

Submission on Productivity Commission Report: Using Land For Housing

David Mead

Hill Young Cooper Ltd

1 August 2015

Introduction

Thank you for the opportunity to respond to the draft report on using land for housing.

I think the name of the report - using land for housing - is unfortunate in that it gives the impression that the supply of more housing is solely dependent upon zoning more land for housing. It also implies that house prices are high due to limited supply.

The notion of a lack of supply may fit the current government's limited agenda relating to housing, but confuses issues of housing demand, housing financing and housing production with the opportunities for the development sector to meet demands. It also masks the fundamental complexity of urban land markets.

As a blog post from the London School of Economics notes¹:

"There is something profoundly wrong with our housing system. No matter how high house prices rise the market does not respond with more supply".

At a simple level, constraints on supply must therefore be the problem, as basic economics says if prices rise, then supply should expand. Planning controls are the obvious reason for a lack of supply, and therefore planning controls must be amended. However as discussed in the blog post:

"Ultimately, this approach misunderstands the nature of land markets: we have a planning system because the right bits of land are inherently scarce, not the other way round".

The planning system is needed to help ensure efficient use and development of what land is available for urban development. Without a planning system, the housing situation could be worse. Having said that, the planning system doesn't always get the allocation right between competing outcomes over urban land. But even where a better calibration of planning controls occurs, it does not mean that housing will be supplied at the right price and in the right location.

The Commissions' draft report acknowledges this point, albeit towards the end of the document. Chapter 10 starts to provide a more fundamental analysis of land markets and housing supply which is helpful, but underdone. The report is extensive, and many of the recommendations in the main sections of the report will be of some benefit in enabling the supply of housing but in my view the report lacks a clear theoretical underpinning of urban land markets and the process of residential development in urban areas. As a result it fails to ascertain the key policy levers that need to be used to enable an appropriate supply of housing. While the nature and extent of development

¹ <http://blogs.lse.ac.uk/politicsandpolicy/why-arent-we-building-enough-homes>

opportunities is important, it is necessary to consider these opportunities in relation to the feasibility of housing development. The two aspects - opportunities and feasibility - are interlinked. Any extra supply may be helpful, but ultimately land markets adjust to the new settings, and development remains a risky business. Returning to the blog post:

"Land markets tend to internalise productive value from elsewhere in the economy, and return them to the landowner, leaving little potential return for building companies, or for residents or the wider community. Typically land markets successfully capture almost all the financial gains from public investment in, for example, new train stations or better schools".

To that list could also be added ' and the benefits that flow from planning'.

Housing is different to other goods because land is different from other assets. This understanding is integral to solving our housing crisis.

"No-one knows how much land is worth. Instead, those in the development and property industries attempt to estimate the 'correct' price for a piece of land using what is known as the 'residual land value' methodology.

At its simplest, you start with what you could sell it for with something on it – e.g. a market value house – and then subtract how much that something costs to build and a reasonable profit margin. The remainder is the 'residual land value' – the price you can offer the land owner. Build costs and profit margins are well established, so both sides have a reasonable estimate of this final price".

Essentially the price of urban land is always hovering around the point of development *infeasibility*. Increasing density, supplying infrastructure or reducing consent costs does not mean that development becomes more feasible, it is more likely to mean that the residual value of land jumps up.

Taking this forward, the report sets out some useful information regarding the overall process of urban growth in Chapter 2. While helpful, this broad picture needs to be taken to a deeper level by looking at development and redevelopment at a suburb and site-by-site level, and the response of land markets to the feasibility of this development. Only at this level can the real issues associated with supply opportunities be understood. In particular:

- There is no real sense of a supply chain or similar type analysis in the report
- Neither any sense of what is the critical path, key bottlenecks in that supply chain
- There needs to be much better understanding of development feasibility at a site level
- There are many players involved in housing production - landowners, developers, financiers, speculators, investors, builders and owner occupiers.
- A systems view is needed of the interactions between these players. Easing up on one aspect may just mean that the benefit gets captured by someone else in the chain, rather than the end user.
- In particular, the ability for landowners to capture benefits, rather than the end user (home owner) is huge. This is acknowledged to an extent in Chapter 10 and the discussion around land value uplift.

I also think any actions to 'increase supply' need to be based on some form of econometric modelling of the different levers that could be used and their impact on land and house prices, over time. Some case studies of urban infill and redevelopment over time would have been very helpful to understand the supply, demand and feasibility issues better.

A critical question is how much supply is needed to ensure an efficient urban development market, in a fast growing area? Does this supply need to be broad based, or concentrated in a spatial sense?

Planning has traditionally sought to provide some stability to the land market, to reduce risks and to increase certainty as to what type of development is likely to occur in an area. This is to ensure that communities see some stability over the environment that they live in and that developers can invest with certainty. Moves over the past few years in Auckland to open up development capacity in and around selected growth centres is part of this approach. The question now raised is whether this attempt to provide some stability has back fired? Does too much certainty give landowners a 'one-way' bet? The answer may well be yes, but that answer doesn't mean that the solution is to reduce certainty and increase risk.

Framework for solutions

In terms of thinking of solutions, Auckland is different from the rest of the country. Auckland solutions are not the solutions that may be needed, or might work, in places like Wellington or Queenstown.

Auckland is about intensification and urban redevelopment. Auckland has constraints to urban expansion and intensification that are both natural and man-made. Many of the man made constraints are important to the overall liveability of the city, and are not to be set aside lightly.

In Auckland, urban intensification is likely to be driven by small scale site-by-site redevelopment. Larger scale urban redevelopment tends to be driven by three forces or events:

1. natural or manmade disasters (such as earthquakes, fires etc)
2. expansion and contraction of commercial and industrial activities
3. substantial decline in sites or areas (slums) followed by rejuvenation.

The first option is not one to be relied upon (although rising sea levels from climate change will force substantial changes in the medium to long term in some parts of the Auckland Region)

The third option is one that was more prevalent before the rise of the welfare state and modern building codes. Areas don't 'decline' to the extent to which they may have once, in terms of the quality of housing and price of housing. While post war, urban expansion and the construction of the motorway system created the conditions for urban renewal in central areas, today's ability to engender a shift in population from one part of a city to another is much reduced. Areas that do decline (like the central Isthmus in the 1950s and 1960s) can become gentrified rather than redeveloped. A growing city does not generate as much decline in the fortune of some suburbs, as a city with a static or declining population.

The second option can be seen in the presence of brownfield (older industrial) and greyfield areas (older malls, large shopping complexes) in the region. These do present options for urban redevelopment at scale. This is an opportunity recognised to a degree in the spatial plans for the Region.

Given this context, there are a range of strategies that need to be used.

Firstly, given size and growth pressures, there is a much bigger need to co-ordinate planning, infrastructure provision and funding than elsewhere. I agree with the call for a metro planning act or similar that can combine the funding and delivery of infrastructure with land use planning. Ultimately there is often a miss match between where infrastructure may be efficiently provided or upgraded and where growth may want to go. I agree that much more use could be made of targeted rates to address issues of specific infrastructure funding packages for different areas of the city.

There is a question mark over environmental protection in this 'integrated model'. There is line of reasoning that environmental protection should be handed to a separate organisation if council's are to take on a more pro active, development focus. This is to ensure accountability and transparency over environmental outcomes; that these outcomes are not lost in some sort of 'uber' trade off between growth, development and environmental quality.

The Auckland spatial plan required by the super city enabling legislation attempted to start this process of integrated planning, but mechanisms to implement the output of that process were lacking. There is no link between the spatial plan and the RMA plans for the region. There is no mechanism to lock in NZTA and other non AK Council agencies. The Productivity Commission's draft report recognises these issues, but recommendations are weak.

The key issue for Auckland is the extent to which overall economic, social and environmental wellbeing will be enhanced through a more plan-led or market-led approach to urban development. At the moment, we tend to seek a mixed approach which often results in a confusion of tools and methods.

Plan-led approaches get undermined by fractured governance, inadequate funding and limited control of market forces. Yet a market-led approach is also often inefficient due to failures to address externalities, control of funding and development decisions by vested interests, as well as short time frames.

In my view both routes could work, and they can work side by side. But the techniques involved in the two approaches differ. What works in a plan led approach is not what will work in a market led approach. And vice versa.

The current government is clearly keen on a more market approach, and well functioning markets have many benefits, but the management frameworks around them have to be very sophisticated, much more sophisticated than current.

As the same LSE blog post stated: *"Any serious attempt to address our housing crisis must include measures to change incentives and price signals in the land market, secure land at low cost, and get it into the hands of those who really want to build"*.

So it is the landowners that the Commission should talk to, not developers. The benefits of planning and investment to land prices need to be acknowledged and mechanisms put in place to share these benefits. Equally the incentives to 'hang onto' land also need to be addressed. More supply options across the board does not address these issues, as development opportunities are inevitably concentrated in cities due to infrastructure, demand profiles and existing conditions. There is a spatial monopoly.

Other elements that a more market approach needs to deal with include:

- equity / equality issues are likely to become as big a management issue as the efficiency of housing markets.
- correctly addressing environmental externalities (what are these in a city environment?) and
- how to value and incorporate future public costs and benefits has to be resolved.

On the issue of equality, I acknowledge the Commission's recognition of Inclusionary Zoning as a possible technique.

Mechanisms

In terms of some of the actions that I think that need to be taken to increase housing supply opportunities, the following come to mind:

Taxing Land

As discussed above, until issues of land prices are addressed, then I think it will be hard to enable a supply of housing that is more broad based than current. Increasing the amount of 'money' involved (for example more infrastructure spending, increased densities, fewer requirements like balconies on apartment developments) will not necessarily result in more dwellings at lower prices. There will be a benefit at the margin when first introduced, but over time land values are likely to capture the benefits.

I support the Commission's call to look more closely at some form of land value uplift capture, but as discussed in the report untangling what is a public versus privately driven uplift in value is not easy, and will be cumbersome to determine.

Ideally, a tax needs to discourage a 'bad' and encourage a 'good'. In the case of urban areas and land prices, that bad could be said to be high land prices that do not translate into more intensive housing developments and redevelopments due to residents (who are also land owners) resisting housing developments, but keeping the benefit of high land prices.

The alternative to an uplift tax could therefore be a progressive land value tax (LVT), with the rate of the tax increasing as there is a greater disparity between the value of the land and the value of improvements on that land. In high priced urban areas with (relatively) lower density development

on that land, the rate of tax would be higher than in the case of modest land values with modest levels of development.

Such a land value tax may need to be levied on a neighbourhood level. If a community wishes to retain their current character and housing density, but live in a high land value area, then their tax rate would be higher. If they accepted more development then the rate would be lower. Rebates would need to be given where the lower level of density relative to the value of land was the result of planning constraints like scheduled heritage areas or volcanic viewshafts.

As noted by the Economist magazine² LVT have a sound theoretical basis. The biggest barrier to their implementation is political. *"LVTs would impose concentrated costs on today's landowners, who face a new tax bill and a reduced sale price. The benefit, by contrast, is spread equally over today's population and future generations. This problem is unlikely to be overcome"*.

Urban development agencies and land acquisition

There is a role for plan-led development and the Commission's call for urban redevelopment agencies is welcome in this context. These agencies need to be well funded and returns recycled into new projects. There are risks: Australia demonstrates that government land development agencies can make big profits in boom years, but also generate substantial losses in downturns. Access to cheaper capital is critical, but also the willingness to ride the development cycle.

Land amalgamation is a big issue in the suburbs (and in some greenfields areas), but no government is going to go out and buy up whole suburbs.

I think Auckland needs to re think its industrial and business areas within and close to the Isthmus, particularly those with water frontage. These have got to cycle over into new suburbs . Urban development agencies could lead this process, finding new land for the businesses to shift to and redeveloping the vacated sites. Land amalgamation would be an important function.

Neighbourhood Plans

Looking at existing suburbs and their redevelopment, in my view two things need to happen in terms of district plan zones and development controls:

- They need to get more place-based
- They need to adjust 'automatically' as an area adjusts, rather than set in place what may be perceived as a final picture in terms of the height and density of development.

The Commission has asked this question:

Q9.2 Does scope exist to introduce mechanisms such as the Brisbane neighbourhood plans into the New Zealand planning and development system? If so, how would it be implemented?

² <http://www.economist.com/blogs/economist-explains/2014/11/economist-explains-0>

A description of the Brisbane Neighbourhood Plans is on pg 239 of the report. In my view the neighbourhood plans look similar to the UK's Local Area Agreements which were scrapped in 2010, These sought to:

'... set out the priorities for a local area agreed between central government and a local area (the local authority and Local Strategic Partnership) and other key partners at the local level. LAAs simplify some central funding, help join up public services more effectively and allow greater flexibility for local solutions to local circumstances'

The objective of a neighbourhood approach needs to be clarified. Is to agree infrastructure upgrades, identify development opportunities in a top-down sense (this is, how much growth is needed), or find what level of growth is acceptable to the community?

Auckland has a long history of developing neighbourhood level plans, but most quickly fall into abeyance due to:

1. lack of long term commitment to funding
2. limited top-down direction as to how much growth needs to be accommodated
3. strong 'under currents' that drag planning back to the status quo and the short term (just a bit more growth that doesn't look too much different from what is currently in the area, please).

Given this experience, I do not agree that neighbourhood plans provide a useful platform. However the idea of organic, neighbourhood level planning has merit.

To my mind, neighbourhood level development controls need to be 'objectively' set, but in a dynamic way. Either we crudely draw back density, height in relation boundary, building coverage, and height limits across the board in the suburbs and see how it goes or we go 'deeper' into some form of algorithms that start to set development envelopes in relation to things like:

- land value
- site size, shape
- topography, aspect
- street environment (arterial, local)
- infrastructure.

These algorithms would be dynamic. Development envelopes would adjust 'automatically' as the place changes. Residents would not be able to resist the changes enabled by these algorithms, but if they knew what was coming in 3 or 5 years time to their area, given changes in the wider urban environment, then they could adjust to this.

So the final call for the Commission is to recognise the need for research into dynamic management of city form and change that is much more based on a 'science of cities'.

Housing Typologies and Mix

The Commission repeatedly acknowledges issues around typology and dwelling size, both in its discussion of the Alonso-Muth-Mills model in section 2.3 of the report and in section 2.6 where it examines the increase in the average floor size of new dwellings and undertakes its own analysis of density/distance for select NZ cities.

In section 2.7 on Housing Tenure and Choice the Commission goes onto state that:

Restrictions on density prevent the construction of smaller and less expensive dwellings on smaller parcels of land closer to the centres of cities. This means that people who do buy a property closer to the centre of a city are restricted in their choice of housing type and may end up buying or renting a property that is larger than they might have preferred. Restrictions on density also affect older people who might prefer to downsize, but are unable to buy a suitable small home or townhouse in the area where they currently live.

While I generally agree with this view, a relaxation of density controls along with the establishment of intensification targets may not be sufficient to deliver the range of housing typologies needed. A view that is supported by the growing trend towards larger homes.

In my view the Commission has missed an opportunity to look at what tools are needed to enable a delivery of a wider range of housing types within neighbourhoods, not just aggregate supply. Some form of incentive or sanction may be needed (e.g. a process or development bonus by way of streamlining applications or allowing greater heights etc) to encourage the “ideal mix” of typologies, which should include buildings with differing specifications (i.e. affordable 3-bedrooms also).

David Mead

4 August 2015

Hill Young Cooper Ltd

d.mead@hyc.co.nz.