To:
*The Productivity Commission*
*Level 15*
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141 The Terrace
Wellington 6011

# Submission by Christchurch City Council on the Productivity Commission's

## Inquiry into Housing Affordability in New Zealand

Written Submissions due 10 February 2012
Coordinated by Strategy and Planning

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**i. Contact Details**

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**ii. Restrictions on Distribution**

All details outlined in this submission are public.

**iii. Speaking to the Submission**

Christchurch City Council does not wish to appear before the Select Committee and speak to the submission.

**iv. Role of the Council**

*Description of Christchurch City*

Christchurch City, including Banks Peninsula, is on the east coast of the South Island. Christchurch is the second largest city in New Zealand and the largest in the South Island.

Christchurch City Council provides services to residents that involve community wellbeing and development, environmental health and safety (including building control, civil defence, and environmental health). The City also provides infrastructure through roading and transport, sewerage, water and stormwater, recreation and culture (libraries, swimming pools, art gallery and museums) and resource management including land use planning and development control.

**iv. Content, Consultation, Limitations (Staff Submission)**

The content herein is a **staff submission** from the Christchurch City Council, and reflects the experience of Council in planning for the growth of the City over recent years. It reflects the experience and lessons learned through the development of the Greater Christchurch Urban Development Strategy. It has been discussed with the Urban Development Strategy Implementation Manager, and reflects CCC thinking at the time of this submission. It is not intended to reflect the opinion of the elected members, and has not been adopted or endorsed by Council.

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## 1. Recommendations

The CCC has several recommendations to the Commission regarding further research or policy prescriptions. The specific recommendations are briefly summarised here, and the rationale behind the recommendations is provided in the main document.

R1. Expand and encourage/incentivise the role of not for profit Housing Associations in affordable housing provision, e.g. supply side regulatory mechanisms and financial tools that incentivise them to construct of affordable housing for home ownership and/or renting. This is consistent with the recommendations of the Centre for Housing Research 2007 report – Affordable Housing: The Community Housing Sector in New Zealand. Such a move would also support the Council's Central City Recovery Plan, which includes a project to establish a housing agency to facilitate affordable housing.

R2. Investigate tools to encourage a more responsive 'short-run' supply-side market land and home packages – e.g. tax breaks for investment in housing companies that promote diversity (size, format & tenure) within their portfolios.

R3. Re-examine preferential tax treatment of alternative investment vehicles assets to shift investment patterns. Alternatives such as a minimum required return capital tax to more appropriately align property and equity investment incentives could also be examined.

R4. Treasury and the Reserve Bank should work with banks and lending institutions to encourage more flexible financing for speculative housing developments in areas of high demand. This may include the Reserve Bank re-examining its prudential requirements for housing assets to determine if they strike the appropriate balance between risk mitigation and access to capital.

R5. Promote more effective planning provisions through Regional & District Plans aimed at achieving a more diverse mixture of housing type (size, format & tenure) that better matches the demographic profile of the area.

R6. Undertake a more detailed investigation regarding the price effects of the zoning of large amounts of land as distinct from the servicing and development of that land. Investigate the degree to which any reductions in raw section price may be offset by increases in the cost of infrastructure provision operation due to under-utilised infrastructure, and other negative consequences.

R7. Further investigate pricing mechanisms to encourage the release of land in oligopolistic markets: e.g. 'inactivity' rates; time-limited development rights, etc. An alternative, which is used in the Canterbury Regional Policy Statement, is that the review provisions specifically provide for other areas identified for future growth to be brought forward if other areas in the current sequence are not being developed.

## 2. What is Housing Affordability?

It is important to distinguish between housing affordability and affordable housing. For the purposes of this discussion, housing affordability is taken to mean the mortgage affordability for housing in NZ. It is assessed by comparing the average weekly earnings with the cost needed to service a mortgage under standard lending terms for the median dwelling prices and mortgage interest rates. Affordable housing refers to secure accommodation for all tenure types, and is measured by linking a household's ability to meet their housing costs, while leaving sufficient income to maintain an acceptable standard of living. The New Zealand Housing Strategy (2005) notes affordable housing as becoming a concern when the housing costs of households in the lower 40% of the income distribution exceed 30% of their income.

As noted by the Commission, factors influencing housing affordability are house prices, household income, and financing costs. Affordability problems therefore arise when these factors are misaligned. Given the long term fall in home ownership rates and the relative variations in these contributing factors, housing affordability is both a structural and a cyclical problem which means that each of the contributing factors will need to be addressed. The structural problem is further evidenced by the greatest fall-offs in home ownership occurring in the under-40 age group[1], potentially related to growing income and wealth inequality and the consequent thinning of 'middle New Zealand'.

This is arguably both a channel for and result of falling home ownership giving rise to an 'intermediate' housing market of those who aspire to home ownership, and in previous years who would have attained this goal. For Christchurch, the intermediate housing market, as defined by those households who cannot afford to buy a house at the lower quartile house price under standard bank lending criteria, is noted to have risen from 19% of the rental market in 1996 to 70% in 2006[2].

The intermediate housing market is also part of the overall rental market, which is becoming less affordable and increasingly financially stressed. Specifically, the percentage of rental households paying more than 30% of their gross income on housing costs increased across all income levels between 2001 and 2007[3]. For all tenure types financially stressed households (who make up 32% of rental households versus 15% of owner-occupier households) are projected in Christchurch to increase by 44% from 2006 to 2026[4].

[1] Home ownership fell nationally from 74% in 1996 to 67% in 2006, with the greatest fall-offs in home ownership are occurring in the under-40 age group (Census 2006; CHRANZ, 2007, Housing in New Zealand).
[2] DTZ (2008). Christchurch City – Housing market assessment and social housing needs analysis.
[3] DTZ (2008). Christchurch City – Housing market assessment and social housing needs analysis.
[4] DTZ (2008). Christchurch City – Housing market assessment and social housing needs analysis.

## 3. Why Care About Housing Ownership?

The Christchurch City Council, hereafter CCC, broadly agrees with the statement that "housing plays a central role in individual and community health, family stability and social well being…." (Housing Affordability Summary Document, p. 16). Housing is a key area of influence for social and economic well-being, and is a significant constituent in building strong communities. There is evidence of a relationship between housing and other factors such as educational achievement, unemployment and family stability (Auckland Regional Council, 2003). Home ownership in particular leads to more involvement and participation in communities helping to foster connectedness and social cohesion. Home ownership has been positively related to social capital formation, with ownership providing an incentive to engage in the local community (DiPasquale and Glaeser, 1999). Reinforcing the beneficial outcomes of home ownership, the desire for home ownership is still the preferred and dominant option among New Zealanders (DTZ, Housing Tenure Aspirations and Attainment, 2005).

The CCC would also emphasise that, in the New Zealand context, home ownership is arguably one of the two most important financial foundations for preventing poverty in old age, notwithstanding the contribution that superannuation and the relatively recently introduced savings schemes such as Kiwisaver may offer. The lack of familiarity with, access to, and comfort with other investment avenues increases the risk that the declining rates of home ownership, coupled delayed entry into the housing market will result will undermine the basis for such security for the elderly if alternative investment avenues are not adequately developed.

The CCC also has a very direct interest in the level of home ownership insofar as demand for its social housing stock remains strong in an environment of declining housing affordability. Further declines in home ownership and/or rental affordability are likely to increase social housing demand, especially for the elderly. If this demand cannot be met then there are clearly consequences for the quality of life that some older adults will experience. Presently this is occurring in a situation where 12% of Council stock is either damaged beyond repair or uninhabitable because of the recent earthquakes.

The Council, in its role as a social housing provider, has a part to play in providing affordable rentals for those on very low incomes. However, a condition assessment carried out in 2007 found that while the overall condition of the Council's social housing stock is in reasonable to good condition, more than 50% was constructed more than 30 years ago. Most of this stock will need to be replaced or demolished over the next decades and replacement will require significant planning ahead. In 2009 CCC unsuccessfully sought a significant contribution of $100 million from central government to upgrade and improve the quality of the housing stock .

## 4. Land Supply Issues

The Commission's findings and recommendations are, rightly, concerned with land supply. Indeed, the Commission seems to suggest that the problem is one of the most tractable and critical issues affecting housing affordability. The CCC submits that, while housing affordability can be affected by supply constraints, that the zoned supply of land is only likely to meaningfully affect market-wide housing prices if there is a significant absence of development-ready land relative to demand. In addition, this land will only affect overall section prices to the degree that it is 'development ready' (i.e. serviced), and is released to the market by an adequately competitive development market.

CCC further submits that releasing and servicing land in a manner that significantly exceeds the scale and timing of demand is unlikely to reduce prices to any significant degree and is likely to impose unnecessary costs on the community through the inefficient provision and operation of infrastructure.

The recent experience of the CCC suggests that land release alone has only a marginal affect on land prices. Through the process of reviewing the Christchurch district plan in the late 1990s and early 2000s, some 1,200 ha of land was released to the market[5]. This release of zoned land does not appear to have significantly dampened or prevented the increase in housing prices starting in the early 2000's. That is in spite of the fact that this release of land represented about 12 years of land supply at very high growth rates for the City. Several of those areas are still being developed even now and their development has not been delayed because of any significant constraints. This suggests that other factors had a considerably greater affect on the affordability of housing and section prices.

The CCC agrees with the commission that there are a multiplicity of other factors driving housing price increases including the slow response of developers and property owners to increased demand and the tendency to engage in 'land-banking' and a 'drip feeding' of land onto the market. CCC would submit that this is a significant driver of section price. In Christchurch it would appear that this is a significantly more important driver than zoned land availability *per* se. Insufficient competition in the Christchurch City context – indeed, outside of Auckland generally – leads to a significant slower and shallower market response to changed market conditions than would be anticipated in a fully competitive market with greater price and demand responsiveness. This low temporal and price elasticity of supply may also help to explain why the analysis in the report shows house prices stabilising, albeit at a higher level, some time after demand subsided at the end of the last housing boom. It is, however, unclear as to what power

[5] The land was rezoned over a period of time through the urban zone extensions that where in the proposed district plan and were not opposed, that were approved by the Council allowing submissions seeking that additional rezoned land be included in the proposed plan, and through Environment Court decisions on appeals.

local Councils have (short of entering the market as developers) to increase competition in the development market; especially in markets with strongly entrenched property owners and developers.

CCC therefore submits that the release of zoned land *on its own* is highly unlikely to materially affect housing prices in Christchurch. It is important to establish if there are benefits to the release of land, because land cannot be rezoned ‘costlessly’. Servicing vast tracks of rezoned land places significant costs on local Councils, infrastructure providers, and ratepayers.

When large amounts of residential land are rezoned, particularly when it is distributed over a number of different locations, a large amount of infrastructure needs to be provided up-front to allow those areas to be subdivided. Trunk infrastructure in particular will be required even if only a small part of the area is initially developed. If the amount of land released and then serviced with infrastructure significantly exceeds the demand, the investment in infrastructure will be inefficient because it exceeds that necessary for the amount of demand. It is also likely to increase debt servicing costs because each individual residential area is likely to have a slower rate of purchase and housing development, due to the total growth being spread more thinly over the larger number of growth areas. This is likely to unnecessarily increase infrastructure costs, and potentially housing costs, irrespective of whether those costs are borne directly by developers, paid through development contributions, or paid through rates. A more efficient approach would be to release and service sufficient land for something close to the maximum expected demand, with a suitable buffer to factor in the time it takes to release more land, and a regular review programme.

The slower housing development of a large number of growth areas also has the potential to increase infrastructure operational costs. For example, low flows in trunk wastewater networks do not flush efficiently requiring extra maintenance and faster deterioration of infrastructure. Slower housing development within individual housing areas also results in slower community formation and slower achievement of the critical mass to support services and facilities.

An additional factor, related to, but distinct from, release of supply to the market is the often fragmented nature of land at the urban boundary. In the case of land at the urban limit of Christchurch, this land is heavily fragmented into ‘lifestyle’ blocks and other uses. This increases transaction costs for land assembly and can delay the entry of that land onto the market. There may be a case for greater lot size restrictions on land in the vicinity of the boundaries of urban areas. This would be consistent with decisions from the Environment Court which have raised concerns about how the fragmentation of rural land creates difficulties for its future use for urban development.

A final factor that is likely to be affecting prices is that land owners and those who subdivide land are not usually the ones who develop housing, leading to a lack of finished housing supply. This means that entry is restricted to new home builders who require a greater up-front capital investment.

## 5. Macroeconomic Drivers of Affordability

The CCC submits that macroeconomic drivers such as migration, ease of credit, and a preference for property investment are much stronger cost drivers than land supply alone. The Commission acknowledges some of these drivers in its key findings, but provides few policy prescriptions regarding how to deal with these issues. It may be that these problems are fundamentally more intractable than land supply or planning regimes; nonetheless it is important to recognise these drivers as critical to the overall housing affordability picture.

It is likely that one of the key macroeconomic drivers of increased housing prices is a combination of property investment 'preference', an insufficiently speculative housing market, and the lack of an institutional rental sector.

There is a well documented and well demonstrated preference for investment in the housing market in New Zealand. New Zealand research shows that 15% of households own investment property with 8% of households owning rental property in NZ [6] Elsewhere it is noted that 80% of all New Zealand residential property investors own either one or two investment properties of any type[7]. This is, in part, attributable to shallow capital markets and a lack of familiarity with other forms of investment, particularly equity investment. While there are other drivers of this disparity, it is worth noting that the market capitalisation of the ASX is in Australia is far higher on a per-capita basis, when compared with New Zealand's NZX.

CCC submits that the commission should re-examine preferential tax treatment of alternative assets to shift investment patterns. There are potential efficiency and transaction costs to such an approach, but such a tax could have profound effects on housing affordability, and could deepen equity markets making capital available for more 'productive' uses. Alternatives such as a minimum required return capital tax to more appropriately align property and equity investment incentives could also be examined.

Recent negative trends in housing affordability were exacerbated by the fact that high point of New Zealand's recent housing cycle followed a period of low exchange rates, a surge in net migration and coincided with higher interest rates and high internal consumer spending[8]. For example, 2003 saw a peak in migration in addition to a peak of New Zealanders returning from overseas[9]. These drivers exacerbated existing trends

6 Scobie *et al* Treasury Working Paper 07/04
7 DTZ 2007
8 Westpac Bank Chief Economist.
9 Statistics New Zealand 2006

with overseas investors and returning residents investing in a (internationally) undervalued domestic property market using overseas funds.[10] In fact, surges in national housing prices correlate surprisingly well with increases in foreign direct investment. Although additional work would need to be undertaken to determine a causal relationship, it seems likely that this surge in inward investment drove higher wages, more investment, cheaper capital, and that some was directly invested in the housing market affecting price.

***The Development and Rental Markets***

The lack of a residential property market that is highly responsive to fluctuation in demand may also drive a trend toward the development of higher-end housing in an insufficiently competitive market. According to discussions with local developers and bankers, most residential developments must be – at least in part – 'pre-sold'. The deposit requirements for houses bought 'off plan', however, are frequently different from those encountered by purchasers of existing structures. This drives a tendency for developers to provide to the market that is most likely to have sufficient wealth to afford these presale requirements.

A market with a strong 'pre-built' development sector that produces sale ready houses would not be as inclined to target this 'top end' of the market, and, in fact, there could be incentives (faster build time, smaller plots leading to greater housing density) to try to break into a lower quartile market if there is substantial pent-up demand for housing at this price point. In addition, the residential development market is quite narrow, and tends to polarise around 'family' homes, which are perceived to be in demand and more profitable. This does not take into account the demographic or economic structure of the local market. More diversity in the development industry could help to produce a more balanced and affordable portfolio.

Finally, the lack of an institutional rental market may lead to investment 'crowd out' of the lower-quartile housing market. As discussed previously, it is well noted that residential investment has had an adverse impact of housing affordability. This is only part of the 'supply-side' story.

The rental market is largely driven by the purchase of existing homes. The lack of institutional / speculative investment in this space means that increased rental *prima facie* crowds out affordable housing by reducing the supply of owner occupied homes. Additionally, a significant proportion of rental accommodation is not purpose built, and is therefore not tailored to the local market need. This can affect the affordability of the rental stock. The report recognises the lack of large-scale landlords in the rental sector. As more affordable residential property is purchased by investors and released to the rental market, this serves to crowd-out owner-occupier purchasers, and at the same

[10] G Page, October 2005, Review of Housing Affordability for the Greater Christchurch Urban Development Strategy

time makes it less attractive for institutional investors to develop fit-for-purpose rental accommodation. The provision of built-for-purpose rental accommodation may lessen demand on the lower-quartile housing stock, making it a less attractive investment, and freeing it for owner-occupier purchase.

## 6. The Role of Planning – CCC Experience

CCC agrees with the Commission that urban planning needs to provide for a balance of greenfield, brownfield and intensification housing development. However it is important that the balance reflects the circumstances of the area and likely changes in population characteristics, such as the rapidly aging population. In the Greater Christchurch area the local and regional councils have developed an urban development strategy, and statutory plans and policy statements that take these matters into account. They provide for the release of greenfield residential land in strategically appropriate areas, including provisions for medium density within those areas, as well as providing for increased densities in the existing urban area, for the next 30 years. Release of land at this magnitude, in many areas for many housing types, does not materially constrain housing choice, and provided that the planning has a strong rationale, does not lead to a meaningful decrease in aggregate welfare (e.g. the total 'wellbeing' of the community from housing). It is also worth noting that this plan was prepared before the Canterbury earthquakes, not as a result of them as indicated in the report. By providing certainty through clearly defining future growth areas, and by identifying how those future housing areas can be developed with minimal consenting processes, this planning helps minimise transaction and compliance costs.

We also agree that urban planning needs to identify long term provision for urban growth. Whether that is for 30 years as was the horizon used for Greater Christchurch or 50 years as suggested in the report is debatable. But we submit that this should not involve rezoning 30/50 years supply of land all at once. That is likely to lead to the inefficiencies and adverse consequences of an oversupply of land as discussed earlier. In Greater Christchurch the 30 year provision for Greenfield land is identified in the Regional Policy Statement, providing a high level of certainty of a continuing supply of land. It was originally also proposed to contain a sequence for the release of land to ensure demand would be met, and to ensure the efficient provision of infrastructure and allowing this to be co-ordinated through Council Long Term Plans and Development Contribution Policies. The actual release of the identified areas of land was to be achieved through rezoning plan changes to the relevant district plan at the appropriate time. It rapidly became clear after the Canterbury earthquakes that changes would need to be made to the sequencing, and it was dropped from the provisions that were finally made operative in those highly unusual circumstances. However, we submit that the concept of identifying long term urban growth through Regional Policy Statements, but controlling the staged release of land through rezoning in District Plans, is a more effective way of providing certainty of land supply, as well as avoiding the adverse consequences from oversupply and providing an efficient way of integrating resource management planning with the delivery of infrastructure and other local government functions. Provided, of course, that this is backed up by appropriate monitoring and review provisions

The CCC also disagrees that urban planning in Christchurch has created a significant regulatory premium on housing prices. Nonetheless, as discussed in evidence submitted to the Environment Court for RPS PC1, some price effects doubtlessly exist. Indeed, price premiums are apparent in any market which is regulated in the interests of greater efficiency. This premium is a reflection of the internalisation of the true cost of suburban expansion, and is accepted because the community through its participation in the political and planning process reflects that it does not desire the results of a 'free for all' of suburban expansion. For the reasons discussed in this submission, it is usually poor policy to promote affordability by failing to properly account for externalities. Furthermore, regulatory cost can be a reflection of the balance a community has selected (public value capture) between the provision or maintenance of public goods and private goods.

## 7. Changing 'Value Added' Expectations in the Housing Market

Costs relating to implementing the Building Acts requirements have an affect on housing affordability. Any increase in costs e.g. of processing, are proportionately higher for lower cost housing when compared to those of higher cost housing. Changes in regulations (e.g. requirement for double glazing, heating and insulation) can also add further costs, which disproportionately impacts lower cost housing.

The design, construction and operation of buildings can have significant impacts upon the use and availability of resources (e.g. energy consumption, labour availability, public health resources, etc.) and on the wellbeing and productivity of people using and living in buildings. Poorly designed houses are more costly to run and maintain and can place an extra burden on infrastructure because of the inefficient use of resources.

It is acknowledged that housing costs have increased due to changes in the Building Act, but that those costs may help to "internalise" costs that were previously placed on the community or moved to market costs elsewhere. For example, increased costs in terms of double glazing, added insulation in walls, ceilings and under-floor, off-set heating costs and may also help to reduce illnesses in infants, the young, and the elderly (a social / economic cost to the community or business). Improved building standards which will give rise to safer houses will ultimately reduce social costs of injury, direct medical costs, and productivity costs due to loss of productive lifespan / work-hours. These added costs are the result of a general societal agreement that homes should meet a certain standard (e.g. of safety and warmth). Such improvements are unlikely to be delivered consistently by the private market alone (e.g. leaky homes). Amended building regulations are therefore necessary to ensure all that new houses are constructed to a minimum standard that will ensure safety and warmth.

Changes to the requirements of the Building Act will therefore have a direct impact on the final cost of new housing. Potential costs of housing will also be affected by any additional compliance costs (e.g. auditing of the building consent processing) and these need to be either absorbed or passed on to the potential home buyer through the cost of the house.

Over the years, expectations about housing type, size and amenities has changed. Housing 'today' is not directly comparable with the existing housing stock (e.g. houses built in the last century). Changing demands and expectations over recent times have delivered larger houses with more amenities and on larger sections. This has in part affected the change in housing affordability and in some cases driven the overall price of houses up. This is not likely to be changed by the release of more land.

The gap between ‘the rich and the poor' has also widened since deregulation in the 1980s. This has helped fuel the trends towards larger houses for those in higher income brackets, while those on lower incomes are often forced to seek older houses which are often less well maintained have poorer insulation and are difficult to heat.

It is likely that the shift to ‘user pays’ in education (e.g. repayment of student loans) may also have an adverse effect on disposable income and therefore on the potential ability of middle income earners to purchase houses at an earlier age. As affordability starts to bite on ‘middle income earners’ there is a likelihood that these home buyers will seek to purchase homes in some of the lower socio-economic areas. This will ultimately reduce the housing stock available to low income families, who will then be forced to rent or move elsewhere

There is a multitude of socio-economic factors that affect property prices in any given location or part of the city. Houses in the north-west of the city for example were more expensive than those in the eastern suburbs even prior the earthquakes. Price differences in housing were also affected by other factors such as school zones, proximity to facilities and ease of access to the city.

## 8. Development Contribution Assessment Regime

Well developed infrastructure charges can overcome some of the negative characteristics of infrastructure (e.g. lumpy costs, cost differentials by location, individual users use a small portion of capacity) and enhance positive characteristics (e.g. economies of scale and installation and capital costs being lowest during the pre-development and development stage of urbanisation). The benefits of well developed charges therefore outweigh cost and difficulty in implementing.

Well developed charges, combined with good quality infrastructure planning, enhance rather than diminish housing affordability by taking advantage of economies of scale, smoothing cost differentials by location, and by allowing for the provision of infrastructure of an appropriate quality just in time for development. They also enable councils to achieve an appropriate balance of funding sources which reflect the considerations of causality, distribution of benefits, and life of benefits that are set out in the Local Government Act 2002. Well thought out charges can also encourage development to align to long term urban plans and other strategic policy objectives of councils, such as environmental impact goals, and can help deliver urban forms which are more cost effective, economically efficient, and sustainable in the long term.

Council agrees that territorial authorities should take advantage of best practice guidance that is available through LGNZ, however the Council does not support an attempt to convert best practice guidance, which allows for the flexibility to reflect local considerations, into legislating that proscribes an inflexible set of rules. The Council does not oppose direct Government support in the implementation of best practice guidance. However, it considers that the current system whereby guidance is developed by the councils, through Local Government New Zealand and the Society of Local Government Managers and in association with the development industry, affords the best opportunity for the development and implementation of robust best practice.

The Council also questions the Commissions distinction between horizontal and community infrastructure. This distinction appears arbitrary. Community halls, libraries, and service centres that, because of their location, draw users principally or totally from a greenfields subdivision catchment are well suited for funding from development contributions. Similarly, significant increases to the scale of existing community facilities to cater for a growing community should be funded from development contributions to the extent that the growth community causes the need for, and benefits from, the enhanced facility.