, section 206(1)(d).

¹⁰⁰ Companies Act 1993, sections 386A-F.

creditors to the company's existing assets. Therefore, transferring profitable assets out of a company and then entering insolvency or liquidation can rid the company of bad contracts and defeat existing creditors' claims. Then, a new profitable company without the debts would continue trading. Undertaking this strategy now and breaching sections 386A(1)(a) or (b) will make the contravener personally liable for the debts of the company, removing the value of asset partitioning.¹⁰¹

Still, the benefits of asset partitioning are commonly sought after, and it can be seen that which entity form is chosen is dependent on the purpose for which the property will be used. As will now be discussed, that choice will also have a number of impacts on financing, tax and compliance requirements, and so their consideration will also be important.

B Financing

1 Debt financing (mortgages and business loans)

For a trust, a mortgage will be made with the trustees who are considered the legal owners of the trust property. Comparatively, due to the legal personality characteristic of companies, a company itself can enter the mortgage. In more complex arrangements, a trustee may itself be a company, which allows it to benefit from the protections offered by both entity forms.

Because of the different legal relationships formed by each entity, it is generally accepted that a trust is worse for creditors when they seek to enforce their agreements.¹⁰² This is perhaps obvious when considering the purposes for establishing these different vehicles. A trust seeks to protect the beneficiaries, with very little room for protecting third parties, including lenders. Trustees owe duties to their beneficiaries, not to others, and distributions of trust assets to lenders may breach those duties in some circumstances.¹⁰³

As a result, creditors only have a limited claim to trust property through a trustee's right to be indemnified.¹⁰⁴ For example, where a trust has taken on a loan, the liability of repaying that

¹⁰¹ Companies Act 1993, section 386C(1). See also *Sojourner v Robb* [2006] 3 NZLR 808.

¹⁰² Kenny and Ormsby, above n 87, at 2.

¹⁰³ Kenny and Ormsby, above n 87, at 2.

¹⁰⁴ Trusts Act 2019, section 86.

loan falls on the trustee, the legal owner.¹⁰⁵ Generally, that trustee then has a right to be indemnified from the trust property.¹⁰⁶ Where a creditor has a claim through that trustee indemnity, it will often take priority over payment to a beneficiary.¹⁰⁷ Without that claim, the creditor will have to compete with the rights of the beneficiaries, which generally take priority.¹⁰⁸

Comparatively, companies are designed to ensure that the entity remains a going-concern and promotes trustworthy business relationships.¹⁰⁹ While the fact that a director must act in the “best interests of the company” may suggest an ability to ignore outsiders, it is to be remembered that companies need finance, and failures to pay creditors will inevitably impact that company’s ability to access finance in the future.¹¹⁰ Furthermore, New Zealand’s laws relating to companies have since the 1980’s tended to shift the balance in favour of creditors anyway.¹¹¹ For example, the ultra vires rules which limited the actions a company could take have been abolished, and transactions previously made without “the capacity, the power or the right” to do so are now valid under law.¹¹² Additionally, changes to the capital maintenance rule¹¹³ mean that a company cannot distribute funds to shareholders, unless it would still satisfy the solvency test after doing so.¹¹⁴

Under either legal form, a creditor is more likely to provide a loan if the obligation to repay is supported by a personal guarantee, either from directors or members within the trust.¹¹⁵ These may be limited or unlimited guarantees.¹¹⁶ Obviously, however, this negates the asset shielding functions of either vehicle.

¹⁰⁵ Trusts Act 2019, section 81(1).

¹⁰⁶ Trusts Act 2019, section 81(2).

¹⁰⁷ Trusts Act 2019, section 86(4).

¹⁰⁸ Kenny and Ormsby, above n 87, at 2.

¹⁰⁹ Companies Act 1993 Long Title.

¹¹⁰ Companies Act 1993, section 131.

¹¹¹ Kenny and Ormsby, above n 87, at 2.

¹¹² Companies Act 1993, sections 16, 17(1) and 18.

¹¹³ Companies Act 1993, section 52 outlines the rules surrounding Board distributions to shareholders.

¹¹⁴ Kenny and Ormsby, above n 87, at 2.

¹¹⁵ Sandy Richardson “Your guide to guarantees” (March 2011) BNZ <<https://www.bnz.co.nz>>.

¹¹⁶ Richardson, above n 115.

2 *Equity financing*

Legal entities can also seek equity financing, although this will not provide the advantages of leverage. Equity financing simply refers to the sale of a part of the equity in the entity for valuable consideration, which is generally done through issuing shares to raise capital.

A company structure is by design more suitable for this form of financing due to the essential characteristics of that legal entity. The ability to issue transferrable shares is crucial for equity financing and are readily provided by a company structure. The asset partitioning function of a company means that the personal assets of a firm's owners and the assets of the firm itself are isolated from one another.¹¹⁷ Therefore, when shares in a company are purchased no knowledge of other share owner's personal finances are necessary; there is very little risk that their bankruptcy will allow their creditors to attack the firm's assets themselves. Further, as ownership and management are generally divided within a company structure, a change in ownership can be affected with minimal impact on the day-to-day running of the business. While shares in a company are therefore by nature transferable, they are not freely tradable; the latter being dependant on public market rules (if the company is listed), the company's internal constitution and any relevant shareholders agreement.¹¹⁸

It must be noted that the transfer of shares themselves does not provide the company with capital; it is only the initial issue of shares which does this. Nonetheless, a company will also indirectly benefit from its shares appreciating in value. Firms can create additional shares to raise further capital, and a higher market price for shares increases the capital they would raise.

The situation for trusts is not so simple. The legal and beneficial rights are divided between the trustee and the beneficiaries and cannot be passed onto another without agreement from all parties involved, or without a clear power in the trust deed to do so.¹¹⁹ The trustee owes fiduciary obligations; a role which is generally accepted as necessitating personal performance

¹¹⁷ John Armour, Henry Hansmann and Reinier Kraakman "The Essential Elements of Corporate Law: What is Corporate Law?" in *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2009) 2 at 9 – 10.

¹¹⁸ Armour, Hansmann and Kraakman, above n 117, at 11.

¹¹⁹ Emma Lindblom "Changing a Discretionary or Family Trust in NZ" (22nd December 2020) LegalVision <<https://legalvision.co.nz>>.

by that person. However, due to the 125-year lifespan of a trust¹²⁰, a power to change trustees is normally contained in the trust deed, generally granted to persons denoted as the ‘appointer’.¹²¹ Similarly, a beneficiary cannot replace themselves with another without agreement from the other trust members, as again that changes the legal relationships involved and who the trustee owes obligations to.¹²² More importantly, it will often change the nature of the beneficial interests, which will commonly require a re-settlement of the trust.¹²³ This result is indifferent for the increasingly popular trading trust form, wherein the trustee is a company itself and the purpose of the trust is to undertake business dealings.¹²⁴ The trust remains a series of relationships, and the impact on the beneficial relationships is still central to whether it must be re-settled.

Therefore, the easiest method of transferring the beneficial ownership is through having the relevant trust property firstly distributed to the beneficiary, who then enters a separate contract with the investor. Unfortunately, this will of course remove the protective functions of having put the property in the trust in the first place, and so a new trust would need to be established. Alternatively, a beneficiary may assign their right to the trust income or property to another. However, that situation is still complicated where the trust is discretionary, like many are, as the value of the right to the income or property is incredibly difficult to value.

As has been explained, if the entity is required to attain financing, either debt or equity, it will be simpler to do so using a company rather than a trust. The legislation surrounding companies prioritizes the protection of creditors, unlike trusts, and the company form allows changes in ownership to occur far more easily than within a trust. These protections for creditors and shareholders make investing in the entity more attractive. Additionally, using the commonly used company structure can also make dealings with third parties, such as creditors, smoother.

Still, whether financing is needed, and thus whether the company form appears more attractive on this point, depends on the purpose sought. Financing will commonly be needed by persons

¹²⁰ Trusts Act 2019, section 16(1).

¹²¹ Lindblom, above n 119.

¹²² See the Trusts Act 2019, section 122.

¹²³ Lindblom, above n 119.

¹²⁴ Law Commission *Court Jurisdiction, Trading Trusts and Other Issues* (NZLC IP28, 2011) at 67.

who intend to create a business out of the property, such as property developers or operators (like rental companies). However, increasing income may not be as important as simply protecting the property. If the property is already freehold, and there are no plans to develop it or to create a rental portfolio, then the financing advantage provided by the company form could be irrelevant to the decision maker.

C Costs and Compliance

1 Tax

Tax is also likely to be a substantial consideration in determining which form of entity to take. For a company, their profit is taxed as income at 28%.¹²⁵ Comparatively, income earned by a trust can either be retained or distributed to beneficiaries, with different tax consequences for each.¹²⁶ If trust income is retained, it will be taxed at 33%, and is paid by the trustee, who would be reimbursed out of the trust assets.¹²⁷ For the income to be considered beneficiary income, it must vest absolutely in the beneficiary during that income year or be paid or applied for the beneficiary's benefit within six months after the end of that income year.¹²⁸ That means that the income may be held as a credit against a beneficiary's current account, rather than directly transferred to them.¹²⁹ The income will then be included as the beneficiary's personal income. Combined with all other income received by that beneficiary during the tax year it will be taxed at that beneficiary's personal income tax rate, which is often lower than the 33% rate applied to trust income, and regularly lower than the company income tax rate as well.¹³⁰

The highest personal income tax rate has recently risen to 39%, meaning either entity offers a clear advantage where income is above \$180,000 a year.¹³¹ Additionally, New Zealand has no

¹²⁵ Inland Revenue Department "Tax rates for businesses" (2021) IRD <<https://www.ird.govt.nz>>.

¹²⁶ Gifford Devine Lawyers "How is a trust's income taxed?" (15th October 2019) Gifford Devine Lawyers <<https://gifforddevine.co.nz>>.

¹²⁷ Kenny and Ormsby, above n 87, at 1.

¹²⁸ Inland Revenue Department "Trusts and estates income tax rules" (July 2020) IR288 <<https://www.ird.govt.nz>> at 11.

¹²⁹ Tanya Speight "New tax disclosure obligations for trustees" (18th December 2020) Saunders Robinson Brown <<https://srblaw.co.nz>>.

¹³⁰ Gifford Devine Lawyers, above n 79 and Inland Revenue Department, above n 126, at 17.

¹³¹ Taxation (Income Tax Rate and Other Amendments) Act 2020, section 5.

estate duty, gift duty, stamp duty or capital gains tax.¹³² This means that placing assets into a trust incurs no tax obligation, nor does any increase in the underlying value of the trust property. The tax loophole left by the new taxation scheme for trusts exists in stark contrast to most other countries. It has already been the subject of criticism, with Inland Revenue raising “significant concerns” about the abuse of trusts to avoid tax obligations.¹³³ It recommended aligning the tax rates by also raising the tax on trust income.¹³⁴ In response, Revenue Minister David Parker has stated that if avoidance “behaviour becomes apparent, then we’ll move to increase the trust rate to avoid that being used as an avoidance loophole.”¹³⁵

It is notable, however, that the reason why tax on trust income was not increased concurrently with the rise in personal income tax is because “there are legitimate reasons for people to use trusts.”¹³⁶ Only 63,000 people in New Zealand (about 1.2% of the population) make more than the \$180,000 threshold and are therefore impacted by the personal income tax increase.¹³⁷ While there are no definitive records of trust usage in New Zealand, estimates place the number between 300,000 and 500,000, clearly indicating a significant number of people unaffected by the personal income tax rise would be impacted by a concurrent rise in tax on trust income.¹³⁸

Regardless of whether trust income tax does rise, the company tax rate of 28% will be lower. This is one significant factor for why commercial-scale property investment tends to be done through companies. These companies can be generally divided into Real Estate Operating Companies (REOC’s) and Real Estate Development Companies (REDC’s), with the distinction being drawn by the extent to which the company creates value through improving property, as opposed to simply holding it. Such commercial investment may also be made through REIT’s, considered Portfolio Investment Entity’s (PIE’s) in New Zealand.¹³⁹ Those structures provide

¹³² Law Commission *Review of the Law of Trusts* (NZLC IP31, 2012) at 1.24.

¹³³ Jenée Tibshraeny “Inland Revenue raises 'significant' concerns over people using trusts to avoid the new 39% income tax rate; Suggests the trustee rate be hiked; Grant Robertson open to the idea” (2nd December 2020) Interest <<https://www.interest.co.nz>>.

¹³⁴ Tibshraeny, above n 133.

¹³⁵ Tibshraeny, above n 133.

¹³⁶ Tibshraeny, above n 133.

¹³⁷ Figure NZ “People earning wages and salaries in New Zealand” (2020) Figure NZ <<https://figure.nz>>.

¹³⁸ Ministry of Justice “Trust law reform” (7th December 2020) Ministry of Justice <<https://www.justice.govt.nz>>.

¹³⁹ Income Tax Act 2007, subpart HM.

less flexibility than a company does, and have different compliance standards, particularly in relation to financial conduct. Nonetheless, there are many REIT's with substantial market valuations on the NZX.

For investors not seeking to operate at a commercial scale, look-through companies (LTC's) tend to be the best option. LTC's provide the additional benefit of allowing company losses to flow to individual shareholders on a pro rata basis, offsetting tax costs. It is notable, however, that changes to the residential property deduction rules in 2019¹⁴⁰ mean that rental deductions (for example expenses or administrative costs) can only be offset against rental income.¹⁴¹ Nonetheless, the tax benefit is only lost where rental deductions are greater than rental income, and careful accountancy can minimise this possibility. As extra requirements must be met for this form of company, such as a five-shareholder limit and a prohibition on non-LTC company's holding shares in an LTC, they are not normally suitable for large commercial enterprise.¹⁴²

2 *Compliance requirements*

The Companies Act 1993 forms the core of New Zealand's corporate regulatory system¹⁴³, bolstered by other legislation such as the Financial Reporting Act 2013 and, to a more limited extent, the Receivership Act 1993.¹⁴⁴ The Companies Act 1993 in particular provides a series of compliance requirements relating to disclosure obligations, the exercise of powers by both directors and shareholders and insolvency rules.¹⁴⁵ Many of these requirements are similar to those of trusts. For example, both directors and trustees owe fiduciary obligations and directors

¹⁴⁰ See generally, Inland Revenue "Residential Rental Property Reductions" (2021) Inland Revenue <<https://www.ird.govt.nz/>>.

¹⁴¹ See Inland Revenue, above n 140.

¹⁴² Inland Revenue "Eligibility to be a look-through company" (2021) Inland Revenue <<https://www.ird.govt.nz/>>.

¹⁴³ New Zealand Companies Office "Corporate Regulation in New Zealand" (2021) New Zealand Companies Office <<https://www.companiesoffice.govt.nz/>>.

¹⁴⁴ New Zealand Companies Office "How we enforce the law" (2021) New Zealand Companies Office <<https://www.companiesoffice.govt.nz/>>.

¹⁴⁵ New Zealand Companies Office, above n 143.

must disclose any personal interest in a transaction undertaken by the company¹⁴⁶, similar to the rule against self-dealing which applies to trustees.¹⁴⁷

Notably, however, key differences also emerge. Where a director fails to disclose a personal interest in a transaction the transaction will not be invalid¹⁴⁸, although the director will be liable for a fine not exceeding \$10,000 under section 373(2).¹⁴⁹ In contrast, a breach of the rule against self-dealing will not only likely form the basis for the removal of the trustee, but the transaction itself will also be voidable, subject to rights of innocent third parties.¹⁵⁰

Directors of companies are also subject to a number of important duties under the Companies Act 1993. The main duties are in sections 131, 133-137 and 145, which are owed to the company itself.¹⁵¹ Breach of these duties may entitle a liquidator, creditor or shareholder to recover from a director or promoter of the company personally. This can be seen in *Yan v Mainzeal*¹⁵² where at the Court of Appeal¹⁵³ the directors were found to have breached sections 135 and 136.¹⁵⁴ Resultingly, they were ordered to personally contribute to the company's assets under section 301 for the section 136 breach.¹⁵⁵ These reckless trading provisions are far more onerous than the prudent investor obligation which applies to trustees.¹⁵⁶ This is because they serve different purposes, with the reckless trading rules intended to protect creditors and the prudent investor obligation intended to protect beneficiaries.

It is also notable that directors are expected to be active within the company, and cannot stand by as passive directors blindly following management or even other directors.¹⁵⁷ Doing so may

¹⁴⁶ Companies Act 1993, section 140.

¹⁴⁷ Stephanie Woods "The rule against self-dealing" (14th August 2018) Wynn Williams & Co <<https://www.wynnwilliams.co.nz>>.

¹⁴⁸ Companies Act 1993, section 140(3).

¹⁴⁹ Companies Act 1993, section 140(4).

¹⁵⁰ Woods, above n 99.

¹⁵¹ Companies Act 1993, section 169(3).

¹⁵² *Yan v Mainzeal Property and Construction Limited (in Liq)* [2021] NZCA 99.

¹⁵³ Note that this decision is yet to be heard on appeal by the Supreme Court of New Zealand.

¹⁵⁴ At [452] and [476].

¹⁵⁵ At [529] – [530].

¹⁵⁶ Trusts Act 2019, section 30.

¹⁵⁷ See Companies Act 1993, sections 128 and 130.

still render them personally liable for breaches of their duties, as seen in the *FXHT Fund Managers v Oberholster*¹⁵⁸ case. In that case, Mr Oberholster had agreed to act as a non-executive director of a company, whose other director was the son of a family-friend, as a favor.¹⁵⁹ This other director essentially ran the investment company as a ‘Ponzi scheme’.¹⁶⁰ Despite Mr Oberholster acting in good faith throughout his directorship and having no knowledge of the fraud¹⁶¹, he was still found to have breached sections 135 and 137.¹⁶² By being only a passive director, he had allowed the company to be carried on in a manner likely to create a substantial risk of serious loss to the company’s creditors.¹⁶³

Both entities also have numerous disclosure and record-keeping requirements, but, again, these are more burdensome for companies than trusts. For companies, these requirements are designed to ensure that shareholders and creditors are well-informed about happenings within the business. For this purpose, accounting and financial records will be needed, as prescribed in Part 11 of the Company’s Act 1993, and additional disclosures to shareholders are required under Part 12. This includes providing sufficient information to analyse whether the company will continue to be a going concern, changes in business focus and the information needed to allow shareholders to make decisions on major transactions¹⁶⁴ – which normally require special resolutions¹⁶⁵ by shareholders.¹⁶⁶ Much of this information will be needed for a company’s annual general meeting¹⁶⁷, although shareholders may also request information directly.¹⁶⁸

¹⁵⁸ See *FXHT Fund Managers Ltd (in liq) & Anor v Oberholster* [2009] 10 NZCLC 264,562 and *FXHT Fund Managers Ltd (in liq) v Oberholster* [2010] NZCA 197.

¹⁵⁹ *FXHT Fund Managers Ltd (in liq) v Oberholster* [2010] NZCA 197 at [8].

¹⁶⁰ At [10].

¹⁶¹ At [10].

¹⁶² At [14] and [16].

¹⁶³ See the headnote of *FXHT Fund Managers Ltd (in liq) & Anor v Oberholster* [2009] 10 NZCLC 264,562.

¹⁶⁴ A ‘major transaction’ is defined in section 129(2) of the Companies Act 1993 as relating to an acquisition/transaction/disposition of assets greater than 50% of the company’s assets.

¹⁶⁵ A ‘special resolution’ is defined in section 2(1) of the Companies Act 1993 as requiring a majority of 75% (or higher, depending on the company constitution) of shareholders to pass.

¹⁶⁶ Companies Act 1993, section 129.

¹⁶⁷ Companies Act 1993, section 120.

¹⁶⁸ Companies Act 1993, section 178.

Comparatively, a trusts record-keeping and disclosure rules are primarily for the beneficiaries. Trustee's must provide 'basic trust information'¹⁶⁹ to beneficiaries¹⁷⁰ and most other information a beneficiary applies for¹⁷¹, unless that presumption does not apply.¹⁷² Core trust documents¹⁷³ must only be kept by at least one trustee, although the trust deed and any variations made to it must be kept by all trustees.¹⁷⁴ However, there is no requirement for an annual general meeting, and there is no need for special resolutions prior to a major transaction being entered. Rather, those transactions are at the trustee's discretion, having regard to their mandatory duties¹⁷⁵ like acting in good faith¹⁷⁶ and for the benefit of beneficiaries.¹⁷⁷

Overall, often the compliance requirements placed on trusts are less significant than those placed on companies, and resultingly the costs associated with meeting those requirements tend to be greater for companies. Nonetheless, where complicated trust structures are established through the trust deed itself, these additional complexities can make it very difficult to ascertain whether all the requirements have been met, increasing costs as a result.¹⁷⁸

D Summary

Ultimately, determining which legal form to take will be heavily context dependant. Private investors seeking to maintain wealth may use family trusts, those looking to develop properties may use look-through companies or commercial actors may use an REIT. The types of relationships the individual will need to establish with third parties will be relevant to the decision, including access to financing and minimising the tax payable to the IRD. Practically,

¹⁶⁹ 'Basic trust information' is defined in section 51(3) of the Trusts Act 2019 as "(a) the fact that a person is a beneficiary of the trust; and (b) the name and contact details of the trustee; and (c) the occurrence of, and details of, each appointment, removal, and retirement of a trustee as it occurs; and (d) the right of the beneficiary to request a copy of the terms of the trust or trust information."

¹⁷⁰ Trusts Act 2019, section 51.

¹⁷¹ Trusts Act 2019, section 52.

¹⁷² Trusts Act 2019, section 53.

¹⁷³ Trusts Act 2019, section 45.

¹⁷⁴ Trusts Act 2019, section 46.

¹⁷⁵ Trusts Act 2019, sections 22 – 27.

¹⁷⁶ Trusts Act 2019, section 25.

¹⁷⁷ Trusts Act 2019, section 26.

¹⁷⁸ Matthew Bartlett "Should I Operate My NZ Business Through a Trust or Company?" (24th March 2021) LegalVision <<https://legalvision.co.nz>>.

many, arguably foundational, elements of the entities can be altered through company constitutions, shareholder agreements or the trust deed to further define relationships. This flexibility allows a great number of purposes to be pursued through either entity, although may complicate compliance.

VII Market Competition in New Zealand

Having outlined both the New Zealand property market and the entities within it, this section of the paper now analyses the competitive forces exerted by these different legal entities on the residential property market in New Zealand. It will quickly become apparent that the relative size of the market limits any single entity or even group of entities being able to substantially impact competition in the broader market. Therefore, relevant smaller markets will also be discussed.

A The New Zealand Market

The New Zealand residential property market is now valued at \$1,305 billion.¹⁷⁹ In combination with commercial property, it is New Zealand's biggest industry, directly contributing \$41.2 billion to New Zealand's GDP.¹⁸⁰ No property investment company in New Zealand is sizeable in comparison. Combined, NZX listed companies operating in the property market (30% of the NZX) had a market value of \$53 billion on April 1st 2021.¹⁸¹ This would amount to 4% of the market.

However, breaking down this amount is crucial. For example, it includes commercial property investment totalling \$13.7 billion, which is only indirectly related to the residential property market.¹⁸² Investors in commercial property may have some degree of difficulty shifting into residential property. Beyond the necessary changes to managing the business itself, there will likely be a time-delay in selling substantial commercial assets or doing so quickly may breach contracts. Despite this, these companies still provide a level of competition through being an entry threat, even if a delayed one. Notably, this threat comes from their asset size relative to

¹⁷⁹ Urban Economics (commissioned by Property Council New Zealand) "New Zealand 2021 Property Industry Impact" Property Council New Zealand (2021) <<https://www.propertynz.co.nz>> at 4.

¹⁸⁰ At 4.

¹⁸¹ At 4.

¹⁸² At 14.

other market competitors, not because they would be capable of exercising substantial market power.

Construction and land development companies worth \$5.4 billion have also been included in the broader \$53 billion valuation.¹⁸³ These companies are best seen as suppliers rather than demanders in this market. At the broadest, they may be demanders for land, but are generally involved with larger development-scale projects which provide homes to regular consumers. As they are contributing to supply, they would not generally be increasing house prices, unless they were being run inefficiently.

Retirement villages could be considered to be investing in residential property. While they provide additional services, it has been argued that at their core these companies are essentially property development and management companies. This is generally where a substantial proportion of their income is made and where their assets are held.¹⁸⁴ Notably, retirement village companies very rarely buy single existing homes. It is at the larger residential development stage, as opposed to single or even multiple units, that retirement villages could contribute to increases in residential real estate prices. At that stage they may purchase land which could have supported dozens of homes. Nonetheless, they do build new homes, which, even if restricted to the elderly, frees up existing homes. In that regard, they can be seen as pro-competitive, in that they are contributing to supply rather than restricting it.

Moving to the public sector, the Crown entity Kāinga Ora currently houses 189,000 people¹⁸⁵ in over 66,000 properties.¹⁸⁶ This is undoubtedly a substantial portfolio, being worth almost \$30.8 billion.¹⁸⁷ Still, this is insignificant compared to the entire market, accounting for only 2.3% of it. To provide those homes, Kāinga Ora either undertakes urban development or purchases the required homes. Crucially, it appears to often choose the latter, increasing demand in the market. In 2019/2020, they “enabled or constructed” 264 homes on land already

¹⁸³ At 14.

¹⁸⁴ See the Annual Reports of Retirement Villages such as [Ryman Healthcare Limited](#), [Summerset Group Holdings Limited](#) and [Oceania Healthcare Limited](#), available at <<https://www.nzx.com/>>.

¹⁸⁵ Kāinga Ora Annual Report 2019/2020 <<https://kaingaora.govt.nz>> at 3.

¹⁸⁶ At 2.

¹⁸⁷ At 2.

owned by the entity, which was 30 fewer than the previous year due to COVID-19 delays.¹⁸⁸ Comparatively, since 2017, they have bought more than 1054 homes.¹⁸⁹

As discussed earlier in this paper, the majority of New Zealand residential rental properties are actually owned by small-time investors, generally through their own trust or company. There are approximately 530,000 rental properties in New Zealand, with 453,000 being privately owned.¹⁹⁰ Out of the 120,330 landlords who lodged bonds in 2021, 93,706 of them lodged just one bond.¹⁹¹ As aforementioned, these ‘smaller’ investors collectively own a third of New Zealand’s *total* property.¹⁹² As a block, therefore, they theoretically could exert influence on the market, especially on the rental market. Nonetheless, this is not realistic, as these landlords are far too dispersed to act in concert. Instead, they are largely price-takers, being able to only charge approximately the market rate.

This does not mean they will not raise prices where possible. Tenancies are most commonly periodic, or are generally for between 6-12 months in length¹⁹³, with the average total occupation time being 27 months.¹⁹⁴ This means there are many opportunities for re-negotiating increases in rent prices, although these increases are determined more by macroeconomic factors than by any particular actors. For example, the worsening housing shortage simply means that there is less supply in the market, leading to the opportunity for landlords to raise rents. This is the ‘simple’ reason for raising house prices. Similarly, increases in benefit payments will lead to increases in rental prices, as has been seen numerous times. The benefit payments increase the individuals disposable income, and concurrently the amount they are prepared to pay for rent. This simply increases the competition in the market, pushing

¹⁸⁸ At 82.

¹⁸⁹ Jenna Lynch “Government buys hundreds of houses in direct competition with first-home buyers” (28th April 2021) Newshub <<https://www.newshub.co.nz>>.

¹⁹⁰ Miriam Bell “Nearly 80 per cent of landlords own just one property, data shows” (26th February 2021) Stuff <<https://www.stuff.co.nz>>.

¹⁹¹ Bell, above n 190.

¹⁹² Johnson, above n 33.

¹⁹³ Barfoot and Thompson “Tenancy types over time” (August 2016) Barfoot & Thompson <<https://www.barfoot.co.nz>>.

¹⁹⁴ Anne Gibson “Now and then: Landlord/tenant law overhaul, how 1.5m lives could change” (18th November 2019) NZ Herald <<https://www.nzherald.co.nz>>.

up the price as renters use up the increased benefit to compete; the renters individually are price-takers too.

However, astute landlords acting in their own best interest may even raise prices in anticipation of a benefit increase. They will be aware that the recipients have more disposable income to compete with and thus that a higher price will be achievable. For example, following the announcement of a \$50 increase in student allowance beginning on the 1st of January 2018, rents in university cities increased almost immediately.¹⁹⁵ In Wellington, rents increased \$42 in the month *preceding* the increase.¹⁹⁶ Notably, these rent rises do not just apply to those who receive the benefits, but impact on the wider market. This is because the rentals occupied by beneficiaries tend to be of lower value, and so increases in their rents also push up the rents of the properties valued higher than them.

B Regional Markets

Confining the market by region instead and focusing on areas where there is concentrated investment by these entities increases their market share only minimally. Firstly, it should be stated that the eight major listed REIT's¹⁹⁷, totalling \$14.4 billion in market share¹⁹⁸, invest in commercial or industrial property, not residential. Some of these entities do hold significant property assets in concentrated locations. For example, Goodman Property Trust owns \$3.5 billion of commercial property, solely in Auckland.¹⁹⁹ Nonetheless, they really only provide competition because they are a potential entry threat.

As aforementioned, the retirement villages are a competitor at a broader level within the residential property market. The NZX listed retirement village companies have a substantial

¹⁹⁵ Henry Cooke "Student allowance boost blamed for rent spikes" (January 11th 2018) Stuff <<https://www.stuff.co.nz>>.

¹⁹⁶ Cooke, above n 195.

¹⁹⁷ See Money King NZ "What's inside your property fund? 5 things to know about REITs" (25 November 2019) Money King NZ <<https://moneykingnz.com>>, Marta Steeman "Listed property companies' shares outperforming the broader sharemarket" (14th October 2020) Stuff <<https://www.stuff.co.nz>>, Simply Wall Street "Biggest 7 Day New Zealand (NZX) Real Estate Market Cap Gainers" (2021) Simply Wall Street <<https://simplywall.st>> and Smartshares "NZ Property ETF" (2021) Smartshares <<https://smartshares.co.nz>>.

¹⁹⁸ On the 16th of August 2021.

¹⁹⁹ See NZX "GMT Analysis" (2021) NZX <<https://www.nzx.com>>.

market valuation of \$12.5 billion²⁰⁰, but this pales in comparison to even the regional residential property market values. It is also crucial that most of these companies spread their operations across the country, such that they often lack an overwhelming presence in any one centre. For example, Arvida Group Limited and Radius Residential Care Limited have approximately a population-proportional spread of locations New Zealand wide.²⁰¹

Still, Oceania Healthcare Limited, Ryman Healthcare Limited and Summerset Group Holdings Limited all have a higher concentration of property in certain locations.²⁰² Using their balance sheet information²⁰³ and dividing their property holdings value by their total number of locations, some approximate value of their holdings in each region can be determined. Using this method in Auckland, Oceania has \$963 million in property, Ryman has \$2.36 billion and Summerset has \$889 million. In comparison, the Auckland residential property market is valued at approximately \$588 billion.²⁰⁴ In total, these three retirement village companies would have .7% of the market. This calculation is assuming the value of their properties are the same, which is very unlikely. However even if *all* of their property assets were in Auckland, it would still only be 1.9% of the market.

The three companies are also concentrated in Christchurch, owning approximately \$340 million, \$1.65 billion and \$635 million in property respectively. Combined, this is \$2.6 billion, again rather insignificant in comparison to the regions residential property valuation of \$147.5 billion²⁰⁵, being only 1.7% of the market. Possibly the greatest market share out of the retirement villages is achieved by Oceania in Nelson, where it owns approximately \$390

²⁰⁰ On the 16th of August 2021.

²⁰¹ See, Arvida Group Ltd “Our Retirement Communities” (2021) Arvida Group Ltd <<https://www.arvida.co.nz>> and Radius Residential Care Ltd “Our Locations” (2021) Radius Residential Care Ltd <<https://radiuscare.co.nz>>.

²⁰² See Oceania Healthcare Limited “Find a Location” (2021) Oceania Healthcare Limited <<https://www.oceaniahealthcare.co.nz>>, Ryman Healthcare Limited “Our Villages” (2021) Ryman Healthcare Limited <<https://www.rymanhealthcare.co.nz>> and Summerset Group Holdings Limited “Find a Village” (2021) Summerset Group Holdings Limited <<https://www.summerset.co.nz>>.

²⁰³ See the Annual Reports of each company. [Ryman Healthcare Limited 2021 Annual Report](#); [Oceania Healthcare Limited 2021 Annual Report](#); [Summerset Group Holdings Limited 2021 Annual Report](#).

²⁰⁴ Urban Economics (PCNZ), above n 179, at 11.

²⁰⁵ Urban Economics (PCNZ), above n 179, at 11.

million in property. The Tasman districts residential property market was recently valued at \$22.8 billion²⁰⁶, indicating Oceania may own up to 1.7% of that market itself.

The country's biggest landlord, Kāinga Ora, does not appear to hold a significant market share in any region either. It owns most of its properties in Auckland, Wellington and Christchurch, totalling 29902, 8737 and 6390 properties respectively.²⁰⁷ Dividing Kāinga Ora's total assets²⁰⁸ by its number of properties²⁰⁹ indicates the average Kāinga Ora property is worth approximately \$465,000. This would value its regional portfolios at \$13.9 billion, \$4 billion and \$2.97 billion respectively. This represents market shares of between 2-3%, meaning it is unlikely the entity has acquired substantial market power in any of the markets.

C Competition by 'Overseas Persons'

As mentioned under sections IV and V above, 'overseas persons' have been seen by current policy as exacerbating house prices in New Zealand through competition. As discussed there, six of the 10 largest property owners in New Zealand are foreign owned forestry companies.²¹⁰ Nonetheless, despite their substantial holdings, these types of entities are unlikely to have any significant effect on the residential market. This is primarily because of the Overseas Investment (Amendment) Act 2021, as discussed under section V, which greatly restricts the ability of 'overseas persons' to invest in residential property because it is 'sensitive land'.

Still, as recent as 2017 regions such as Auckland and Queenstown saw 5-7%²¹¹ of property transfers being "entered into by people without New Zealand citizenship or residency".²¹² This does not include foreign citizens with resident visas, which may take a further 8% of the market.²¹³ This rate had been growing; 2016 saw almost six times the number of residential

²⁰⁶ Quotable Value "New rating valuations for Tasman District" (January 25 2021) Quotable Value <<https://www.qv.co.nz>>.

²⁰⁷ Kāinga Ora, above n 185, at 2.

²⁰⁸ Kāinga Ora, above n 185, at 2 notes the entities total assets as being \$30.8 billion.

²⁰⁹ Kāinga Ora, above n 185, at 2 notes the entities total properties as being 66,253.

²¹⁰ Newsroom Staff, above n 41.

²¹¹ Statistics New Zealand "Property transfer statistics: December 2018 quarter" (8 February 2019).

²¹² Tran Bao Cao "Foreign Investment in New Zealand Residential Property" (2019) 25 CLJP 129 at 130.

²¹³ Daniel Dunkley "Foreign buyers are out of the market - but it hasn't solved our problems" (1st March 2020) Stuff <<https://www.stuff.co.nz>>.

properties being sold to ‘overseas persons’ as in 2015.²¹⁴ At the time, this was seen as a source of competition to New Zealand citizens and residents which warranted the 2018 Amendment being enacted.

Following the two Amendments, foreign investment in residential property has expectedly declined. By 2020, only 0.8% of property transfers in Auckland were to “overseas persons”, and only 3% were in Queenstown.²¹⁵ This would indicate a sizeable decrease in their impact on the demand side of the market. Additionally, this year foreign owners have been selling at twice the rate they are buying,²¹⁶ which would be contributing to supply, although minimally.²¹⁷

It is notable that 11% of property transfers New Zealand wide in the December 2020 quarter were to corporate entities.²¹⁸ These entities may have New Zealand or foreign owners, in accordance with the discussion under section V above. This may indicate that corporate entities are still being used by ‘overseas persons’ to invest in the land. However, given that 9.9% of property transfers were to corporate entities in the March 2018 Quarter as well (before the 2018 Amendment), that would seem unlikely.²¹⁹ While some ‘overseas persons’ may have switched to using them, the majority do not seem to have, given the changes in the relevant percentages.

The restriction of foreign purchasers from the market has not resulted in lowering house prices. Possibly, the prices have increased at a rate lower than they would have, but economists have doubted whether they really held any “material influence on the housing market”.²²⁰ Their key

²¹⁴ Tran Bao Cao, above n 212, at 130.

²¹⁵ Statistics New Zealand “Property transfer statistics: December 2020 quarter” (2nd February 2021) Statistics New Zealand <<https://www.stats.govt.nz>>.

²¹⁶ Statistics New Zealand “More overseas people selling than buying homes” (1st May 2020) Statistics New Zealand <<https://www.stats.govt.nz>>.

²¹⁷ Greg Ninness “Foreign owners selling their New Zealand residential properties at more than twice the rate they are buying them” (28th July 2021) Interest.co.nz <<https://www.interest.co.nz>>.

²¹⁸ Statistics New Zealand, above n 215.

²¹⁹ Statistics New Zealand “Property transfer statistics: March 2018 quarter” (7th June 2018) Statistics New Zealand <<https://www.stats.govt.nz>>.

²²⁰ Dunkley, above n 213.

method of influence now is through legal entities, although any complete control is limited and therefore, at current, they provide little competition to the market.

As has been explained throughout this part, some of the entities certainly have access to significant resources, yet their control on the market is negligible. This is both at a New Zealand wide and regional level. Many of the actors provide some level of demand in the residential property market, most notably being the private investors. Others, however, provide little to no competition presently in that market, such as many of the listed REIT's, and 'overseas persons' personally. Entities are being used by most of the actors in the market, generally for the protective features or to structure relationships with third parties. Still, their existence and the legal protections afforded to them through the different entity forms do not appear to contribute to a noticeable increase in the value of residential property in themselves.

D Other Conduct

1 Landbanking

Some practices taken by these entities, however, do contribute to increasing prices through further restricting the supply, even if the entities are not substantially increasing demand. In particular, landbanking, the practice of purchasing vacant land and holding it either to reap capital gains or to prevent competitors from using the locations, has been seen as a substantial part of the existing housing crisis.²²¹ Some companies now operate equity crowdfunding platforms to allow retail investors access to landbanking opportunities, from as low as \$100.²²² This really only exacerbates the housing crisis, by allowing even greater volumes of capital to be directed to restricting the land supply. The practice has been especially common on the outskirts of major centres, where investors have been able to make over 100 times their initial investment in a little over 20 years.²²³ For example, in 2017 it was estimated that just two landbankers in Wellington owned 500 hectares on the city's outskirts – enough for 2740 new homes.

²²¹ Stuff New Zealand "Editorial: Landbanking is a big part of the housing crisis" (28th March 2017) Stuff New Zealand <<https://www.stuff.co.nz>>.

²²² Opolo "New kiwi start-up making land banking possible from \$100" (18th August 2021) Scoop <<https://www.scoop.co.nz>>.

²²³ Stuff New Zealand, above n 221.

One of the proposed measures for addressing this practice is by introducing a tax on vacant land. The idea is simple – if the property is not being used or does not have plans for its development, it can be taxed proportionality according to the land value. However, this idea has been firmly shut down by subsequent reports, especially those from the New Zealand Productivity Commission^{224, 225}. This was for a number of reasons. Firstly, it would be incredibly difficult to accurately define what constitutes “vacant land” in a way which does not include legitimate uses of vacant land.²²⁶ It was estimated by the report that between 70-90% of vacant land in Auckland may need be excluded from the tax in order to minimise the economic costs of taxing legitimate uses of vacant land.²²⁷ Additionally, landbankers “could easily switch their vacant land to some form of productive use to avoid the vacant-land tax”, meaning it would be a very weak incentive to change the practice.²²⁸

There are still further issues with such a policy. It is not likely to reduce land speculation or price bubbles in the long-run, and would require a very high tax for it to be effective at all. For example, where land investment has been returning 10, 15 or even 30% per annum, a tax of 5% of the lands value is unlikely to dissuade investors.²²⁹ Further, where there is strong speculation, as is seen in the current market, “land price rises would simply continue ‘over the top’ of the fixed rate”.²³⁰ Having a variable rate dependant on market conditions could limit this, but increases uncertainty for investors and developers with possible negative impacts on housing development.²³¹

²²⁴ Productivity Commission “Local Government Funding and Financing” (2019) Productivity Commission <<https://www.productivity.govt.nz>>.

²²⁵ David Hargreaves “Tax Working Group proposal for vacant land tax that was referred for further investigation by Finance Minister Grant Robertson has been given a firm thumbs-down” (12th December 2019) Interest.co.nz <<https://www.interest.co.nz>>.

²²⁶ Productivity Commission, above n 224, at 191.

²²⁷ At 190.

²²⁸ At 192.

²²⁹ At 191.

²³⁰ At 191.

²³¹ At 191.

2 *Purchasing Above Rateable Value*

The entities are also normally able to outbid private citizens, often by paying more than the rateable value (RV) of the property. It is arguable that paying amounts significantly more than the RV of a property would be unreasonable for a company to do, as it would be an immediate loss in the books. Nonetheless, where multiple property purchases together allow for a higher value development to be constructed, it may be reasonable to pay more than RV. For retirement villages this may occur for land purchases, which would otherwise be subdivided into single-lot residential properties. However, there is little evidence of the public being outbid by retirement village companies, predominately due to the scale at which they operate. Additionally, the retirement villages, beyond building property developments, also provide a needed service for our ageing population.

Kāinga Ora also purchases and develops large-scale housing complexes, as well as standalone homes. As aforementioned, the entity buys at least as many homes as it builds, and often this can be in competition with the public. Like the other entities, it can use its substantial cash assets to outbid private buyers. They do this because “there might be a specific home in a specific community that is required, and it does make sense to go and buy it because the house exists”.²³² However, these are very small numbers of properties relative to the market, such that the majority of the public are not impacted by the purchases. Sometimes, still, Kāinga Ora purchases may result in previous agreements being cancelled, such as occurred for a woman purchasing an Auckland apartment in a building which was subsequently purchased by Kāinga Ora.²³³ As the entity should be focusing on improving supply to ease the crisis (which they are responding to through these purchases), this purchasing is arguably introducing unnecessary competition.

Nonetheless, while building the properties is very likely the better long-term strategy, vulnerable people need to be homed now. Kāinga Ora provides social housing for many of New Zealand’s most vulnerable people. It is “focused on providing public housing principally

²³² Lynch, above n 189.

²³³ Susan Edmonds “First-home buyer's dream shattered by Government purchase” (16th February 2020) Stuff New Zealand <<https://www.stuff.co.nz>>.

for those most in need”, highlighting the social aspects of the crisis.²³⁴ That social mission remains the primary aim of Kāinga Ora, and justifies the minimal demand pressure the organisation places on the market. These benefits for society should be taken into account when assessing whether any additional competition they provide is harmful.

VIII Development Regulations

As explained above, legal entities can provide a level of competition in the residential property market, yet this tends to reflect access to significant capital rather than due to having dominant market share. These entities operate within a rapidly changing regulatory landscape, with those changes being sought to remedy structural issues long seen as leading to increases in house prices.²³⁵ Land use restrictions, including urban planning rules relating to density and zoning, limit the land available for use, subsequently impeding “the ability of the market to increase the supply of houses when demand for houses increases.”²³⁶ This section will explain the recent changes and their impact on entities and investors in the market. As will be seen, these structural issues have had a far greater impact on house price increases than the availability of entities and their accompanying protections.

The Productivity Commission’s report considers that it would be more effective to focus on the underlying systemic issues, such as the inefficient land-use regulations or the slow development of infrastructure²³⁷ rather than landbanking or similar conduct.²³⁸ Land-use plans and zoning decisions in New Zealand are made by both national and local authorities.²³⁹ No ‘general plan’ for the country exists, although “National Environmental Standards and National Policy Statements... must be given effect in regional and district plans”.²⁴⁰

²³⁴ Ministry of Housing and Urban Development “Kāinga Ora—Homes and Communities” (18th May 2020)

Ministry of Housing and Urban Development <<https://www.hud.govt.nz>>.

²³⁵ Reserve Bank of New Zealand *Monetary Policy Statement: May 2021* (May 2021) at 29.

²³⁶ Reserve Bank of New Zealand, above n 8, at 28.

²³⁷ Productivity Commission, above n 223, at 193.

²³⁸ Similar arguments are made by others. See, for example, Anthony Breach “No, landbanking does not cause the housing crisis – here’s why” (17th July 2020) Centre for Cities <<https://www.centreforcities.org>>.

²³⁹ OECD, above n 72, at 1.

²⁴⁰ OECD, above n 72, at 1.

This whole planning system is governed by the Resource Management Act 1991 (RMA).²⁴¹ The Act is currently undergoing reform, and is planned to be divided into three separate acts “targeting the environment, development and climate mitigation.”²⁴² The main replacement legislation is the Natural and Built Environments Bill (NBA), with the Environment Committee recently receiving more than 720 submissions on the Exposure Draft, including from some of the retirement villages above.^{243, 244} The legislation is presently far from complete, with the submissions on the Exposure Draft informing the final Bill which will then go through the normal legislative process.²⁴⁵ At present, it is only 20 pages long, and is expected to become significantly larger, given the RMA is 835 pages long.²⁴⁶ Notably, much of the existing process will not be re-structured, but simplified. For example, a major part is the reduction in the number of district or regional plans from over 100 to just 14 major regional plans, in order to make the entire process more efficient.²⁴⁷

Local authorities will still be the ones determining zoning under the Exposure Draft. Therefore, it does not appear this will have much of an impact on entities within the market, although a more efficient planning process would be beneficial for many of them. Regional plans are intended to “manage the same parts of the environment, and generally control the same activities and effects, that local authorities manage and control in carrying out their functions” under the existing RMA, in particular their powers under sections 30 and 31.²⁴⁸ How the local authorities zone land can have substantial impacts on the affordability of housing. Including

²⁴¹ OECD, above n 72, at 3.

²⁴² Jamie Morton “Government scrapping Resource Management Act to tackle the housing crisis” (11th February 2021) NZ Herald <<https://www.nzherald.co.nz>>.

²⁴³ Summerset Group Holdings Limited “[Submission on Natural and Built Environments Act Exposure Draft](#)” (3rd August 2021).

²⁴⁴ See generally New Zealand Parliament “Submissions and Advice” (2021) New Zealand Parliament <<https://www.parliament.nz>>. Search terms: “Inquiry on the Natural and Built Environments Bill: Parliamentary Paper”.

²⁴⁵ Thomas Coughlan “David Parker unveils new planning law, which will squeeze 100 plans into just 14” (29th June 2021) Stuff <<https://www.stuff.co.nz>>.

²⁴⁶ Laura Murphy “New Directions and New Name for Resource Management” (7th July 2021) Holland Beckett Law <<https://hobec.co.nz>>.

²⁴⁷ Coughlan, above n 245.

²⁴⁸ [Natural and Built Environments Bill Exposure Draft 2021 section 22\(1\)\(f\)](#) (currently a placeholder provision).

requirements such as minimum lot/house sizes or density limits can prevent affordable housing development. Where zoning plans require these minimum sizes, or maximum densities, property development and construction companies are incentivised to provide high-value homes. This results in what is called ‘exclusionary zoning’.²⁴⁹ It has arguably not been as commonplace in New Zealand as in overseas jurisdictions, but it does not appear to have been something actively avoided by councils under the RMA framework either.

A Inclusionary Zoning

Inclusionary zoning is essentially the opposite. It requires “land developers to dedicate a certain percentage of the total number of dwellings in a development for affordable units.”²⁵⁰ Part of the concept’s underlying philosophy is the idea that encouraging new housing supply without affordability restraints will lead to more expensive homes being built, as developers seek to maximise profit.²⁵¹ While increasing the housing stock in this way can lead to ‘second-hand’ homes becoming more affordable, this only occurs in the long term, and so does not represent a solution to the present housing crisis. Therefore, incentivising the construction of affordable units is necessary.

The concept is not new in New Zealand, with the Affordable Housing Enabling Territorial Authorities Act 2008 being the first piece of legislation to introduce the concept.²⁵² The concept has since been used by different councils, with some limited success. The Queenstown Lakes District Council has previously implemented plans which followed inclusionary zoning principles, but which were unable to withstand the political pressures.²⁵³ These political pressures tend to be based on a fear that inclusionary zoning leads to devaluation of neighbouring properties, increases crime or can become “a blight on the neighbourhood” when they are not maintained.²⁵⁴ Nonetheless, these fears do not tend to be borne out in practice. For example, there was no significant difference found in house price increases between

²⁴⁹ Ravi Teja Ayyagari “[Affordable Housing through Inclusionary Zoning – Case of Auckland](#)” (MEP Thesis, University of Waikato, 2018) at 8.

²⁵⁰ At ii (Abstract).

²⁵¹ Shamubeel Eaqub “Housing needs inclusionary zoning” (2nd July 2017) Stuff <<https://www.stuff.co.nz>>.

²⁵² Ayyagari, above n 249, at ii.

²⁵³ Ayyagari, above n 249, at 19.

²⁵⁴ Eaqub, above n 251.

neighbours of affordable housing (provided through inclusionary zoning) and control groups in Queenstown.²⁵⁵

More recently, the Proposed Auckland Unitary Plan also contains inclusionary zoning provisions, such as in Rule H6.6.1.1 (1) which requires 10% of total dwellings be set aside for affordable housing.²⁵⁶ This only applies where the new development contains 15 dwellings or vacant sites, meaning it will realistically only apply to large scale development companies. That only 10% of total dwellings need to be set aside as affordable housing appears to reflect practice in other jurisdictions. In South Australia, for example, where a development comprises of 20 or more units, then 15% of them must be provided at an affordable price point.²⁵⁷

There has been some debate on the merits of inclusionary zoning, although typically this revolves around the extent to which the method should be used, rather than whether it should be used at all. Firstly, it should be stated that ‘greenfield’ land is agricultural or forest land which was presently undeveloped, and can be compared to ‘brownfield’ land which is ex-commercial developments. Returning to South Australia, analysis of inclusionary zoning there tended to suggest that it was “achieved relatively easily in greenfield sections”, primarily because developers were able to create small lot sizes for the affordable sections relative to the rest of the development.²⁵⁸ Additionally, the land is generally cheaper than for brownfield sections, as it tends to be nearer to the outskirts of cities. Comparatively, the same analysis suggested that inclusionary zoning principles do not work well in brownfield sections. Because of the lack of lot size variance, the higher land prices and costs for establishing the development (including demolition of existing constructions), it becomes increasingly difficult for development companies to turn a profit, or even meet costs, on the affordable units in the development.²⁵⁹ Instead, the affordable housing is effectively subsidised through higher prices on the market rate units.²⁶⁰ Despite these findings, the analysis did not recommend against

²⁵⁵ Eaub, above n 251.

²⁵⁶ Auckland Council “The Proposed Auckland Unitary Plan” (8th July 2016) Auckland Council <<https://unitaryplan.aucklandcouncil.govt.nz>>.

²⁵⁷ Matthew Paetz and Andrew Macleod “Housing Our Nation: Rebalancing the Equation in Planning” (2016) The Property Group <<https://planning.org.nz>> at 15.

²⁵⁸ At 15 to 16.

²⁵⁹ At 16.

²⁶⁰ At 15.

using inclusionary zoning, simply noting that where it is used for brownfield sections it should be used in combination with cost-offsetting incentives, to limit the market units' price being raised.²⁶¹ This is a viewpoint supported by other researchers.²⁶²

Generally, therefore, inclusionary zoning is perceived as an effective method to create affordable housing. In fact, some research suggests that the rules under the Proposed Auckland Unitary Plan are already helping to create affordable housing faster.²⁶³ Perhaps more importantly, this concept can be implemented under both the existing legislation and under the current Exposure Draft. Existing “case law has established that affordable housing and inclusionary zoning can be considered under the RMA”²⁶⁴, and local authorities will still consider these factors for zoning under the Natural and Built Environments Bill, as drafted. It is also notable that these principles can be incorporated in a way which retains the profitability of development companies, and incentivises affordable development. Focusing attention on developing affordable housing rather than just increasing supply is better at reducing, or slowing increases in, house prices.²⁶⁵

B Density

While inclusionary zoning should be emphasised in the National Policy Statement on Urban Development Capacity, which directs the Regional and District Policy Statements, this alone will not solve the issue. Another central issue is density restrictions, especially in major cities. Some suggest that utilising new greenfield sites, the easiest method for implementing inclusionary zoning, may worsen the situation.²⁶⁶ This is because it can lead to large single lot housing, causing urban sprawl and increasing infrastructure costs, subsequently slowing development. It has thus been said that “supply shortages can better be attributed to lack of density, rather than lack of land”.²⁶⁷

²⁶¹ Paetz and Macleod, above n 257, at 16.

²⁶² Ayyagari, above n 249, at 77.

²⁶³ Ayyagari, above n 249, at 77.

²⁶⁴ Ayyagari, above n 249, at 75.

²⁶⁵ Ayyagari, above n 249, at 74.

²⁶⁶ Michelle Tustin “[Legal Interventions to Meaningfully Increase Housing Supply in New Zealand Cities with Housing Shortages](#)” (2017) VUWLawRw 7 133 at 134.

²⁶⁷ At 134.

Regional plans often contain regulations “like minimum car parking, size and square metre requirements and maximum heights” which limit the density achievable.²⁶⁸ This is similar to exclusionary zoning, as the regulations increase the lot sizes and thus prices. Increasing density can make housing more affordable, and has done in major cities around the world.²⁶⁹ Its implementation would likely still need to be incentivised, which it has been suggested can be achieved through density bonuses for development companies.²⁷⁰ The creation of these density bonuses could represent a major development within the construction market, making a greater number of affordable housing developments profitable. Nonetheless, it is to be remembered that having to use these density bonuses as incentives essentially means that the housing would need to be marketed at a higher, unaffordable, price if they were not provided. Otherwise, they would not be needed as an incentive, as the projects would already be profitable. Where bonuses are required, the increases in density have still not made developing the affordable housing efficient enough for development companies to be profitable; it is simply the Government paying the difference.

C Building Infrastructure using Special Purpose Vehicles

As aforementioned, urban sprawl through developing low density greenfield sections brings substantial infrastructure costs with it. The Housing Minister has said that “investment in infrastructure has been identified as one of the key actions the Government can take to increase the supply of housing in the short term”²⁷¹, with \$1 billion recently being announced to support housing through focusing on density and infrastructure.²⁷²

The Government has also used legislation to speed up the delivery of infrastructure projects. The Infrastructure Funding and Financing Act 2020 “creates a new model where a ‘Special Purpose Vehicle’ (SPV) is used to fund and construct infrastructure to support housing and

²⁶⁸ Tustin, above n 266, at 139.

²⁶⁹ At 141.

²⁷⁰ At 156.

²⁷¹ AsiaPacific Infrastructure “Will These Changes Solve New Zealand’s Housing Crisis?” (1st April 2021)

Scoop <<https://www.scoop.co.nz>>.

²⁷² Susan Edmunds and Dileepa Fonseka “Government reveals criteria for \$1b funding to speed up housing development, seeks urban density” (22nd June 2021) Stuff <<https://www.stuff.co.nz>>.

urban development.”²⁷³ SPV’s are not radically new, although using them for infrastructure projects in New Zealand is recent.²⁷⁴ The entities essentially allow the private market to help fund the projects in exchange for returns paid over two to three decades. This is a private-public partnership model, as opposed to a purely private model such as toll bridges.²⁷⁵ The money is raised from a number of stakeholders which is then used to finance the project being carried out by an infrastructure company. The SPV is essentially the middle-man.

An SPV may then propose a levy on the eligible infrastructure costs under section 17. The subsequent property purchasers then pay this levy similar to rates, with the council collecting it on the SPV’s behalf.²⁷⁶ This means that those benefitting most from the infrastructure are the ones which help pay the bill.

The SPV itself may be a company, limited partnership, Crown entity or “other person”.²⁷⁷ Trusts are a notable exception to this, although not every company, limited partnership or Crown entity can become an SPV either. The entity must be established and operate “for the sole purpose of acting as a responsible SPV under [the Act].”²⁷⁸

In 2018 (prior to the Infrastructure Funding and Financing Act 2020) an SPV had been used in the Milldale Development, north of Auckland. Milldale Infrastructure GP Limited was created as a SPV to generate financing for five Bulk Housing Infrastructure projects which would facilitate the development.²⁷⁹ The company was registered in September 2018. It is a wholly owned subsidiary of another company, Milldale Holdco GP Limited, itself a wholly owned

²⁷³ Ministry of Housing and Urban Development “The new funding and financing model” (13rd June 2021) Ministry of Housing and Urban Development <<https://www.hud.govt.nz>>.

²⁷⁴ Christy Gomez and Muhammad Gambo “Evaluation of special purpose vehicle organisation skill sets taxonomy for effective public-private partnership infrastructure project delivery” (2016) 21(1) Journal of Construction in Developing Countries 147 at 148.

²⁷⁵ See generally Gomez and Gambo, above n 274.

²⁷⁶ Ministry of Housing and Urban Development, above n 273.

²⁷⁷ Infrastructure Funding and Financing Act 2020 section 10(1).

²⁷⁸ Infrastructure Funding and Financing Act 2020 section 10(1)(a).

²⁷⁹ Infrastructure Payments “Milldale Infrastructure” (2018) Infrastructure Payments <<https://infrastructurepayments.co.nz/>>.

subsidiary of Crown Infrastructure Partners Limited.²⁸⁰ This final company is split evenly between the Minister of Finance and Minister for State Owned Enterprises.²⁸¹

The SPV was able to raise around \$50 million in financing which was provided to Fulton Hogan.²⁸² An encumbrance was placed on the properties to secure the owners obligation to pay the infrastructure payments, which were simply a line item on the general Auckland Council rates invoice.²⁸³ These payments were between \$650-1000 per property annually.²⁸⁴ As a result of using an SPV, infrastructure supporting 9000 homes has been built 10-years earlier than was provided in the Council's long term plan.²⁸⁵

SPV's do improve the rate of infrastructure construction, which allows more housing supply to be built and therefore should help reduce prices. It is notable that the property value under the model may appear more directly tied to the infrastructure cost, but "Councils often require developers to pay 'development contributions'" for impacts on existing infrastructure and for required upgrades.²⁸⁶ These costs are then passed on by the development companies to purchasers in the sale price anyway.²⁸⁷ The mechanism enabled by the Act is intended to simply work as another method for accessing finance for infrastructure, to prevent it restricting housing supply.

²⁸⁰ See New Zealand Companies Office "Milldale Infrastructure GP Limited (7019173) Registered" (2021) New Zealand Companies Office <<https://app.companiesoffice.govt.nz>> and New Zealand Companies Office "Milldale Holdco GP Limited (7012493) Registered" (2021) New Zealand Companies Office <<https://app.companiesoffice.govt.nz>>.

²⁸¹ New Zealand Companies Office "Crown Infrastructure Partners Limited (2346751) Registered" (2021) New Zealand Companies Office <<https://app.companiesoffice.govt.nz>>.

²⁸² Ministry of Housing and Urban Development, above n 273.

²⁸³ Infrastructure Payments, above n 279.

²⁸⁴ Ministry of Housing and Urban Development, above n 273.

²⁸⁵ Ministry of Housing and Urban Development, above n 273.

²⁸⁶ Ministry of Housing and Urban Development, above n 273.

²⁸⁷ Ministry of Housing and Urban Development, above n 273.

D Tax Regulation: Capital Gains Tax and the Bright-line Test

“While the tax system is not the primary driver of housing affordability”, it can be used to disincentivise investment in property.²⁸⁸ This is normally done through a capital gains tax, which is simply a tax on the increases in value of property. In New Zealand, the bright-line test essentially acts as a more limited version of this tax. The test defines a period during which sale of the property will incur a tax on the profit from the sale.²⁸⁹ That tax is dependent on the individuals personal income tax rate, with the profit being treated as income.²⁹⁰ With the highest personal income tax rate now being 39%, as aforementioned, this can substantially reduce investors rates of return. It should be noted that the bright-line test also applies to trusts and companies. Therefore, if a property which was purchased after the test was introduced is transferred to a trust and subsequently sold within the applicable period, the trustee will be liable to pay the tax.²⁹¹

When first introduced in 2015, the period was initially two-years. This was subsequently extended to five-years in 2018, and was extended again to 10-years earlier in 2021. The fundamental idea behind extending the period is that it means property becomes a less liquid investment, discouraging speculation. As a result, such a policy is likely to “put downward pressure on house prices in the short to medium term”.²⁹²

Still, while this should lower investor demand for property, it will also slow future investors from selling. This is a result of the lock-in effect, wherein for investors to avoid the tax they must hold the property for the entire period. The longer the period, the stronger the lock-in effect is because the absolute value of the tax cost will be greater if the property is sold prior to the end of the period. This could suggest that extending the length of the period could result in fewer homes being sold, and thus a lower housing supply. Considering that a third of New Zealand property is owned by small-time investors generally as rental properties, if these

²⁸⁸ The New Zealand Treasury [Regulatory Impact Statement: Tax measures to moderate house price growth - extension of the bright-line test](#) (23rd March 2021) at 1.

²⁸⁹ At 1.

²⁹⁰ Henry Cooke “Housing: Government to double bright-line test and end interest writeoff in war on property speculation, will spend \$3.8b on new supply” (23rd March 2021) Stuff <<https://www.stuff.co.nz>>.

²⁹¹ New Zealand Trustee Services “The extended bright line test” (November 2018) New Zealand Trustee Services <<https://www.nztrustees.co.nz>>.

²⁹² The New Zealand Treasury, above n 288, at 2.

investors were to ‘trade up’ on their rental properties, a substantial amount of property could be restricted from the housing supply.

Still, such a result is unlikely. Properties already owned are excluded, and losing liquidity may be a sufficient disincentive for investors to not ‘trade up’. Additionally, it must be considered in combination with the other restrictions placed on investors recently, including the LVR rules and the changes to tax-deductible interest, discussed shortly. Further, the bright-line test does not apply to owner-occupied properties, and so as first-home buyers enter the market the property can again be re-sold on quickly.

It is notable that the Treasury suggested that a 20-year period should be implemented during the recent revision. They considered such a period would best support the Government’s objective of supporting more sustainable house prices.²⁹³ While the latter’s lock-in effects would be greater than for a 10-year period, the earlier lock-in effects would be smaller. This is because for the 20-year period it is more likely the investor would sell early (such as after four years) than for the 10-year period; they are more likely to choose to pay the tax when they must wait 16 more years than six for it to be removed.

There do remain concerns that the policy could lead to long-term supply issues or increases in rental prices.²⁹⁴ New builds are not exempt to the bright-line rule, with the Government indicating that they will continue to be subject to the 5-year period.²⁹⁵ Currently, this has not been legislated, with the definition of “new build” currently being consulted on. When the legislation is passed, however, it will have retroactive effect to the 27th of March 2021.²⁹⁶ The inclusion was recommended by the Treasury, although it will lead to fewer investors committing to developing new properties.

Additionally, as investors leave the market, and first-home buyers purchase ex-rentals, the supply of rentals could decrease over time.²⁹⁷ Landlords may also increase rents to partially

²⁹³ The New Zealand Treasury, above n 288, at 1 and 2.

²⁹⁴ At 4.

²⁹⁵ Inland Revenue Department “Changes to the bright-line property rules” (1st April 2021) Inland Revenue Department <<https://www.ird.govt.nz>>.

²⁹⁶ Inland Revenue Department, above n 295.

²⁹⁷ The New Zealand Treasury, above n 288, at 4.

offset the tax costs where possible. Still, the extent to which rents may be impacted is not known, as first-home buyers are commonly ex-renters, and so their exit would also reduce demand in the rental market.²⁹⁸

E Tax-Deductible Interest Rules

Recent changes to the tax-deductible interest rules also target investors in the market. Previously, owners of residential investment property were able to deduct the interest on loans that relate to the income generated by that property from their taxable income.²⁹⁹ Therefore, investors were able to fund a residential property investment through debt, commonly a mortgage, and would be able to offset the cost of the debt interest by simply claiming it as an expense and reducing the tax they need to pay.³⁰⁰

This will no longer be the case. For properties purchased, or home loans entered into, after the 27th of March 2021, the interest on any home loan will not be able to be deducted as an expense.³⁰¹ This will primarily pass extra costs onto investors rather than owner-occupiers because the latter do not tend to make an income on their home. For properties purchased prior to the 27th of March 2021, they will currently still be able to deduct their loan interest, although this will be progressively phased out until the 1st of April 2025.³⁰²

Unlike the bright-line test, “new builds” acquired as residential investment properties are exempt from this change.³⁰³ This is in order to support housing supply, with the exemption applying from the date the new build receives its code compliance certificate or is acquired.³⁰⁴ In line with this, there is also a development exemption, “intended to apply to any activity that

²⁹⁸ The New Zealand Treasury, above n 288, at 4.

²⁹⁹ Inland Revenue Department “Fact Sheet: Interest deductions on residential property income - Proposed changes” (March 2021) Inland Revenue Department <<https://taxpolicy.ird.govt.nz>> at 1.

³⁰⁰ At 1.

³⁰¹ Inland Revenue Department, above n 299, at 2.

³⁰² At 2.

³⁰³ Inland Revenue Department “The treatment of new builds under the bright-line test and changes to interest deductibility” (10th June 2021) Inland Revenue Department <<https://taxpolicy.ird.govt.nz>> at 1.

³⁰⁴ At 2.

results in a dwelling that qualifies as a new build.”³⁰⁵ This means large development companies will also continue to be able to deduct interest on loans used to develop properties or land from their income related to the sale of those properties.³⁰⁶

F Summary of this Section

This section has canvassed some of the rules and regulations influencing the decisions of property development and management entities. A number of previous policies have exacerbated the housing crisis, with there now being substantial debates about how to best ease it. These debates become more detailed than outlined above, although it has been seen how their concepts may be implemented in New Zealand at a general level. The different policies being considered and implemented create a shifting legislative landscape which the entities exist in. Many of these policies are likely to be beneficial to legal entities, and development companies in particular. Still, entities which are being used as passive investment vehicles will likely be negatively affected by some of the policies directed to limiting investor interest in the market.

IX Conclusion

This paper has analysed the use of legal entities within the New Zealand property market. It has outlined the existing state of the housing crisis within the country, and the increasing prominence of legal entities within residential markets globally. As discussed in section VI, a key reason entities are being used for property operation and management is because of their asset partitioning function, although the particular entity choice will depend on a variety of further factors. What is crucial to this decision is the purpose for which the property will be used, and it has been seen that a multitude of different purposes can be successfully achieved using legal entities.

Despite their prominence, it has been explained that the entities do not individually hold any sizeable influence over the residential property market, either nationally or regionally. Generally, their existence does not seem to influence house prices, although certain conduct can do so. While it can be said that investors, whether personally or through an entity, do exert

³⁰⁵ Inland Revenue Department “Summary sheet: Development exemption” (10th June 2021) Inland Revenue Department <<https://taxpolicy.ird.govt.nz>> at 1.

³⁰⁶ At 1.

substantial demand on the market as a collective and thus increase prices, this is a macroeconomic effect rather than the result of them having acted in deliberate concert. Finally, the paper considered the changing regulatory framework in the residential property market and the possible impacts on different entities operating within that market. That the area has been, and is currently, undergoing substantial reform which is particularly relevant to entities being used as property investment vehicles.

Overall, the property market has long been crucial to the New Zealand economy and investment into that market is still seen by many as an attractive way of increasing net worth and maintaining income during retirement. Against this, house prices have become unaffordable for many New Zealanders, most of whom now earn less per hour than the property they seek to buy. Ultimately, the housing crisis is a very complex issue, caused by a variety of historical, cultural, political and legal factors. Given property's importance to New Zealand's economy and social wellbeing, continued failure to adequately address the crisis risks disaster.

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