

Using Land For Housing

Submission to N.Z. Productivity Commission

By Peter McDermott

Introduction

First, I note you will post submissions on your website. I am comfortable with this. However I believe many potential submitters may not engage with you as they would prefer their suggestions, criticisms and ideas to remain anonymous, including planning professionals who receive fee income or work closely with and depend on the goodwill of Local Authorities. I recommend you consider also allowing anonymous submissions.

General Background

I believe that any useful contributor to a discussion of the supply of land ought to understand the economics of buying developing and selling sections. Many people do not understand the costs and risks of land subdivision regarding it as an ‘easy way to make money’. It is not.

I recommend the Productivity Commission make available a sample ‘Land Developer’s Spreadsheet’ showing the expenses and revenue, and ultimate profit (or loss) from a typical land subdivision. The key variables (eg Development contributions, time taken to sell sections, etc) should be able to be changed to see the flow-on effects.

I have a firm view that many people involved in land subdivision approvals have a poor understanding of the flow-on effects of their actions on section prices (eg increased costs of development contributions or delays getting consents). That is not to say no costs should be imposed or that matters should be rushed but to point out that an understanding of the impact on the developer will assist understanding impediments to land supply.

Some General Comments - observations about land subdivision and development.

- Typically it is very difficult to find and acquire land for subdivision. It is a competitive process. Some developers spend years chasing blocks of land and incurring costs when no acquisition results. The costs and time of the ‘failed’ deals must be taken into account in the ‘successful’ ones.
- Many developers have been bankrupted doing land development. It is a high-risk endeavour. Witness the period 2007 onwards as just one example. It is easy to forget that one principal reason many finance companies collapsed is because they held undeveloped land as security – often in urban locations. The Productivity Commission may wish to cite examples where, especially in the period 2008-10, land was sold for a fraction of its acquisition cost. In a recession you may not find a buyer for undeveloped land at all. This is all reflected in the cost and terms of loans for land development and the developer’s required profit.

- Many land developers are entrepreneurs with a low capital base. They may only secure finance that involves high up-front fees and a high interest rate. As land development often takes several years the effect of a high interest rate can be very pronounced and even in relatively benign times lead to a business-threatening debt burden.
- Loans for land usually require much more of the buyer's own equity than loans for income-producing real estate (i.e. they are only available at lower LVRs). The developer will therefore require a higher return on their investment reflecting the lower asset value they are able to acquire.
- Land development often takes longer and costs more than originally anticipated. Reasons include; Professional fees incurred in obtaining consents (planning advice, legal, engineering reports (land, services, roading), urban design, landscaping etc). From their past experience, developers may assume that Council approvals will take much longer than statutory minimums, an appeal may be necessary, and conditions will be imposed which are costly.
- Any delay leads to a much higher loan interest cost. The risk of refinancing may be of concern as land loans are often short term and require renewal. If at the time of renewal the value of the land has fallen or not risen enough to support continuing costs and capitalised loan interest, the developer may fail. Many developers went bankrupt post-2007 because they could not refinance their land despite having an otherwise sound project.
- The current media context (2014) of discussion about land supply is the very strong Auckland and Canterbury housing markets. However this is historically unusual. These markets have had prolonged periods where land uptake was low. Much of regional New Zealand also has comparatively low land demand. Demand for land (and therefore its value) is exaggerated in economic cycles and that combined with the long lead times for acquiring and developing land makes it very risky. It is not many years ago that large-scale landowners in both Auckland and Christchurch became insolvent. 'Land banking' in normal times (ie. land value is not growing strongly and demand for sections is average) is not easy.
- Gain from the long-term ownership of income-producing property is often not taxable. Profit from land development usually is. The development of land therefore delivers an after-tax profit. A developer will need a higher profit to compensate for this. Further, becoming a developer (absent complex tax structuring that may not ultimately work) can 'taint' all future property buying and selling and make it taxable. 'Small-time' landowners may decide not to subdivide as it will taint their other long term property investments that would ordinarily not be taxed, offsetting any gain from the subdivision itself.

- Subdivisions often take many years to complete. Usually, the market is not able to absorb many sections at once. The cost of land acquisition may occur on Day 1 but the final stage of a large subdivision could be many years later. Costs such as roading, services, and development contributions will be incurred up-front, but revenue from sale of the sections may be staggered over many years later. Local body rates are payable in the meantime. Sections must be maintained. Many subdivisions that are years old still have unsold sections in them. Once this aspect of selling land (and financing it) is understood it becomes apparent that to make a suitable 'profit' the sections must be sold at a very much higher cost than a simplistic formula of 'cost of land plus development costs'.
- The above factors combine to mean that if a Council adds say \$1,000 to the development contributions payable on a section, then the affect on the final section price is far more because the developer needs to take into account the financing cost, the delay getting his sales proceeds, and his margin for profit and risk. Any baseline cost will be reflected in a much greater 'final section price' cost, including GST. And that excludes the impact of any 'cost plus' expense where the market for sections in that location won't just take an increase in price. It may instead lead to a reduction in the developer's profit. If the supply of land by private developers is to be healthy developers need to be confident they can make a profit. Any uncertainty and they will 'load' their sums for the next project in case negative events happen.
- As always it is difficult to generalise. There are large subdivisions on the edge of our large cities. There are single-plot subdivisions of an existing small section in town. However I believe the costs, timing, financing, and volatility of land sales often make land development an unattractive option compared to other investments, unless the potential profit is high.

Issues Paper Comments

I set out below responses to the numbered questions in the 'Using Land for Housing' document. Please note that many of these comments apply to more than one question.

Q.1

The objectives of land planning are very unclear including the purpose sections of the RMA and voluminous Plan Documents to the point that it could be argued there is no clear purpose at all.

There is much uncertainty in the planning process. Even when the outcome 'granting of consent' is known (eg Permitted Activity) the time, Council processing cost, and cost of implementing any consent Conditions can be uncertain. This also impacts on uncertain professional fees (the need to respond to requests by Council). More time means greater funding costs. As land development projects (contrary to public perception) may have small or vulnerable profit margins this can have an impact on the decision whether to proceed with a project to develop land at all.

Many players in the Local Government planning system do not understand the financial and other impacts of their decisions. Often externalities are addressed without an evaluation of other costs and benefits.

I believe anybody trying to understand residential land supply in New Zealand should ensure they fully understand the financial position of the property developer (please note I am not a developer but have dealt with many in my professional capacities as a property lender, consultant and Director).

I have read and understood the Commission's Terms Of Reference but believe the context of the land developer needs to be understood when addressing land supply issues including planning policies and infrastructure.

History

It is important to remember that developing land for residential use is very risky and often leads to bankruptcy or insolvency. Therefore land developers need to see a good profit in it if they are to invest in bare land instead of income-producing real estate or other asset classes.

Less than 15 years ago one landowner of substantial tracts of residential land in Christchurch faced financial difficulty.

One of Auckland's largest residential-land owners failed post-2008.

A major contributing factor to most NZ Finance Company collapses were due to underlying failures of residential property development borrowers.

Hurdles to Acquiring Land for Development

Briefly somebody intending to develop a block of bare land into individual residential sections will face the following;

Substantial time effort skill and cost finding a suitable land development site.

Professional and Council fees doing due diligence on potential sites that are not proceeded with.

Strong competition with other buyers of bare land

Requirement to have considerable capital as equity as it is difficult to get high leverage for land.

An expensive loan interest rate to reflect the risk perceived by the lender (land for development tends to have a more volatile value and is extremely difficult to sell in a recession (eg witness the number of land owners who failed in the 2008 period and after).

Low or no holding income from the land prior to its eventual sale.

Very large development costs (roading, stormwater and sewerage, landscaping etc)

Staged developments may take many years to be fully sold down. The developer must buy and pay for the land of 'Stage 4' now and it may be many years before debt is repaid.

Development work is often seasonal (eg earthworks for new roads cannot be done in the wet winter) so delays (eg in consent processing) could mean a much greater delay before progress can be made.

Other factors which may affect the supply of land include;

An owner of a large area of land may have its own strategy of releasing sections in order to maximise profit.

There is not the same second-tier finance market for subdivisions since the collapse of many NZ finance companies. The large Banks do not lend as aggressively as the finance companies used to do. Banks are (understandably in many instances) very conservative lenders. So many developers will not be able to get funding at all. This will (already has) lead to decreased land and dwelling supply.

Some land developers are in the business of building dwellings therefore the type and speed of development will be influenced by this, not just getting title and selling for cash.

Many land developers sell sections to building companies therefore must take into account the demand of these buyers (eg section size, subdivision covenants).

Q2

Consider;

Is cost recovery of planning consultations by Council consistent with National or Regional objective of increasing land supply?

Clearer information (District Plans too complex to read and understand even for a sophisticated user; conflicting rules;)

Q3

Criteria for a planning system for land planning and development could usefully include;

Clarity of information and planning rules, including for lay people

Speed

Certainty of outcome

Certainty of cost

Simpler cheaper Plan Change processes

Clearer publicly available information about land demand and supply

Take into account when land given subdivision consent may be available for sale

Allow subdivision consent for say 10 years before it expires rather than five.

-Clear understanding by all parties (Council, Community, Landowners) of the cost of planning processes eg Require Subdivision consent conditions to be individually costed by Council and made public.

Q4

Other steps will be required especially in Auckland (and probably most other cities)

Land development tends to be for larger and more expensive homes.

Reasons include;

Good demand from affluent end-buyers

Prescribed minimum section sizes.

Covenants requiring large homes.

Development Contributions are a fixed amount per Lot so are proportionately more expensive for small sections (consider pro rata by land size?).

Developer inexperience of smaller cheaper housing

Acquisition and development cost precludes 'cheap' sections and a 'cheap' house (if it was allowed) would undercapitalise the property.

Other interventions could include;

No or low minimum section size

Plans or rules to specify *maximum* section size.

Action to limit affects of covenants and their impact on affordability (examples: a) some covenants preclude relocateable housing when modern manufactured housing is of very high quality. 2) some covenants prescribe a large minimum house area 3) many covenants stop future subdivision). These covenants may have their place in some developments but often they seem to be "copied" from another subdivision without much thought.

Knowledge

Many land owners in cities do not realise the land which they own is subdivisible.

Because planning rules change often and also are very difficult to understand without costly professional guidance - knowledge of the rules is a competitive advantage.

Example: In Wellington where I live many residential sections could comfortably fit one more dwelling and subdivision would be a Permitted Activity. Many owners will be unaware of this fact. Most will not wish to subdivide but land supply may increase if these rules were widely understood or even promoted by Council (eg include on rates notice "Your section size 800m²; Dwelling 140m²; Possible additional dwelling of 140m² *may* be permissible –please see Council for further information")

A related issue is the culture of some consenting authorities . Often it is perceived that they are anti-subdivision or anti-development. This arises from experiences such as difficulty understanding Plans, Development Contributions that seem uneconomic; reluctance to solve problems or issues in an application; processing delays and requests for further information. Generally it is perceived there a few organisational incentives to encourage successful subdivision applications and many to discourage them.

Affordable Housing

Theoretically the RMA Purpose and Principles require efficiency to be taken into account. But as the overall purpose of the Act is so wide this is not very meaningful.

The increased supply of affordable housing may require some of the following;
An understanding of whether land zoned for residential use will actually be developed for that use in the foreseeable future (example: In some small towns there are only a few large blocks of land zoned for new subdivision in the latest District Plan. But sometimes the owners of that land have no intention of developing or selling in the medium term so there is no 'supply. The owners of other land cannot afford the expense and risk of a Plan change application)

Encouragement to use existing land more intensively.

Plans sometimes claim to wish to 'encourage infill development' but after a consideration of restrictions on building height, minimum sideyards, maximum site coverage, driveway and off-street carparking requirements and sunlight recession planes it becomes apparent that this will not be achieved by the Plan.

I am not necessarily suggesting intensive development in leafy suburbs but I am saying that a decision needs to be made as to whether in-fill is wanted or not.

In District Plan submission stages most people do not have the time or expertise to read and cross-reference all the Rules and their implication. There is also the not insignificant matter of continual periodic Council Plan changes to 'clarify' the Rules. These changes are often significant. It is very difficult (and expensive) to keep on top of District Plan proposals and changes. Most people cannot afford a planner or lawyer to be on the lookout. Also it is uneconomic to fight the changes any way.

Council District Plan decision-making

Some Plan submitters feel that the decision has been made anyway.

Question: Should a body independent of Council decide the final District Plan Rules which affect housing affordability or intensity after taking into account both the Council aims and non-Council Submissions?

Better information on supply and demand for land for decision making

Better information will lead to more informed decisions by potential land sellers.

Background: It is difficult to know for any geographic area how many residential sections may come up for sale. Consider whether it would be desirable to have more readily accessible and easily understood publicly available information of – subdivision consents lodged and granted by Councils and summary details eg number of lots lot sizes and related consents eg you could see if an earthworks consent has been granted . This could lead to better understanding of what is happening in an area in terms of land supply and may assist .

Better information on land sales could be available freely. Some organisations sell property transaction data. Consider whether if this information was available free of charge this would allow much better decision making by land and house buyers or developers. (Example: A landowner could see all recent local section sales with email alerts as they occurred. This may result in a decision to develop and sell when it is considered to be economic).

Manufactured housing / Prefabricated housing

Even if land becomes available some forms of economical housing are still not permitted or permitted only with limitations.

More housing especially lower cost housing is built off-site as a whole or in modules. Rules should permit and encourage this form of dwelling.

This is in addition to the problem of covenants restricting or banning houses constructed off-site.

Relocated old houses

Many Plan Rules (and also subdivision covenants) make it difficult to find a section for an existing house that is to be transported on-site. Suitable requirements for appearance and cladding can be made. Again these rules have a not insignificant cost. (Example; Should insulation to current code requirement for insulation be mandatory when the house can presently be used *in situ* without this being compulsory?)

Q5

See above. Database of consents showing number of subdivision consents lodged approved processing time costs.

Also consider a requirement for a statement of the costs of complying with any consent conditions.

Data should be easily understood by layperson eg simple graphs and comparable across Local Authorities.

Could also include a separate column showing a subdivision consent for a lot and whether it has been built on eg Lot 5 Smith Street. Consent lodged April 2009

Subdivision consent granted July 2009 Lot5A title issued March 2010 500m2 section. Expected density; 1 dwelling As at April 2011 – no building consents applied for .

Also consider easily comparable data for Development contributions (reserves, roading, water etc)so Local Authorities can be compared.

Consider ‘Planning Ombudsman’ or body along lines of Tenancy Tribunal or Small Claims Tribunal . Low cost. Able to award costs against Council.

Q8

The Income Tax Act and related laws play a significant role.

I am not a tax expert. However the tax treatment of property has a significant influence on land and housing supply.

The law of property transactions is very complex. Generally property speculation or trading is taxed. Long term investment is not.

1. Many property investors would subdivide and sell a dwelling if they could be sure that activity did not 'taint' their other property interests. If they are classed as a dealer or trader from that one transaction so future sales are taxed then it would negate any benefit. If an owner of multiple properties had certainty that they would pay tax on a sale but that it would not taint their other properties this may increase the supply of 'infill' land.
2. Some 'pre-packaged' investments are hotel or tourist accommodation 'hotel rooms' or 'apartments' sold as going concern investments and therefore the purchase price is lower as it does not include GST. This makes such developments attractive to a developer compared to selling say leased apartments.

Building Act and regulations have a great impact. Without debating the merits of any particular provision the more expensive compliance with the Act is the more likely a more expensive home will be built by a developer as the base 'fixed' costs of the minimum standard are already high.

Local Govt Act

It should be readily available so ratepayers can clearly see the proportion of their rates spent on property-related matters (eg water treatment and reticulation, sewerage etc) and costs to be spent servicing new development. Full justification for reserve contribution calculations should be required that is clearer than present. Separate accounting for eg economic development swimming pools libraries etc.). Low cost appeal rights (eg Tribunal with paid-for Counsel for 'development interests') when contributions set so it doesn't require expensive Court proceedings.

There should be developed a standard economic model so Councils can only charge for the true marginal costs of additional network provision. Development contributions should be more transparent so there can be no suspicion of them being a Council fundraiser for other purposes.

Q9

Generally they are difficult to read.

Councils should be required to disclose if text is just copied from other Plans.

There should be a strictly enforced Plain English policy or audit.

Consideration should be given to a maximum 'reading age' for Planning documents

They should require thorough indexation.

You should not need to be a planner or lawyer to understand a District Plan. Plans should have a compulsory FAQ section with thorough and simple answers to standard questions. E.g. Can I subdivide an Outer Residential section? What dwelling can I build on my section?

If a clear concise answer cannot be written and or it requires the reader to then cross-reference to multiple sections of the District Plan then that indicates a poor Plan.

District Plans should include more visual information eg Infographics of permitted site envelopes.

Thought: Should more parts of District Plans be standardised nationally eg site coverage, side yards, building height, in Residential Zones but Councils could choose form say 3 or 4 types so they don't need to rewrite the rules but can take into account local preferences.

Q11 & 12

See above comments. Consider: should an independent representative be appointed to argue on behalf of developers; homeowners; affordability issues; so all these proposals are contested by somebody with expertise.

Proposed Plan changes should be costed in terms of financial cost and also number of dwellings eg "We are increasing minimum section size to 500m². This will result in X fewer dwellings being possible"

Consider professional such as surveyors, planners, lawyers who have considerable knowledge but will not make submissions if there is not a paying client e.g. pay small industry groups to hold workshops on Plan rules.

Q12

Involve affected parties earlier in the process not after draft rules are decided upon. Eg valuers, surveyors, planners, builders, investors

Q13

Zone more land than is thought to be required so that if conditions change there is land available which is suitably zoned.

Give some land a 'contingent' eg residential zoning which can be granted quickly later.

Give more weight to housing affordability and intensive use than is currently the case.

Q21

Arguably yes. In-fill housing has quite limiting site coverage and height restrictions. For example site coverage is limited to 35%. But there are also height rules side-yard requirements and a living court (outside area) requirement. These latter Rules effectively negate the need for a site coverage rule.

In Wellington's case the hilly topography can mean economic building on a site is impossible as recession planes calculated from the lower part of a section make for a very limited building envelope.

Driveway widths can be quite wide for multi-unit developments. But many occupants use public transport so there are few vehicle movements.

Outside space is often not used by occupants especially in 'inner' suburbs that are zoned Outer Residential. Smaller outside areas are not allowed. All these rules mean many fewer dwellings can be built on a site relatively near to the centre of the City.

There is also a minimum section size of 400m². So terraced houses with say a 70m² footprint and 100m² rear garden are not permitted.

The costs and time involved in getting a consent beyond that allowed by Permitted or Discretionary Rules is not worth it.

There is an increasing demand for small houses. These are also more affordable. Such houses are sometimes not permitted or encouraged under the Rules.

Q22

Very important. But that alone will not lead to the level of land supply sufficient to improve housing affordability materially

Q23

Some people would argue that when Council seek consent for their own activities it is more readily granted.

I believe it is important that there is full transparency with consents eg Are political donations from entities that seek Council approvals clearly visible? Overseas experience would suggest that some approvals can be 'bought'. We wouldn't want that in NZ.

Full disclosure: It is unclear to me whether the system requires Independent Commissioners to fully and publicly disclose potential conflicts of interest. This is not to criticise Commissioners but there seems no requirement to disclose general conflicts of interest. If a Commissioner rules counter to the Council's known views might they suffer in other areas (eg fewer future appointments)?

Q27

It may be worthwhile considering whether the huge cost of a bespoke District Plan is worth it and if a mix and match approach where Councils choose from 'Standard' sections is worth investigating eg If a Council could choose from say 5 'standard' Residential Zone types for a particular area. Everyone would more readily understand that zone type. May also help with any precedents.

Q30

There must be cases where a faster processing time is possible. Is an online 'watch the processing steps' system possible.

Question: Is the fact that 'very fast' processing is rare a symptom of the fact that despite the 'Rules' the criteria are really highly subjective?

Q35

It is difficult to see how the appearance of impartiality can be obtained when some Commissioners rely on Council patronage to get more hearings.

Ex-Councillors may be perceived to have a certain disposition to a hearing given their policy track record.

Q38

There is sometimes a feeling abroad that “the project can afford these costs”. Often the project proceeds but with a lower profit or margin for error. Longer term however there may be an overall effect of discounting so developers will not do their next project without a large discount for ‘uncertain’ costs. There is not enough consideration of the actual cost of conditions. Could it be required that they are individually costed by Council when imposing them to inform public debate?

Q54

Development contributions are a large expense.

The Council will get a stream of rating income from a new ratepayer. The marginal costs of providing for a new dwelling and household may in *some* instances be less than the rates as many Council services already exist (libraries, pools, administration etc).

Should development contributions be adjusted if a household uses Council infrastructure less. eg if an urban household has tankwater.

Q63

Heritage rules are *sometimes* counterproductive. Developers have sometimes demolished buildings or felled trees as a pre-emptive move because they fear a heritage order will substantially devalue the land or lead to financial ruin and they do not wish to take the risk.

Time constraints have limited my response to parts of your paper. Thank you for the opportunity to submit.

E&OE

Please note: The comments and suggestions in this submission include arguments encountered by the author but not necessarily supported by the author.

Thank you

Peter McDermott

petermcdermott@xtra.co.nz

Company Director and Consultant. Former Independent Director of a non-Bank property finance lender. Qualified as an Independent Commissioner in 2009. Author ‘Lower Risk Real Estate’.

Please note: I have not been a developer but have advised several and been involved in providing loans for land development.