Submission on draft report on Housing Affordability

Introduction

Thank you for the opportunity to comment on the draft report.

I am an urban planner in private practise in Auckland (I am a Director of Hill Young Cooper Ltd).

I make the following comments on the section of the report on urban planning, this being my area of interest.

General Observation

As a first general observation, the draft report seems to pick out land supply as being one of its main targets. The reasons for this are not clear to me, and I suspect it is more to do with the Commission wishing to be seen to be “doing something” rather than search for a lasting solution to what is a very complex problem (and will therefore involve a complex solution which may vary from place-to-place. That is, the solution to Auckland’s problems is likely to different to Wellington City, for example).

I do not disagree that land supply is a factor in housing costs, but its relative role in relation to all of the other factors that may influence housing costs (both supply and demand) is not well investigated. For example, a notable absence in Box 4, page 14 is reference to personal income tax rates. In 2007 Westpact Bank NZ[1] reported that the increase in the top marginal tax rate in 2000 made investment property more valuable as a tax shelter, pushing up house prices. They went on to state that an increase in the average inflation rate has increased the long-run nominal capital gain that property investors can expect. These enhanced capital gains are tax free in New Zealand, whereas the higher nominal mortgage rates that accompany inflation are tax-deductible. In their view ”interaction between inflation and the tax system has had a surprisingly large influence on house prices in New Zealand”. Since then changes have been made to the tax system which will take a while to work their way through the system that should make investment in a rental property less attractive compared to other forms of investment.

Is land supply picked out because it is a political “hot spot” and all the other solutions like further changes to taxation, and a more stable immigration policy too hard? There is an impression that all of the demand-side factors are too intractable to unravel, but so long as supply can respond to demand shifts, then everything will be ok. However the supply side has as many issues as the demand side, and is equally complex.

The effect of changes to tax, immigration spikes, easier access to finance and the like can be gauged in simple terms by looking at most cities which do not constrain land supply and do not have high population growth rates, yet these cities have seen lifts in median house prices. The Wellington region has seen substantial growth in median house prices, but cannot be said to constrain land supply, so to with places like Whangarei.

Clearly, supply is an issue if housing supply cannot keep up with demand. But in periods of high demand, can housing supply ever keep up with demand? If immigration rates swing widely from high outflows to high inflows, as occurred in the mid 2000s, plus taxation benefits are introduced on top of this, as well as lower interest rates and increased risk taking by banks, is it ever realistic that supply can keep up with short term fluctuations? As noted in the Commission’s report, it can take up to 7 to 10 years to alter planning documents to increase housing supply. The ability to speed up this process

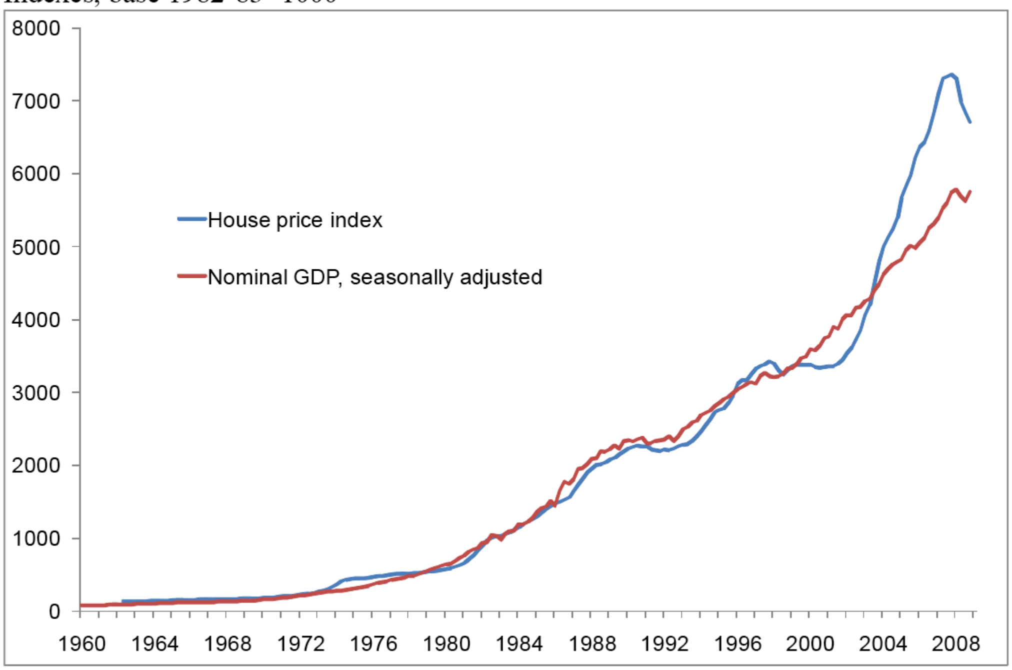
[1] Sourced from: http://www.westpac.co.nz/olcontent/olcontent.nsf/content/FM_Occasional_Paper_20070723/$FILE/Submission%20to%20monetary%20policy%20review.pdf

is as constrained as options to alter taxation, monetary and immigration settings. This is not to say that supply responses cannot be made faster, however, it's not just a matter of turning a housing supply dial from "slow" to fast".

Secondly, there is a danger that analysis and possible measures focus on moderating short term price swings and not on the long run problem of house prices relative to incomes. In general, house prices should reflect growth in GDP. The Figure below is from a Reserve Bank report quoted in the Commission's report. It shows house prices growing at the same rate as GDP, with cyclical booms and busts overlaying this general trend.

We have seen a period of stagnation in house prices for much of the country over the past 3 years or so. Is this the start of another period of adjustment after a boom?

Figure 1 House price index and nominal GDP
Indexes, base 1982-83=1000



Sources: Quotable Value, Statistics New Zealand, Reserve Bank of New Zealand

There have been previous periods of time when house prices have increased faster than GDP, followed by periods of consolidation. At the time of the boom part of the cycle, issues of land supply have been identified as the problem.

In 1996, a report by Owen McShane[2] stated that:

> *Auckland has recently experienced a property boom, especially in the residential market. This boom has been driven by an increase in demand which has led to a rapid and significant increase in housing prices.....*

[2] http://www.rmastudies.org.nz/documents/ResBankF.pdf

.... In particular the report examines the impact of the Resource Management Act and its implementation on the residential property market in the Auckland Region.

Yet the above graph (albeit national figures), shows that the mid 1990s boom in house prices was followed by a period of limited growth through the late 1990s and early 2000s when house prices and GDP came back into line.

Without some form of long run modelling of the relative importance of the different inputs into housing demands (population growth, taxation, interest rates, incomes) and constraints on supply (labour, land, materials etc), I find it difficult to understand the relative role of these elements and if hastily “loosening” one constraint (such that other problems are created) will fix the long run problem. What is structural and what is cyclical?

The more structural problem to me is why an ever larger proportion of households cannot afford to own a house, if in the long run, house prices and GDP increase at the same rate? Is this because of increasing income inequality, with lower to middle income households seeing their incomes stagnate relative to overall growth of GDP? There is very little analysis of the changes to the distribution of household income growth in the report, relative to house prices. This seems a big omission to me.

How to deliver a home affordable to a mid income household is not explored in any actual sense (in terms of what cost of construction, land, finance etc is needed). What are we aiming for and is this feasible/realistic, particularly a new home in a greenfields situation? Even where land is plentiful, houses on greenfields sections still seem to cost upwards of $400,000. Older homes in established suburbs should offer a more affordable home, in that their price should reflect the older age of the asset, but this is dependent upon current owners moving on and up the property ladder. If their options are limited, then this constricts the flow in the housing market.

This leads on to the third general observation, that cities are systems and flows of people, businesses and money. The draft report acknowledges that cities are complex systems where there are many sub markets and in each sub market a range of trade offs are made between different factors. However, it is all too easy to look at one aspect (e.g. land costs) when considering how to reduce the costs of one element (housing) and ignore all the other factors involved in city house prices such as incomes, house preferences, transport costs, household running costs and proximity to social networks. Being interconnected systems where people and households constantly trade off these factors, often a reduction in cost of one aspect is off set by an increase on other costs, for example cheaper housing on the edge of the city comes with higher transport costs and fewer amenities. So, rather than look at house prices in isolation, it is really necessary to look at total household running costs of different home locations and housing types, as well as the options open to the households to move to areas that improve their overall trade offs.

As the relative importance of these costs change, then households make different trade offs. If anything, I think where the supply of housing has not kept up with demand (and therefore there has been a structural shift in house prices that has had consequences for the whole of the market) has been in the supply of housing within established suburbs. My own rough calculations is that over the period of 1996 to 2006, around 55% of new houses were built in established, already urbanised areas in the Auckland Region on vacant sections, infill (subdivision of one property into two), flats etc. This shows a very high demand for housing within existing suburbs and a swing away from a complete reliance on urban expansion as a way to supply housing. This pressure has seen established homes rise in value, meaning one affordable option for new home owners has been closed off. Release of more land on the edge of the city, while useful, will not meet this demand.

Specific Responses to the Report

The prevailing approach to urban planning in New Zealand has a negative influence on housing affordability in our faster growing cities. The widespread planning preference for increasing residential density, and limiting greenfield development to achieve this, places upward pressure on house prices across the board.

Comment:

I do not agree that there is a *wide spread* preference for increasing residential density. In most towns and cities, there is no specific preference to more intensive development. It is only the larger metro centres (Auckland, Tauranga, Christchurch) where there are stated urban containment policies. But even in these centres, there are degrees of containment, with Tauranga and Christchurch more even handed in terms of the extent to which they favour containment over expansion than in Auckland. Even in Auckland, more horizontal expansion of the urban area has occurred than vertical expansion over the past 10 years. In other words, the draft report has not undertaken any meaningful analysis of actual growth patterns within cities, rather it has relied upon anecdotes. This does the Commission no credit.

I agree that limiting the outward expansion of the city results in upward pressure on urban **land** prices, but provided additional density can be provided on this land, then there is not necessarily upward pressure on *house* prices (in economic terms capital is substituted for land, in that on more expensive land, house prices are maintained by building taller buildings, compared to the cost of lower rise housing on cheaper land).

Per square metre, an apartment building is more expensive to build than a timber framed, single story house, and to this extent, a 150m^2 apartment will be more expensive than a 150m^2 stand alone house. However if other costs are taken into account (such as transport costs, heating costs and the like), then the differences should begin to even out for a household over the life time of a building.

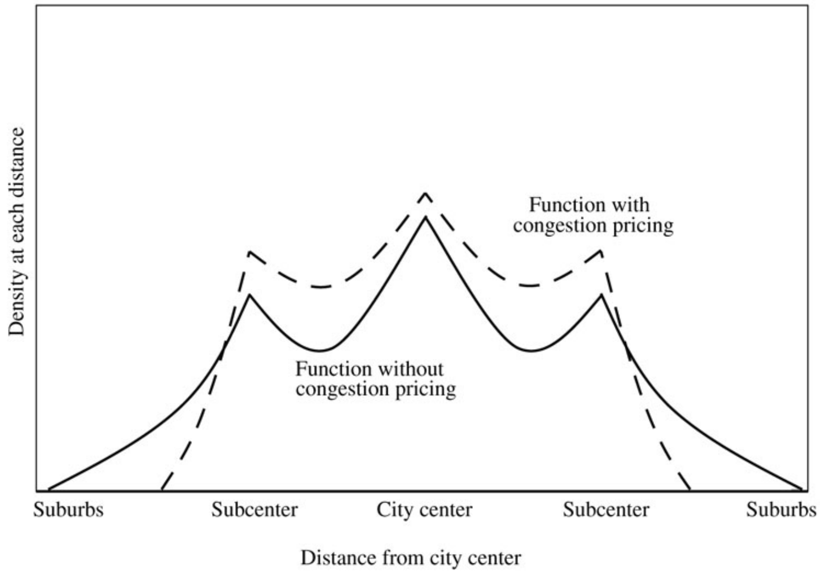
The problem encountered is where there is both limited greenfields development as well as limited residential redevelopment within the existing urban area. This is the conundrum that NZ (and most western) cities face. Existing communities hotly contest proposals to increase housing within their local area, while urban expansion is opposed by rural and environmental interests. Where neither gives, both land and house prices go up.

Constraints on the release of new residential land create scarcity, limit housing choice, and are increasing prices across the market. These impacts may be disproportionately felt by particular sub-markets.

Comment:

Constraints on the rate of urban expansion are justifiable on the basis of incorrectly priced infrastructure (particularly transport), as well as amenity and environmental effects/externalities of urban expansion. In particular if the full costs of urban transport systems are not accounted for by users (which is the case in New Zealand), then there is subsidy towards urban expansion. See diagram below. Without correct pricing of roads, city's expand more than they should, and so there is an argument that some form of control on urban expansion is needed to correct this externality (even if planning controls on outward expansion are a second best option). However how much control is needed is unclear.

Conceptual picture of a city with and without correct pricing of road congestion



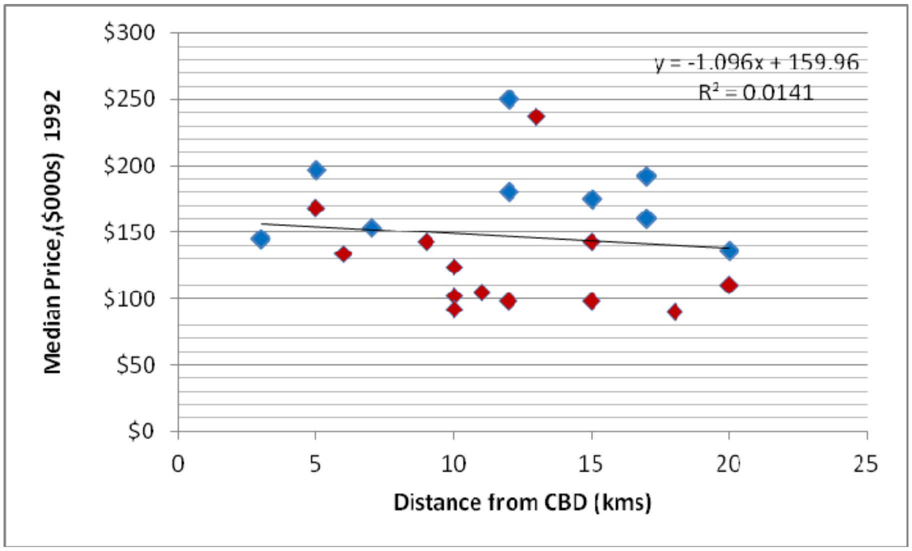
Similar arguments apply in relation to the pricing of urban infrastructure for greenfields area, which tend to be on an average rather than marginal basis, and therefore residents on the edge of a city, furthest away from services and networks do not bear the full cost of extensions of services to them. In contrast, in an infill / urban redevelopment situation, often the marginal cost of an additional new house is held up as the reason why that development should not be allowed, where that house places additional strain on old infrastructure, yet the ability for that additional house to lower the average cost for the necessary replacement of that same infrastructure is not taken into account.

As noted in the draft report, the more significant constraint on housing supply is the constraints on additional residential capacity within the existing urban area; that is the constraint on urban redevelopment. Height and density controls in the existing urban area add up to much more of a constraint than the constraints on greenfields expansion. What is more, these constraints are much harder to shift. The impact of this on affordability and housing choice is massive, but largely hidden. The planning justifications for limiting urban redevelopment are much less sound than those for managing urban expansion, and hence the “preference” in some planning documents for seeing urban infill and redevelopment occur. There are urban design implications of poor intensification, but these effects can be managed though good controls. There are also infrastructure upgrade timing issues, but these are not insurmountable.

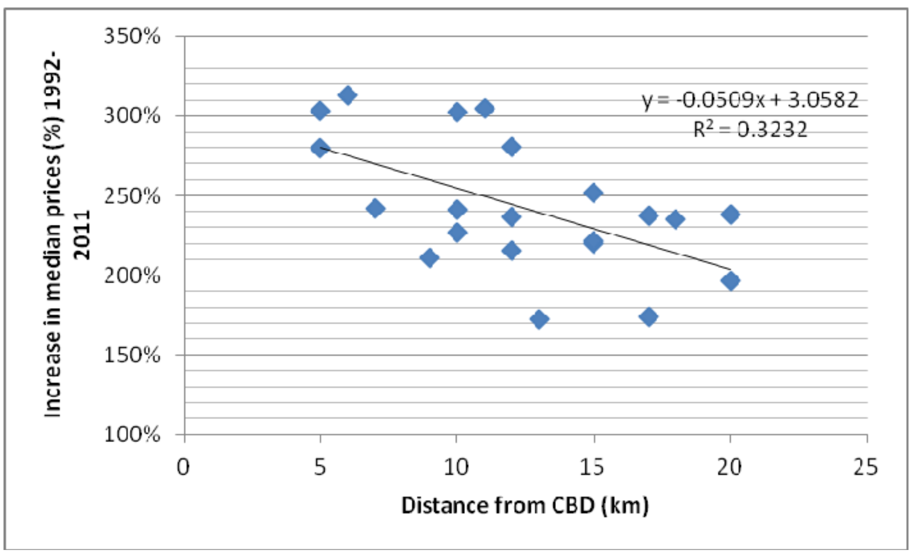
Limits on urban intensification basically stem from a (natural) NIMBY type response from existing residents to change: fear of loss/adverse effects from new development is rated much more highly by residents than any positive effects from that development, with costs seen to be local (more traffic, less privacy quiet), while benefits are seen to be more regional and dispersed (less sprawl, reduced per capita infrastructure costs). The costs of the affordability of housing for new households are not recognised. In return for protecting “their” amenity, residents who resist urban intensification see a massive rise in house values: who wouldn’t resist urban intensification in this case?

As an example of theses impacts, the constraint on urban development (redevelopment and expansion) has seen house prices lift the greatest close to the Auckland CBD, as seen in the two graphs below which compare house prices and distance from the CBD, in 1992 and in terms of increased prices through to 2010 (based on data from the Real Estate Institute of New Zealand website).

House prices in the Auckland Region and distance from the CBD, 1992



Change in house prices 1992 to 2010, by distance from the CBD



In 1992, there was a relatively flat gradient between house prices in the inner city and those on the fringe. Partly this reflect living preferences, low transport costs, but also a density gradient, whereby closer to the city, residential density was higher compared to fringe areas.

By 2010, there was a much steeper gradient in house prices, showing increased demand for living in the inner city suburbs, higher transport costs of more peripheral areas, but constrained supply. The density of the inner city areas has not increased in response to the higher land prices. Only the CBD has been able to adjust in any substantial way.

Two points are important:

- The greatest upward pressure on land prices has been in the inner city suburbs, not the edge, and as additional housing has been scarce due to zoning constraints, house prices have sky rocketed along with this surge in land prices.

- Additional land on the urban fringe is not going to improve the situation for those wishing to locate closer to central areas, nor reduce this pressure to do so.

In economic terms the most efficient way to bring down prices should be to add supply where it is most needed (i.e. close to central services and facilities, provided environmental conditions permit). However, Auckland wishes to protect its ring of inner city heritage suburbs. There is a cost here that residents in those suburbs do not face.

Heritage areas need to be retained. But how can the urban system adjust to the growing demand (but limited supply) for housing in established suburbs with good amenities? New communities on the edge of the city are part of the answer, but far from the only answer.

Prices are also likely to be reflecting the significant transaction and compliance costs associated with housing development. These costs include hefty impacts associated with delays encountered in releasing land and through the consenting process.

Comment:

This is true, but the culprits are many – including NIMBY groups, heritage interests, environmental groups, competing developers wishing to stall a rival, as well as councillors and local boards with short time horizons. Planners are also to blame, but most often are the meat in the sandwich.

NZ has a participatory planning system, and public input and consultation is highly prized. By its nature, this involves a high degree of transaction costs. Unravel that one at your peril! But to get traction, there has to be a refocusing of participation and what is up for grabs in that process. This is not a simple or quick win.

An immediate release of land for residential development will ease supply constraints and reduce the pressure on prices. This should include a combination of significant tracts of both greenfield and brownfield land catering to a variety of sub-markets, with an immediate focus on Auckland. Any such release should be contingent on meeting requisite geophysical and environmental standards, favour land that can be readily connected to existing urban areas and amenities, and provide for a variety of housing markets. The aim would be to identify, assemble, and develop substantial parcels of land for housing and associated uses of such a scale that it leads to a rapid easing of current supply constraints and consequently a reduction in price pressures.

Comment:

It is heartening to see reference to both horizontal and vertical urban expansion. Cities need to do both. As identified, this is really an Auckland issue. But as outlined above, in it Auckland it is really the vertical expansion that needs to be supported most, and in my view is the strategy that will help produce the most amount of more affordable housing. However it is a complex issue.

In my experience in Auckland, there are not large tracts of brownfields land that can be released immediately and/or which are free of constraints like flooding, major power lines or contaminated land. There are industrial areas which could be turned over the residential uses, but alternative industrial areas will need to be identified to accommodate the displaced industrial uses. There are also issues of housing / job balances to consider

In most cases, urban redevelopment is needed. This could be termed greyfields development – areas of older housing that are a bit run down and where redevelopment to higher intensity is a natural step. However the tools to facilitate this process are substantially different to greenfields development and much more complex and less well developed in this country, relative to greenfields growth. Land ownership is fragmented, local amenities may need improvement to cope with/ attract development, local communities need to be consulted and convinced of the need for change. None of that is easy or quick, yet it is the most important issue to tackle. Some form of support for urban redevelopment is needed, and this is likely to include new tools and legislative changes. The RMA has not proven to be a useful vehicle to promote urban redevelopment; if anything the Act lends weight to the "keep things as they are" view of cities.

In terms of greenfields land, it is an easier road to follow in political and public sector cost terms, and hence it has been the main way cities have developed over the past 30 to 50 years since zoning controls on redevelopment of existing urban areas have come into play. If there is to be continual reliance on horizontal expansion, and limited (real, not rhetorical) support for vertical urban expansion, then there needs to be management responses to the downsides of this form of adding supply:

- An emphasis on lateral expansion is likely to come with the cost of ever rising urban inefficiency. This loss of urban efficiency is not necessarily negative if we are prepared to pay for it. However if urban running costs continue to rise (higher energy, petrol etc) and incomes do not grow fast, then the loss of urban efficiency will be a major handicap in years to come (in much the same way that the massive expansion of credit over the last 10 years, the ensuring credit crunch and associated public debt burden will slow growth for the foreseeable future).

- There is evidence to suggest that how greenfields land is released is as important to housing affordability outcomes as how much land is released. A big bang approach to urban expansion will not necessarily see land and house prices fall. In fact the opposite could occur if necessary public infrastructure extensions cannot be funded from public funds. Greater contributions from development are needed to help meet infrastructure costs, yet this puts upward pressure on land prices.

- Greater competition between landowners needs to be built into the system of land release development (ie auctioning development rights), rather than through a simplistic addition of supply.

- Additional land / housing supply has to come with an obligation to provide a portion of the housing to be built as affordable houses, and protected for the long term as affordable. Otherwise, the additional supply will not necessarily see a permanent reduction in land and house prices. It is not uncommon in other countries for there to be a requirement that a percentage of new housing in any development be retained as affordable housing through restrictions on resale value, for example.

Auckland does not have an inexhaustible supply of greenfields land. It is on a narrow Isthmus with three major harbours. This elongates the urban area and increases infrastructure costs, as well as private travel costs. The natural environmental setting of the city is stunning and highly valued. What greenfields land is available, needs to be well used.

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