

## Memo

To: Property Council New Zealand

From: Greg Akehurst, Director Market Economics

Date: 15 October 2021

Re: Auckland Council Development Contributions Review 2021

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### Introduction

Auckland Council are carrying out a review of their Development Contributions Policy, with the aim to have a new policy take effect from 10 January 2022. Council reporting states that changes to the existing policy result from updates to the growth component of capital expenditure in the 10 year budget. In addition, Council are proposing to introduce charges for infrastructure projects required to support growth over a 30 year period. In the first instance Council is beginning with Drury as they consider they have detailed information covering the Drury Future Urban Zone E. The Council also states they will extend the approach taken in Drury to other areas across Auckland as work progresses.

Development Contributions ('DC') are an important and appropriate funding mechanism, and if applied appropriately, promote fairness, equity and proportionality with respect to the consumption of infrastructure. However, it is important that the process and modelling that lead to the striking of a development contribution rate is sound, transparent and evidence based, such that all parties are able to review and satisfy themselves that the rate is fair, equitable and proportionate.


Market Economics has been commissioned by Property Council New Zealand ('Property Council') to review the work Council have released in support of the proposed changes to the DC policy and to advise on the economic merits of the proposals using the LGA tests as a benchmark.

Given the short timeframe for consultation and the volume of material released, Market Economics has (out of necessity) only been able to undertake an initial assessment of the documentation provided, noting that the models used to calculate the development contribution charge have not been made available for review. This initial assessment has also formed the basis of the Property Council presentation to Councillors on 12 October 2021.

The following sections outline the key findings of our initial assessment and the conclusions we are able to draw from the material released to date.

### Key findings of the Review

Having reviewed the Contributions Policy 2021 (draft) document and the Council's supporting documentation, and having initially assessed the released models (in pdf form only), the key findings



of our review are centred around the process Council have engaged with and some of the material components of the three models as released. In summary the key points are;

- There is a lack of ability to assess the decisions Council has made with respect to splitting infrastructure costs between renewal, growth and level of service because the development contributions Cost Allocation Model (ACDCCAM) and assumptions are not available.
- There is no evidence of any work carried out by Council to determine demand factors or the distribution of benefits for some key areas of cost – notably Community Infrastructure.
- The documentation creates uncertainty about how Council have determined what is needed and how costs are to be split. In particular, how costs associated with infrastructure that could potentially be built up to 30 years into the future, should or could be sheeted home to development that occurs today.
- We have identified some material issues with the three models that combine to calculate development contribution charges – the growth model, the cost allocation model and the funding model
- The inclusion of cost over-runs and re-evaluations in the DC policy leads to intergenerational equity issues.
- Concerns that the impact of the development contribution charges on developer businesses will lead to issues around housing supply and prices/affordability


#### **Development Contributions Modelling and Assumptions Assessment**

Auckland Council's Development Contributions Model as a whole is made up from three interlinked models:

- The Auckland Council Development Contributions Growth Model ('ACDCGM')
- The Auckland Council Development Contributions Cost Allocation Model ('ACDCCAM')
- The Auckland Council Development Contributions Financial Model ('ACDCFM')

These models work together to first identify the volume and location of growth over the next 30 years or so (ACDCGM), then to collate and distribute infrastructure projects and their cost between three categories of charge (renewal, improved level of service and growth)(ACDCCAM), and finally to combine growth by location with the costs of infrastructure required to support the growth into a framework that allows a DC charge to be set within different catchments on a Household Equivalent Unit (HUE) basis (the ACDCFM).

By necessity these are very large and reasonably complex models that need to be developed carefully and need to be maintained rigorously to ensure that changes in growth or new infrastructure projects are incorporated accordingly. It is vital that these models are made available in an appropriate format to interested parties so they can appraise themselves that the processes, and assumptions Council are relying upon are correct and appropriate.



This important requirement of consultation processes for new DC policies is that they must adhere to the principles of consultation as defined under the Local Government Act 2002. Section 82 (1) states that:

*82 Principles of consultation*

*(1) Consultation that a local authority undertakes in relation to any decision or other matter must be undertaken, subject to subsections (3) to (5), in accordance with the following principles;*

- a. that persons who will or may be affected by, or have an interest in, the decision or matter should be provided by the local authority with **reasonable access to relevant information in a manner and format that is appropriate to the preferences and needs of those persons.** (emphasis added)*


In order for interested and affected persons to be consulted with properly, they must have access to the relevant information and models that make up the proposed DC policy in a manner and format that is appropriate to their preferences. In other words, in order to review the models and come to a position as to their merit, affected persons must have access to the three models listed above (ACDCGM, ACDCCAM and the ACDCFM).

It is insufficient to provide snapshot pictures (in pdf format) of these models via the DC consultation website (<https://akhaveyoursay.aucklandcouncil.govt.nz/dc-policy>). The provision of very large pdf documents does not fulfil Council's requirements under the Local Government Act, as it makes it impossible for any reviewer to:

- Track or trace how the model works;
- Assess and understand the assumptions made;
- Understand how the catchments are set;
- Assess or understand how the demand factors have been arrived at; and
- Finally, understand how all of the above factors work together to arrive at a final DC charge.

In addition, since the start of the consultation period, the Council has been releasing information on an on-going basis, without extending the consultation timeframe, and therefore not providing enough time to affected persons to properly assess the additional documentation. Moreover, the additional documentation released by Council is extensive and complex, and has only been provided in PDF format, which makes it very difficult and time-consuming for affected persons to assess and comprehend. Given that many documents were not released when the consultation opened for feedback, it is also possible that some affected persons are not aware of the existence of such documents.

For example, Council initially posted 2 documents totalling approximately 400 pages of pdf pictures of the modelling spreadsheets the week before the 12 October hearing. These are detailed and



complex models and difficult if not impossible to follow in themselves. A further 4 pdf documents were posted the day before the hearing totalling some 1,200 pages of pdf pictures of various growth and allocation models

Overall, I consider that the Council has not complied with its requirement to provide affected persons with *“reasonable access to relevant information in a manner and format that is appropriate to the preferences and needs of those persons”*.

In order to provide the Property Council with an informed opinion of the veracity of the models and the assumptions that underpin them, the models (and underlying assumptions) need to be provided in excel spreadsheet form.

### **Demand Factors and consumption of Infrastructure**


In order to determine the provision of infrastructure of any kind it is necessary to understand the nature of the population the infrastructure is being provided for and the use they are liable to make of it. There are significant differences in usage rates for community infrastructure (for example) for retirement village households and family households with children. These rates and ratios need to be considered at the formation of the project to ensure that resources are being applied sustainably and efficiently. To properly assess demand factors requires robust collection of evidence, involving population wide surveys, the translation of usage rates or activity profiles into demand factors and the application of those demand factors to growth by location. This is then translated into infrastructure demand.

The resulting usage rates and ratios should then be used to distribute the costs of providing infrastructure between the different groups within the community.

This principle guided the decision made to adjust the DC fees paid by Ryman Healthcare for their Pukekohe Village, following an objection lodged by Ryman, which led to a significant reduction in the fees charged overall for retirement villages in 2015 and 2016.

The basis of the objection to the initial DC charge was that Council had no basis for assuming how much retirement village households used community infrastructure when compared to households. Although the policy applied a discount to retirement units and aged care rooms, there was very little Council evidence to support these charges. Ryman considered it had substantially less demand on community infrastructure than the policy provided for. The only study that had been carried out by Auckland Council was over 10 years old at that point and it highlighted that retirement aged people had very low usage of community infrastructure. This coupled with the fact that the villages provided many of the same facilities internally (libraries, sports facilities, meeting rooms etc) meant that the load imposed on Council provided infrastructure was exceedingly light. This fact was borne out by a subsequent survey carried out in support of that hearing and contributed to by Council.

There is no evidence that any of that type of work has been carried out with respect to this latest update of the DC policy. Rather, it is understood Council intends to progress this work in ‘Stage 2’ of



its policy development process. Undertaking appropriate survey work is a cornerstone piece of analysis that needs to occur before the decisions Council is currently considering can be made.

This analysis also contributes to the assessment of how the costs of infrastructure should be split between renewal, improvements in levels of service and growth. Having survey work that allows understanding of how different groups use infrastructure in terms of visitation or access, it is possible to combine that data with current usage rates to assess under or over utilisation and thereby the level of service offered by existing infrastructure.

Without knowing how the existing infrastructure is meeting the existing needs of Auckland households, it is impossible to know the current levels of service offered and or how additional infrastructure might improve levels of service to existing users.

The application of usage rates will help guide the provision of additional infrastructure required by growth and will help determine benefits obtained from the infrastructure. Again, this is important when determining how infrastructure costs are to be split.

Finally, infrastructure life cycles, age and consumption of existing infrastructure are used to determine what infrastructure needs renewing and when and the degree to which newly provided infrastructure is done so to renew or replace existing end of life infrastructure.

Based on the documentation and pictures of the models released as part of the consultation, it is not clear that this work has been carried out by Council. Therefore, it is not clear that the proposed revised DC Policy is well founded and appropriate.

### **Material issues with data**

Of the data that has been released we have some concerns. The ACDCGM is driven by a projection set of population, household and employment projections contained within Council's I11 v6 Growth Model. This model projects at the Auckland Regional Transport Zone level (596 'ART' zones) across the entire region. As the name suggests, this is a transport model framework and the projections are required to allow Auckland Transport's large transport models to run (origin destination models by mode and purpose by time slot). Household and population are distributed according to the Auckland Unitary Plan and employment is distributed to zones that cater for employment.

On reviewing the data that underpins the Council's I11 v6 model, it is clear that there are issues with the starting point (2018) for the employment estimates at least. The Figure 1 below includes the regional totals for employment drawn from the Council's i11v6 model and Statistics New Zealand's business frame. While the numbers are slightly different in terms of what they are capturing, the difference in quantum is significant.

Figure 1: Regional Employment Estimates i11v6 Model vs Statistics NZ Business Frame.

	2018	2020	2021	2026	2031	2036
I 11 v6 Scenario	680,600	696,700	705,500	754,000	809,800	851,800
StatsNZ Business Frame (EC's + WP's)	885,400	914,000				

The i11v6 employment estimates (as I understand it) measure Employee Counts across the different ART zones and total 680,600 for the region as a whole. The Statistics New Zealand based numbers are a combination of employee counts (ECs) and working proprietors who are not recorded as employees in their businesses (WPs). In total, this amounts to 885,400 people actually employed or working across the region. Including the working proprietors is important as it presents a far more complete number of 'bodies' in any given location. This is the important metric when it comes to providing different infrastructure to meet their needs.

However, the difference between the values (over 200,000 persons) is not solely due to the working proprietors that amount to less than 100,000. The Statistics NZ EC count for Auckland Region for 2018 is approximately 781,000<sup>1</sup>, or more than 100,000 higher than the i11v6 total.

Effectively the actual total number of persons employed within Auckland is some 30% higher than the numbers in Council's model. This is likely to have implications for future infrastructure provision as any estimates of infrastructure per worker taken based on the i11v6 values would overstate the volume required on a per worker or per person basis. If that is then applied to employment growth and translated into infrastructure charges, it will overstate DCS significantly for commercial and industrial developers. To the extent that household generated demand is translated into employment and the infrastructure required that is then sheeted home to household DC charges, it will lead to higher DC charges than required.

### Rates offsets to Development Contributions

Development entities, or the households that these entities facilitate in a growth area, pay through DCS for the infrastructure that they cause Council to spend money providing or drawing benefit from. These charges are embedded into the price they pay for their dwelling or section. Once they are resident, they begin to also pay rates. A portion of the money they pay in rates goes to fund the renewals and improvements in levels of service for infrastructure that they do not draw any benefit from (given that they have paid for the construction of their infrastructure up front).

New and future households are paying for their own infrastructure and for the renewal of existing households infrastructure. In the information provided, it is not clear whether this has been recognised and that a suitable off set mechanism has been included in the DCs models (presumably the ACDCFM). If the offset has not occurred – it is not fair or equitable and growth households are paying for existing households or the underinvestment in existing infrastructure by Council.

<sup>1</sup> Taken from Statistics NZ's Business Directory, in 2021, for 2018.



## **Cost Over-runs and Re-evaluations**

In the 2021 draft DC policy Council is proposing a \$500m increase in the City Rail Link ('CRL') budget decided in 2019. This adjustment may be the result of underinvestment in the CRL previously or errors in the estimation of the costs of the project. Regardless, the effect of including a \$500m increase into the 2021 Draft policy is that current and future developers pay significantly higher DC fees compared with developers in recent years. This means that households in the immediate future are paying significantly more than households in the immediate past for exactly the same infrastructure.

This represents a clear case of intergenerational inequity.

The economic justification for why DC payers should cover either historic underinvestment or inaccurate estimation of Council projects is unclear. Any underinvestment or material inaccuracies should be covered by the current population – not loaded onto households of the future who played no part in either the decision to build or have the capacity to vote for or against decisions the current or past councils have made.

The \$500m increase should be removed from the calculation of DCs until it can be shown that growth households should be responsible for cost over-runs or cost re-evaluations as a result of current under investment.


## **Pace and nature of Policy change**

The 2021 draft DC policy represents significant development contribution increases in a number of areas – in a manner that is not equitable across the region, or through time. Council have stated they are starting with Drury as they understand Drury better than other areas as there is significant information to undertake the DC calculations contained in the Structure Plan and the applications by the number of land owners for development rights. The values proposed in the draft DC policy show increases in Drury ranging from \$11,000 - \$18,300 to \$84,300 - \$89,200 per HUE. Put in the wider context, the average DC charge (according to Council) drops from an average of \$23,000 to \$21,000 on a weighted average basis.

The significant increases in DC prices in Drury will lead to inappropriate price signals being delivered to the market as development will be diverted from areas identified by Council as appropriate to accommodate future growth to other areas – simply on the basis that Council hasn't yet identified all the infrastructure required in the alternative locations.

This adverse consequence (residential growth being diverted to less efficient locations in this instance), highlights the need for Council to pause this process and not adopt the 2021 draft DC policy until such a time as they have comprehensively assessed all growth areas – rather than focus on Drury. The approach of using a 30 year horizon for funding infrastructure also needs to be thoroughly tested against other alternatives. Only then will the relative costs be appropriately set and the market will be responding to appropriate price signals.

The net effect of adopting the 2021 draft DC policy with its lumpy effects is inappropriate price signals sent to the market and development occurring in different locations and at a rate that may not be



fully costed in terms of infrastructure provision, and not in locations where Council has accepted as being appropriate to cater for growth.

### **Significant impact on housing affordability**

The impact of such large increases in DC fees (up to 660% increases in Drury), which are also proposed to be rolled out across other parts of Auckland, will impact on house prices and housing affordability overall. This comes about through a number of mechanisms. I understand that Council's position is that the imposition of significantly higher DC charges will have no effect on house prices because, (to paraphrase the response given by Council's economist in answer to the question posed by the hearing Chairperson, why Council have assumed that development contributions will not adversely impact housing affordability) *"a developer is a price taker and the price of housing is set within the market based on the interactions of many players. The developer has no control over that price"*.

In particular, Council's position is that with Auckland house prices at record highs, buyers' willingness to pay is arguably equivalent to market price and therefore consumer surplus is effectively zero. Because consumer surplus is zero then a developer cannot affect market prices. While it is true that an individual developer in the Auckland market cannot affect the market price of houses given they are usually a small portion of the total market, developers as a group certainly can. It also may not be the case that consumer surplus is at zero.

Over the past 5 – 10 years this exact same statement could have been made (that prices are at record highs and willingness to pay is equivalent to market prices) and yet prices have continued to increase. The reasons for that are numerous. However, the most important one is that house-buyers looked into the future and believed that house prices tomorrow were going to be higher than house prices today. This combined with relatively low-cost finance meant that they were willing to pay more for houses today and therefore prices rose – irrespective of the fact that they were at record highs. It may still be the case today (in a market where population growth is continuing and construction costs are increasing) that buyers think the price of housing tomorrow or into the future will be higher than today. If that holds then upward pressure on residential market prices is likely to continue.

Council's economists are also ignoring the actual effect of DCs. A 660% increase in fees that adds between \$60,000 and \$70,000 (over and above last year's fees) to the price of each section puts a lot of pressure on DC payers. Those that have already purchased land and are in the process of subdividing, will attempt to increase prices. This may not be 100% successful as Council economists predict. However, developers may, with a mix of price increases and margin reductions, pass on some of the shift to home buyers.

Others may not be in a position to do this and will go out of business. This is an effect Council have acknowledged as likely. This reduces the supply of housing to the market (possibly temporarily, depending on what happens to their holdings). In addition, other developers may delay the development of housing in a certain area or halt altogether, further reducing supply.

The degree to which these events occur determine the degree to which housing supply reduces. As housing supply reduces (assuming demand stays the same) the price at which the market clears increases. Therefore, the combined effect of increasing fees such as this is that house prices increase

– not because an individual developer tries to influence the market, but the combined effect of some price increases being passed on, some developers shutting down and some delaying development.

The net effect of increasing DCs is that housing affordability reduces in Auckland.

## Conclusions

The 2021 Draft Development Contribution Policy should not be adopted by Council. Affected persons have not had the ability to fully assess the modelling and assumptions that underpin the models and the limited information we have been able to review raises significant concerns, because Council has failed to meet its obligations under the LGA s82 (1)(a).

The review should be halted until all the relevant information is released by Council in an appropriate format to allow affected persons to fully assess and understand the impact of the proposed changes, and the issues identified throughout this memorandum have been rectified.

In addition, Council must explore funding alternatives to incorporating projects that may occur 30 years into the future into the development contributions regime. Given the extreme timeframes (longer than a generation) and the potentially nationally significant impacts of Auckland's growth, all other alternatives to funding need to be explored, including; partnerships with central government, public private partnerships, special purpose vehicles and other funding and financing structures. Incorporating projects out to the 30 year horizon into the DC policy leads to intergenerational equity issues that must be avoided.

Cost over-runs and cost re-evaluations should be also removed from the DC estimates.

In summary, the policy review should be put on hold until all these issues can be rectified and the policy developed to a point where it equitably applies across the entire region rather than singling out Drury as the starting point.

**Greg Akehurst**

Director



market economics ltd

level 5 507 lake road po box 331297

takapuna 0740 auckland new zealand

ddi +64 9 915 5511

mob 021 896 537

[www.me.co.nz](http://www.me.co.nz)