

# Submission to the NZ Productivity Commissions' Inquiry into Using Land for Housing

## Summary

The range of issues the NZ Productivity Commission proposes to study in this inquiry should produce some very interesting and helpful findings. However, if the problem is delivering affordable housing to New Zealanders then the problem statement is comparatively simple. In areas such as Auckland we need developers to operate in a competitive **buyer's market** for land not the seller's market we currently have.

There will be a number of solutions proposed but I submit that councils use spatial planning in district plans as a means to constrain where and when core infrastructure is built. They do this to guarantee that none of the costs of development are borne by existing ratepayers. The smaller the allowable zones for development the lower the risk for the council but, conversely the higher the probability that owners of undeveloped land and developers alike can force the price of land up and extract windfall profits.

Any effective means for bring house prices back to an affordable level will have to include some means of removing local government concerns over the political impacts of funding infrastructure provision.

## A. Preamble

This submission is based on my experiences as a senior manager in a fast-growing council. My role was cross-functional and did not require significant knowledge of district plan development and administration. But I did acquire a sound knowledge of territorial local authority finances and decision-making as well as an understanding of the processes of most parts of a council

I also spent some years as a management consultant with an international firm. During that time I consulted to local government and developed an understanding of the similarities and differences with respect to other types of organization.

My submission especially focuses on the systemic pressures that influence how councils act. I have met many enthusiastic and skilled local government staff over the years. But, no matter how good individual staff may be, the actual results delivered by a council to its community are often mediocre or disappointing. The President of Local Government New Zealand, Lawrence Yule, admitted as much recently when he referred to the "challenging" results of a nation-wide "Reputational Survey"

conducted by his organization. This would indicate that there are issues both of culture and system that strongly influence the quality of outcomes produced by councils.

Please note that this submission refers to territorial local authorities only unless I specify otherwise.

## **B. The nature of local government**

It occasionally helps to remember that our form of local government has its roots in the institutions of medieval England, the manors and the town councils. And that local government largely preceded national institutions and, for many centuries enjoyed total autonomy from central government.

When we look now at the range of functions of our councils there is no particular set of principles that defines why they do what they do. In most cases they simply do what councils have always done. The main rationale for local government has always been that, when transport and communications links were poor or non-existent, there was no choice but to have some local body to provide local public goods. They could never feasibly be provided from a remote central government. I note that that constraint no longer exists and there are more options now for how we configure provision of community infrastructure.

Financially councils are a conglomerate of 30-40 separate lines of business, each with its own budget, its own funding requirements and so on. The accounts are only aggregated in the consolidated financial statements, rates funding requirements, and external debt funding requirement. It was not a big step for Auckland Council to separate out its roading and water functions, provide each with its own operating location and its own separate governance. It was simply a more formal version of the usual arrangement in all councils.

It is fundamental to this inquiry that everyone understands that **councils are not their communities**.

A council must exercise its powers for the benefit of its community (LGA2002 s(12)(2)) but that is not the same as being responsible for the community in any way. In practice councils don't have enough powers that they could ever be held responsible for their communities. Also the way the rating system works council revenue is not directly linked to the economic health of their community. So success for a council is self-defined and has more to do with delivering promised outputs within budget than achieving a measurable set of outcomes in the community.

From all this discussion a three key principles emerge:

1. Councils, as institutions, can be inventivised to act in ways that go against the interests of their communities

2. Councils don't always embrace the spirit of legislation. They can preserve their tradition of autonomy through minimal compliance with legislation and use of non-statutory practices
3. The services councils provide are historical and were a matter of practical convenience. As circumstances change the reasons for why a council should provide any particular service may become tenuous.

## **C. Council finances**

The Commission must become very familiar with council finances. The willingness of a council to provide for development depends on the way it finances infrastructure.

### **C.1 The politics of rates**

Local government is a mature sector in that capital expenditure largely targets replacement of existing assets. There is very little by way of political choice-making required apart from tweaking the timing of replacement or capital upgrade projects. Combine this with the declining interest in local government by the public and the media and local government politics in TLA's is largely the politics of rates.

The problem with rates politics is that there is no perception of the absolute or theoretical value of rates. For instance there are many people in New Zealand who would spend more each year on takeaway lattes than they spend as their personal share of household rates. But, unless there is a major disaster such as the Christchurch earthquakes, most people take basic services such as water, sewer and roads for granted. Rates are actually set to maintain relativity with the previous year's rates. The phenomenon of consumers developing set ideas of what the price of something ought to be is well known in Marketing research. And it applies very much in the setting of rates.

Since elected members have no executive powers and work in committees there is little opportunity for individual local politicians to create a public profile for themselves. But they will share in the halo of bad news if some plan goes off the rails, there is white elephant expenditure or rates blow out. The key principle that emerges is that

4. Elected members – and therefore staff – are strongly incentivized to ensure that uncertainty about future council plans is eliminated and that rates only rise within a narrow pre-determined range.

As I noted above following these incentives may mean a council looking after its own interests at the expense of the community's. In the course of this inquiry the Commission will be asked by many to consider the effects of restricting land supply such as raising the general level of house prices to levels of unaffordability, the impacts of extracting high levels of economic rent out of the community, the contribution of high housing costs on poverty. I submit that it is these systemic pressures on councils that lead them to act to cause these negative outcomes in their communities.

From time to time the fallacy pops up that councils are failing in their duties to reign in house prices or whatever. I hope I have made it clear that councils have a very narrow view of the world and are not responsible for the overall well-being of their communities. In fact they act very logically within the system in which they operate.

## C.2 Council finances

It will help if the Commission understands that the core strength of councils is acting as a financial intermediary. In their case they translate intermittent, large capital expenditure on infrastructure into what amounts to a daily charge for services. In fact rates largely pay for basic infrastructure. About 50% of rates pay for the network infrastructure (water, sewer, stormwater and roading); add in parks, reserves, sportsgrounds and sports facilities (including aquatic centres) and you have about 75% of rates accounted for. Rates are very largely determined by infrastructure spend. It is no accident that annual rates rises over the last ten or so years have mirrored the Civil Construction Price Index maintained by Statistics NZ (which has risen about 50% faster than CPI during that time).

### C.2.1 Rates do **not** equal capital

The two most common fallacies I run into are the idea that existing ratepayers have some kind of moral claim because they built the existing infrastructure through past rates payments or that councils should be happy to pay for new infrastructure because it is an investment in future income. Both statements are wrong.

By default rates only pay for legitimate operating costs. The Local Government Act 2002 s100 (1) states:

A local authority must ensure that each year's projected operating revenues are set at a level sufficient to meet that year's projected operating expenses.

In my experience councils do not budget for a surplus on their operating budgets apart from depreciation charges. Just to be very clear councils **do not make income (=surplus or profit)** they only receive revenue; they aim to break even so, by definition, expenditure on growth related infrastructure is not an investment it is a cost. Once that infrastructure is fully subscribed the cost allocated per rateable unit will theoretically come back to what it was before the expenditure but, until that time, the existing ratepayers will have to bear all the carrying costs (i.e. **rates go up**).

I don't think there is any rule against it but councils try not to levy capital via rates. They may well have done so in the past but it is not standard practice currently. Councils pay particular attention to intergenerational equity issues so prefer mechanisms such as debt funding to allocate costs across the lifetime of assets. What this means is that rates cover only legitimate operating expenses and that the household that has been paying rates for one day is in the same position as the household that has been paying rates for fifty years. Rates are a pay as you go scheme. Capital funding follows different pathways.

#### C.2.2 Funding capital expenditure

Councils fully fund depreciation and, because they don't pay income tax, transfer the depreciation charge straight through from operating expense to the capital account. This is usually a considerable sum and can be applied for renewal, life extension maintenance or debt repayment. What it doesn't theoretically pay for is new spend i.e. growth related expenditure.

For that councils look either to debt or financial and development contributions. Debt is underrated as a means of financing growth. Apart from its generational equity advantages in times of moderate inflation costs are inflated away given the long periods of repayment. Depreciation is based on replacement cost not historic cost so the amounts collected via depreciation grow in line with CPI while the original debt stays anchored to its nominal amount. Of course in times of low inflation that practice is not so great.

## D. Responses to Specific Questions

**Q1. Is it helpful to think of the planning and development system as a means of dealing with externalities associated with land use and coordination problems? What other factors should the Commission consider in evaluating the role of the planning and development system?**

New Zealand's planning and development systems can serve multiple purposes. I recommend the Productivity Commission keep an open mind as to the purpose or purposes of planning and development systems as they are implemented within specific territorial authorities.

For instance the high-level process diagram, Figure 9, implies that infrastructure considerations follow spatial design considerations. This may well be the technical ideal for a planning system but, in practice, many other roles and considerations come into play.

The general political incentives that apply in local government would suggest that spatial design considerations **follow** the need to minimize any rates impacts from infrastructure development in support of population growth. So it would be just as valid to think of the planning and development system as a means of constraining infrastructure development for the political advantage of existing elected members.

The Productivity Commission would do well to consider the report into the first year's operation of the Housing Accord in Auckland. The maps showing the location of areas designated for development through this programme indicate that development tends to follow **existing** infrastructure.

In terms of the specific requirements that applicants for resource consent must meet, planning systems are also a vehicle for any value sets that staff or the council feel fit to impose. Every district plan will contain rules that are not specifically referenced within the RMA. For instance, requirement for neighbourhood parks or safe designs for walkways between streets are not necessarily imposed by legislation or imposed by the community on the council. The reality has almost certainly been a conviction by staff that such requirements are the "right" thing to do. And that conviction has found its way into the rules.

**Q2. Can the current land planning and development system be made to work better to benefit cities throughout New Zealand? Is a different type of planning system required to meet the needs for housing in New Zealand's fastest growing cities?**

Yes. Recommend that the Productivity Commission assume that other systems are not only possible but, in some circumstances, desirable.

The Commission will receive much advice as to the nature of other possible systems to which I will only add that territorial authorities have only one statutory monopoly: the right to approve subdivision. Infrastructure provision looks monopolistic but, legally, isn't. Therefore a wide variety of approaches are possible within the existing legal framework.

The Commission should also consider that different systems may be appropriate in different circumstances. Currently we have one legal system that covers every area from declining areas like Ruapehu District through to high-growth areas like Selwyn District. There are four broad categories that our cities and district fall into:

- High growth within a large population (Auckland)
- High population growth within a small population (e.g Selwyn District)
- Low to average population growth (any area that has experienced  $\leq 1.0\%$  annual population growth)
- High development not related to population growth (usually holiday or tourist centres such as Queenstown-Lakes, Whangarei)

### **Q3 What criteria should the Commission consider in evaluating the current land planning and development system in New Zealand?**

Amongst all the competing measures of effectiveness the Commission should consider two criteria that don't compete with other criteria:

- The system (especially the district plan) as a genuine expression of community wishes
- The degree to which other interventions are required to compensate for the deficiencies of the system

The first is very hard to evaluate but the second offers a few very simple metrics. If the system should provide sufficient housing for our population at a price that most households can afford then there will be little need for social housing, housing grants or other interventions.

**Q4 Would a significantly increased supply of development capacity lead to an increased supply of affordable housing, or would further regulatory or other interventions be required to achieve that outcome?**

It is a subtle point but what is required is elasticity of supply. The experience of the first year of the Housing Accord in Auckland shows that simply declaring that more land is available for development does not automatically lead to reductions in land prices. The ideal system would accelerate and decelerate land supply at the same time as the market.

**Q5 What data sources will be most useful in identifying effective local authority planning processes for the development of land for housing?**

As well as the obvious data sources the Commission may find the following useful:

- Customer Satisfaction Surveys (Council-wide and specific to the planning function)
- Complaints registers
- Litigation history (if they are willing to share)
- Commentaries to Ten Year Plans, Annual Plans, Infrastructure Strategy and especially Development Contributions Policy
- Media files (coverage of council activities in local media)
- Interview other infrastructure providers especially the lines companies

**Q6 Are there other local authorities exhibiting good policies or practices in making land available for housing that the Commission should investigate?**

- Recommend the Commission add Waipa District Council , Western Bay of Plenty District Council, Hurunui District Council and Ashburton District Council to its list of councils to study. Further recommend that the Commission remove Wellington City Council, Wellington Regional Council, Queenstown-Lakes District Council and Otago Regional Council from its list.

I believe the Commission is flawed in its choice of councils. The key factor is **rate of growth** not **quantum of growth**. Although Wellington City has added some 12,300 to its normally resident population over the last 8 years, at a leisurely 0.8% annual growth, they have not needed to break a sweat to do so. The major point is that, whether or not development contributions are collected, Wellington City can fund the infrastructure capacity upgrades required to accommodate growth without



putting pressure on rates. Once the annual growth rate climbs above 1%-1.25% that is no longer possible especially in smaller districts.

When districts are classified by growth rate it becomes clear there are two zones that are experiencing consistently high rates of population growth:

- Whanagarei District, Auckland, Waikato District, Hamilton City, and Waipa District
- Hurunui District, Waimakariri District, Christchurch City, Selwyn District, Ashburton District

Queenstown-Lakes is a special case in that it experiences high rates of development related to non-resident populations (tourists and holiday-makers). Districts like these certainly have problems with facilitating development but they probably lie outside the scope of this inquiry.

The Commission needs to pay special attention to the practices of the peri-urban districts (Waikato, Waipa, Waimakariri and Selwyn) in the context of the practices of the adjoining major cities. Likewise Tauranga City and Western Bay of Plenty need to be looked at as a whole.

**Q8 Alongside the Resource Management, Local Government and Land Transport Management Acts, are there other statutes that play a significant role in New Zealand's planning and development system?**

There are a number of sources of authority that do not directly shape or define the planning system but which do contribute to the rules controlling development and ultimately to the cost of complying with the rules. The Commission needs to keep itself aware that, in addition to primary and secondary sources of authority (statute and regulations), tertiary level authority (government to local government advice at the staff level) also impacts the content of the planning and development system.

For instance the publication of the Ministry of Health's *Drinking Water Standards 2000* caused many councils in the country to upgrade community water supplies to meet the higher standards. Overall this made development more expensive and set higher standards for any development intending to create its own water supply. And, as a one-off it diverted council resources away from development-related expenditure leading, possibly, to a general reluctance to support growth until some of the costs of the water upgrades had been absorbed. The key point in this example is that there was no public or political process considering the impacts or even the desirability of implementing these higher standards. There was no form of co-ordination to ensure that councils had the capacity to implement these expensive upgrades at this time.

When the Commission enquires to the reasons for certain rules in a District Plan it is likely to be told that the source of the rules are various central government entities such as Health, NZTA, Police, ACC, Environment. There will not necessarily be any legislation or regulation specifically requiring these rules but simply advice on good practice or similar.

**Q18. How effective are local authority processes for connecting decisions across the different planning frameworks? Which particular processes have been successful? What explains their success?**

The Commission needs to define success.

The most common mechanism used to connect the planning frameworks is the outline development plan. As the Commission notes this type of plan is non-statutory and unnecessary for a council to fulfil its obligations under the RMA. So, the land-use planning process is not just co-ordinated with the infrastructure planning process but is also subordinated to it.

The set of incentives operating within a council mean that the primary purpose of the outline development plan (spatial plan) is to **constrain council infrastructure expenditure**.

In a nutshell local government politicians will not get credit for the economic growth and improvement in local services and amenities that come with population growth. But they will be punished for letting rates blow out. In the current environment where there is very little public interest in councils, movements in rates are about the only thing that ever gets noticed apart from major scandals.

Since the costs of any infrastructure built in advance of development will impact rates councillors prefer mechanisms that ensure all impacts are passed on to developers (and then buyers). Bear in mind that we are not just talking about infrastructure in the immediate vicinity of development but also way “upstream” also. Network infrastructure (roads, water, sewer, stormwater) tend to be configured in radial or star-type topologies emanating from points such as CBD’s, water sources and sewage treatment plants. Councils have a lot to gain from forcing development not just into specific locations but also specific directions (“east not west”).

Councils can recoup much of their outlays through financial and development contributions but the nature of both regimes is such that councils need to force development into restricted areas to maximise what they can recover.

Firstly development contribution charges must be based on the estimated cost of specific growth-related projects. To create a lawful Development Contributions Policy a council must have already designed its future networks and scheduled those projects. But they will be open to challenge from developers especially if the proposed projects are too disconnected from likely development either in time or space.

Secondly financial contributions may only work to eliminate the requirement for rates funding projects when the contributions of more than one development are aggregated.

Thirdly a council has limited time to apply financial and development contributions. The former has an effective life of about five years before they must be returned to the developer. The latter doesn’t have the same statutory limits but effectively it is a maximum of ten years; developers would be well within their rights to ask for return of contributions if a growth project signalled in a Ten Year Plan did not proceed.

So the game for councils is to restrict development activity to the smallest areas possible to allow for foreseeable population growth. And those areas have to be delineated well in advance. This allows councils then to

1. Design upgrades to networks to accommodate development and population growth in those areas
2. Cost those upgrades and schedule the projects
3. Add those projects to the Ten Year Plan
4. Allocate all the funding requirements across development contributions and financial contributions
5. Revise the Development Contribution Policy to include the projects
6. Preferably forecast no growth-related rates rises in the Ten Year Plan

It is no concern of councils what impact that process has the price of land. The absolute value of land does not impact council finances at all only the relative values across rateable properties. So yes the process can be very successful for councils just not great for buyers of sections.

#### **Q19. What impact does transport planning have on the supply of development capacity?**

Pretty much everything.

The empirical evidence is simple in NZ. Take a look at the meshblock level census data for population growth over the last say three years from Amberley to Darfield including all of Christchurch, Waimakariri District and Selwyn District. The patterns of high growth essentially follow the State Highway network (SH1 and SH71). Waimakariri District usually grew at a faster rate than Selwyn District while its motorway access to the city was better. Post earthquakes and post the completion of the Southern Motorway the situation has reversed.

Look also at the report on the first year of the Auckland Housing Accord. It is obvious from the maps that when quick development is the objective areas near state highways will be developed first.

#### **Infrastructure Charges**

The development contributions regime is fatally flawed in several ways and a better way of funding new infrastructure must be found.

In the first place development contributions are levied at the start of the process and added to the purchase price of new sections. This has had the effect of lifting the general price of all properties in places like Auckland. A contribution that is recovered gradually after purchase would not have a similar effect.

Secondly, although the broad concept of new residents paying for themselves and not getting a free ride from the existing community is a sound concept that is not how development contributions work. When the N<sup>th</sup> resident creates a new section and attaches it to infrastructure they attach it to existing infrastructure paid for the (N-1)<sup>th</sup> new resident; the projects they are required to contribute to will enable the (N+1)<sup>th</sup> resident to join. Development contributions only make logical sense if you apply the

“what goes around comes around” maxim. If you apply that then you don’t need a process that is as unwieldy as development contributions.

Thirdly there is a moral hazard in being able to allocate funding for new expenditure to a non-ratepayer group. In practice some projects will be funded from multiple sources and there is no way of telling whether a council’s allocation of the funding split to DC’s is accurate and fair or not. The 2014 amendments have considerably lessened this hazard but it still exists.

Fourthly, there are issues with nexus between development and nominated projects. The development contributions regime is deliberately weak on nexus as it was created largely to overcome the defects of the financial contributions regime where nexus must be shown. Even so the quantum collected is based on scheduled projects up to ten years in the future. In rapidly growing areas circumstances often overtake the best laid plans. And the regime, as it now stands, actually allows Councils to charge forwards and backwards with no constraint. There comes a point where a legitimate capital levy is in danger of becoming a free-for-all.

Lastly, and most importantly for this inquiry, the development contributions regime encourages councils to constrain development and stick to very rigid plans. As we know the quantum collected by way of DC’s must be based on estimates for nominated projects that are included in a Ten Year Plan. Allowing for the planning time required before a Development Contributions Policy can be published for consultation, councils must form a confident view as to where development will occur for 12+ years into the future. Plans have a tendency to become fixtures once they are accepted so development contributions tends to rigidify council planning.

**Q58 Do development contribution policies incentivise efficient decisions about land use, or do they unduly restrict the supply of land for housing?**

The design of the DC regime would push councils towards inflexible and constrained approaches to development. If a council relies on development contributions to fund expansions of infrastructure then constraining growth delivers several benefits:

- gives more opportunity to crib some funds from DC’s to pay for combined growth/renewal projects (moral hazard)
- minimises the opportunity for challenges against funding questionable projects
- minimises the chance that the obscure provision requiring councils to refund contributions towards projects that are not carried out is ever invoked. This would be an administrative nightmare; I doubt any council has the capability of doing this today so it easier to avoid ever having to do it.

**Q60 What are the main advantages and disadvantages of having infrastructure vested in Council Controlled Organisations?**

By law, the first duty of the directors of a CCO is to the company which effectively puts them beyond any material control by the council. This can be good or bad depending on how you look at it. Social outcomes cannot be forced on a CCO if they run counter to the economic well-being of the company.

The main advantages of taking management of assets (they don't have to be vested, ownership can stay with the council) into a CCO (or any other entity) is the ability to respond to changing conditions more flexibly and to access more flexible funding options.

CCO's sit outside the long term planning processes of the parent council which gives them more flexibility to extend or upgrade infrastructure. The Infrastructure Strategy would remain as the overall guiding agreement but the CCO would have more flexibility to alter the details of the work plan to respond to changing conditions. I note that our local community-owned lines company can respond up to ten times faster than the council to growth.

It may also be possible for a CCO to budget to make a modest operational surplus. Effectively this would take away some of the need for complicated development contributions. Although technically unfair on existing ratepayers it is only another variation on the "what goes around comes around" mechanism that development contributions actually are.

The disadvantages of transferring management of assets to CCO's is the lack of transparency and lack of control by elected members over their operation. There is potential for some lack of co-ordination but the requirement to develop Infrastructure Strategies ensures some co-ordination is maintained at the top level.

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