Property Council New Zealand

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Submission on

Auckland Council's draft Development Contribution Policy

15 October 2021

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Auckland Council draft Development Contribution Policy

1. Recommendations

1.1. Property Council New Zealand ("**Property Council**") welcomes the opportunity to provide feedback on the Auckland Council's ("**Council**") Development Contribution policy 2021 ("**DC policy**"). It is absolutely critical to have a robust DC policy that would allow the industry to make informed long-term investment decisions and ensure fair distribution of fees amongst all ratepayers.

1.2. We were pleased to be involved in early engagement with the Council to inform development of the DC policy. However, the proposed changes do raise **some serious concerns** in the sector. We have made a list of recommendations to influence better and fairer outcomes for all:

Update of 10-year Budget capital projects

- Consider alternative funding and financing models as well as partnering with others (Government, other councils and the private sector) for joint funding opportunities;
- Consider findings from the assessment undertaken by Market Economics (see **attached**) when finalising the DC policy;
- **Do not** include community infrastructure into DC fees and consider alternative tools to cover the costs (e.g. rates, targeted rates, Special Purpose Vehicles);

Inclusion of capital projects beyond 10 years

- Keep the status quo (i.e. 10-year approach);
- Review the proposed increases for Drury (see **attached** report from Market Economics);

Payment timing

- Keep the status quo (as per the current DC policy);

Changes to funding areas

- Reconsider approach to identifying funding areas to avoid cross-subsidisation;

Additional comments

- Take into consideration other factors when finalising the DC policy:
  - Significant increases in building costs and the latest lockdown in Auckland;
  - Broader impact from key reforms on the property industry, such as housing affordability.

2. Introduction

2.1. Property Council's purpose is; "Together, shaping cities where communities thrive". We believe in the creation and retention of well-designed, functional and sustainable built environments which contribute to New Zealand's overall prosperity. We support policies that provide a framework to enhance economic growth, development, liveability and growing communities.

2.2. Property is currently New Zealand's largest industry with a direct contribution to GDP of $41.2 billion (15 per cent). The property sector is a key foundation of New Zealand's economy and caters for growth by developing, building and owning all types of property.

2.3. Property Council is the leading not-for-profit advocate for New Zealand's largest industry – property. Connecting people from throughout the country and across all property disciplines is what makes our organisation unique. We connect over 10,000 property professionals, championing the interests of over 560 member companies who have a collective $50 billion investment in New Zealand property.

2.4. This submission responds to Auckland Council Contributions Policy 2021 Consultation Document and other supporting materials. In preparing our submission we sought and received feedback from a selection of our Auckland-based members. Comments and recommendations are provided on those issues that are relevant to Property Council and its members.

3. Economics Assessment

3.1. It is essential that the Council has a robust DC policy that allows developers to make informed long-term investment decisions and ensures a fair distribution of fees amongst all ratepayers. However, given the lack of evidence provided by the Council, the Property Council has commissioned independent research to test the data that has informed development of the Council's DC policy.

3.2. Mr Akehurst of Market Economics has prepared an initial assessment ("**Economics Assessment**"), based on the limited time provided to review the available Council material. The key conclusions of the Economics Assessment are:

- The Council **has not** demonstrated how infrastructure costs have been split between renewal, growth, and level of service because its model and assumptions are not available.
- There is no evidence of any work undertaken to determine demand factors or distribution of benefits for some key areas of cost (e.g. community infrastructure).
- There are material issues with the growth and funding models.
- The inclusion of cost overruns and re-evaluations in the DC policy leads to intergenerational equity issues.

3.3. Given uncertainties as to how the Council has determined the funding allocations and capital expenditure under the DC policy, and the piecemeal approach to which the Council has provided further information over a short consultation period, the Council has failed to demonstrate:

- capital expenditure, both in terms of updates to the 10-year budget updates and inclusion of capital projects beyond 10 years, is attributable to demand resulting from growth; and
- capital expenditure is being allocated in a fair, equitable and proportionate way.

3.4. The Economics Assessment is **attached** to this submission and informs a number of the key issues and recommendations raised in this submission below.

4. Historic underinvestment

4.1 We acknowledge the Council's funding and financing limitations. However, historic underinvestment in infrastructure should not be viewed as a growth cost. Under Schedule 13 of the Local Government Act 2002 ("**LGA**"), development contributions must be calculated based on capital expenditure required to meet increased demand resulting from growth. Capital expenditure required as a result of historic underinvestment is not demand resulting from growth and cannot be recovered through a development contribution ("**DC**") and must be addressed through alternative funding tools.

4.2 Auckland is the fastest growing city in New Zealand, and it will continue to require significant capital investment over the coming years. Therefore, we strongly encourage the Council to utilise alternative funding and financing models as well as partner with others (Government, other councils and the private sector) for joint funding opportunities. These funding and financing tools include user charges (e.g. water charges and congestion charging), targeted rates, public-private partnerships and Special Purpose Vehicles ("**SPVs**") under the Infrastructure Funding and Financing Act 2020. SPVs were introduced by the government in recognition that existing development contributions mechanisms have been unsuccessful in appropriately allocating growth costs, and have already been successfully utilised in Auckland for greenfield development in Milldale and are implemented internationally.

5. Update of 10-year Budget capital projects

5.1. The Council proposes to update the DC policy to reflect the latest cost projections and timing of the 10-year capital programme in the 10-year Budget. The key changes reflected in the policy are:

- $500 million increase in the CRL budget decided in 2019;
- revising the share of the cost of the CRL attributable to growth from 16 per cent to 23 per cent;
- addition of $107 million of community infrastructure projects (noting some investment is part of larger projects).

CRL project

5.2. We are concerned with the Council's proposals around the CRL project. Budget overruns should not lead to increases in DCs fees. The Council has not provided enough evidence to justify the proposed increases, or demonstrated why additional costs not previously budgeted should be covered by DC increases. As identified in the Economics Assessment, this creates an intergenerational equity issue, because it results in future DC payers absorbing costs of historic underinvestment or inaccurate estimations of capital projects that played no part in the decision to build the CRL or had the capacity to vote for or against current or historic Council decisions in relation to that capital expenditure.

Charging DCs for community infrastructure

5.3. The DC policy includes addition of $107 million of community infrastructure projects. The Property Council has long opposed the incorporation of community infrastructure into DC fees. Collecting DCs to fund community infrastructure will result in an increase in DC fees charged to developers (ultimately passed on to the tenant or retail purchaser). Increasing DC fees will negatively impact Auckland as developers will need to factor in the additional costs in their feasibility. Additional costs coupled with other current uncertainties will impact on whether projects proceed. This is particularly concerning given the devastating impact of COVID-19 on both retail and housing affordability.

5.4. Increased DC fees will likely result in the following outcomes:

- Additional costs being passed on to the eventual buyer or occupier, making housing and occupancy costs more expensive; and/or
- Planned developments are postponed or cancelled, due to increased costs reducing the overall affordability of the development or project.

5.5. In 2018, the Council commissioned Insight Economics[1] to complete an independent report on the likely developer reactions to increased DC charges. The report signalled a number of issues with DCs, which align with our concerns. In particular:

> "**As DCs increase, the cost of land development rise, and thus its profitability falls**…In other words, land developers (who physically pay the DC) will seek to share some of the cost with raw land owners by paying them less for their land…it is unlikely that the resulting fall in land prices will be sufficient to fully compensate them. **As a result, the increase in DCs will also increase the total cost of land development**…"
>
> "**In summary,** economic theory predicts that the imposition of **higher DCs will impact most, if not all, participants in the wider property market.**"

5.6. Given the above, we recommend the Council consider alternatives such as recovering the costs (or at least a portion of the costs of community infrastructure) through rates or targeted rates over the life of the infrastructure, or through a Special Purpose Vehicle. We believe that these alternatives would improve intergenerational equity and ensure that those who benefit from the community infrastructure help contribute towards it over a longer period of time, reducing the financial burden upfront (i.e. within house prices).

6. Inclusion of capital projects beyond 10 years

30-year approach

6.1. The Council is looking to allocate DCs based on capital expenditure anticipated over the next 30 years rather than solely from that provided for in the Long-Term Plan budget. This new approach will have significant implications for some areas of Auckland, experimental and presents a number of risks.

6.2. Under section 197AA of the **LGA**, the Council must ensure that this new approach aligns with the DC principles to recover from those persons undertaking development a fair, equitable and proportionate portion of the total cost of capital expenditure necessary to service growth over the long term. From a fairness and equity point of view, the Council will need to be very careful about

[1] Insight Economics. (2018). Likely Developer Reactions to Increased Development Contribution Charges. Retrieved from https://www.hamilton.govt.nz/our-council/10-year-plan/10Year%20Plan%20documents/Economic%20report%20-%20Likely%20Developer%20Reactions%20to%20Increased%20Development%20Contributions%20Charges%20-%20Insight%20Economics%20Ltd.pdf

proposing to apportion some costs to developers today for projects that are not going to be built in the next decade. Therefore, there are a number of things that will need to be considered:

- impact of inflation on delivery of projects over time;
- benefits of paying upfront vs. delivery risks;
- the accuracy of capital expenditure allocations that far in advance, given that each development will not necessarily generate the same demand on infrastructure;
- evidence supporting the Council's decision to take a 30-year approach;
- actions the Council will have to take to ensure money collected today will be spent on delivery of the projects over 30-year period;
- the impacts on development in the short term;
- lack of evidence suggesting that a 30-year approach is better than a 10-year one;
- the time value of money, and how the real value of contributions collected today will not erode through inflation, specifically in relation to the increasing costs of the anticipated future infrastructure against which it is allocated.

6.3. The proposed changes lack transparency. The public has not been given enough time to properly evaluate the Council's proposal, due to the formal consultation period lasting less than a month. The entire consultation period has also occurred while Auckland has been in a COVID-19 lockdown. Without the Council's modelling available, and with the short consultation period, more time is needed to understand these significant changes and in particular, how capital expenditure for Drury beyond 10 years has been calculated and allocated.

6.4. The Council has not demonstrated whether the projected capital expenditure is related to growth, rather than historic underinvestment and budget overruns. The Property Council is also concerned that the Council has not demonstrated consideration of alternative funding methods such as targeted rates in any detail.

6.5. The Economics Assessment says in relation to the DC Policy: [2]

> *The net effect of adopting the 2021 draft development contribution policy with its lumpy effects is inappropriate price signals sent to the market and development occurring in places at a rate that may not be fully costed and not in locations where Council has accepted as being appropriate to cater for growth.*

6.6. Therefore, the 30-year horizon approach needs to be thoroughly tested against other alternatives. Given the above, we recommend the Council retain the status quo (i.e. 10-year approach) and seek to utilise alternative funding tools to supplement this. This will help ensure fairer allocation, better transparency and intergenerational equity.

Increase in Drury and housing affordability

6.7. Of serious concern is the proposed changes for Drury developments. The proposal adds a programme of expenditure to fund some of the key infrastructure required to support growth in the Drury area. It will raise the DC price substantially for development in the area reflecting the infrastructure investments required.

6.8. The Council themselves have raised concerns that the proposed draft DC policy could force house prices up even further. Should the proposed almost 700 per cent fee rise for Drury developers go

[2] Economics Assessment, page 8

ahead, this will materially affect house prices over time. This is concerning given the current housing crisis and the overarching Government's strategy to provide affordable housing for New Zealanders. It also contradicts with Direction 3 of the Auckland Plan which refers to the shift to a housing system that ensures secure and affordable homes for all.

6.9. The Council has said that it does not consider these increases will impact housing affordability. **We disagree**. The Economics Assessment concludes that the changes will reduce supply, pushing prices up for existing stock and passing on the DC increases in the price of new housing stock (in cases where developers are not entirely deterred from constructing more housing).[3]

6.10. It is difficult to understand how the Council can demonstrate these changes based on the data and the model provided. Greater transparency from the Council is required to understand its methodology.

6.11. As the Council has signalled that Drury will be first of many areas where this approach will be taken, it must ensure this approach is fair and robust. Given the above, we recommend the Council review the proposed increases taking our concerns into consideration.

7. Payment timing

7.1. The Council proposes that DCs are paid at the time of building consent for all development (residential and non-residential) except non-commercial development on Māori land. **We do not support** the proposal as it is neither practical nor beneficial. Payment on obtaining building consent has cashflow implications for developers.

7.2. Many developers operate on tight margins where small changes in the costs can impact on the viability of development. This is something that the Council recognises.[4] Where developers could finance contributions through sales or tenants, under the new policy they would be required to obtain finance from elsewhere and bear the additional costs of this. These costs are then exacerbated by construction delays and result in more interest being payable in addition to other costs such as overheads, and insurance.

7.3. COVID-19 has significantly impacted the construction sector. Alert level changes and supply chain issues have contributed to construction delays and rising construction costs.[5] While on its face earlier payment might result in marginally lower contributions, earlier payments put further pressure on developers from construction delays that are often outside of their reasonable control. Keeping the payment timings as they are under the 2019 Policy provides flexibility for developers and assists with ensuring the development is successfully completed. Developers are already incentivised, from a business perspective to complete developments in a timely manner and this will not change by retaining the existing approach to payment timings.

7.4. The Council has said that DCs could be slightly lower because receiving revenue earlier lowers the Council's interest costs, but has said that the net impact of earlier payment is neutral because while the Council would benefit from lower interest costs, its revenue would decrease.[6] If that is the case, given the negative of the change on developers, the status quo should be retained.

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3 Economics Assessment, pages 8 and 9
4 Attachment F: Payment Timing Changes, Auckland Council, 2021 Draft Contributions Policy Document consultation, at paragraph 35
5 Construction Fact Sheet – January 2021, Ministry of Business, Innovation and Employment
6 Auckland Council, Sharing the Cost of Auckland's Growth – Contributions Policy 2021 Consultation Document, at page 17

7.5. The Council has also acknowledged that the extended the payment timing for development contributions under the 2019 Policy reduced the outstanding DCs debt markedly, halving from $45 million in January 2019 to $22 million in December of the same year.[7] COVID-19 has led to outstanding DCs debt increasing again to $37.5 million in April 2021. Due to the pressures of COVID-19 on developers, and the substantially shortened timeframe to pay DCs under the proposed 2021 plan, outstanding DCs debt will get worse under the Draft Policy. Retaining the payment timings will assist with keeping the outstanding DCs debt balances low.

7.6. Further to this, the draft DC policy does not make it clear what part of building consent the payment will be required. In practice, most consents for projects are multi staged consents (e.g. structure, façade, fit out) which means the proposal does not make any practical sense.

7.7. While earlier receipt of payment will allow the Council to bring forward some of its planned investment, we are concerned that what may seem like a small timing change on paper could materially affect a developer's cashflow and therefore the viability of the project. For any developer, cashflow is critical and bringing the timing of payments to the front end of a development project creates another barrier to affordable development product. Given the above, we recommend the Council keep the status quo.

8. Changes to funding areas

8.1. The DC policy includes two additional funding areas for transport, and one new and four amended funding areas for stormwater. These funding areas allocate the cost of transport infrastructure to the investment priority areas in Drury and the Auckland Housing Programme areas and provide close alignment with planned investment in stormwater within the Central and Takanini areas.

8.2. We are concerned with the proposal as it seems that funding for infrastructure is going to privileged suburbs only. This raises serious concerns around equity, fairness and cross-subsidisation (i.e. what about other areas that also require infrastructure). Therefore, we recommend the Council reconsider their position on identifying funding areas. It is also important to make sure that evidence-based approach is applied.

9. Additional comments

9.1. There are additional factors the Council has to take into consideration before finalising the DC policy.

Significant increase in costs

9.2. Our Auckland industry members are already facing huge inflationary costs across the board. In particular, construction costs have gone up between 5-15 per cent, land values have increased between 20-30 per cent, while building material costs have gone up by 5-15 per cent in the last year alone.[8] These increases have to be factored into the DC policy.

9.3. It is also important to take into account the latest lockdown in Auckland and the impact it will have on the sector (e.g. the time to get developments off the ground and complete).

[7] Attachment F: Payment Timing Changes, Auckland Council, 2021 Draft Contributions Policy Document consultation, at paragraph 12

[8] Consumers set to pay, as builders have a supply chain reaction. Stuff NZ. 9 July 2021. Retrieved from https://www.stuff.co.nz/business/125690062/consumers-set-to-pay-as-builders-have-a-supply-chain-reaction

Wider work programme

9.4. We also encourage the Council to take into consideration the broader impact from key reforms on the property industry. This includes, but not limited to the National Policy Statement on Urban Development, recent Inland Revenue tax change announcements, the Fire and Emergency New Zealand funding review, the Climate Change Commission's advice, Resource Management Act reform, Building System reform (including Building Code updates), and the Local Government review.

9.5. It's easy to look at one proposed change and expect that it will have minimal impact, but collectively these reforms could significantly increase the cost and risk of development. At a time when we desperately need to be increasing our housing supply and streamlining development, we are potentially creating a 'perfect storm' that could have the opposite effect.

10. Conclusion

10.1. The DC policy is of significant importance to our members in the Auckland region. It is absolutely critical to have a robust DC policy that would allow the industry to make informed long-term investment decisions and ensure fair distribution of fees amongst all ratepayers while not creating a further barrier to the development of affordable housing.

10.2. Without the modelling available, and with the short consultation period, **the Council should pause proceedings to allow a more in-depth process and flow of information.** We are offering our assistance on any matters we have raised above if needed.

10.3. We keen to continue working with the Council to ensure fairness and equity of DC charges for all. **We also wish to be heard in support of our submission for any additional hearings as part of a broader public consultation process.**

10.4. For any further queries contact Natalia Tropotova, Senior Advocacy Advisor, via email: natalia@propertynz.co.nz or cell: 021863015.

Yours sincerely,

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