

Submission to the  
Productivity Commission  
Housing Affordability  
Issues Paper

Tauranga City Council

August 2011

## Introduction

In Tauranga City Council's view, housing affordability is now one of the most significant challenges facing New Zealand. Tauranga City Council (TCC) has undertaken some research into this issue and wishes to share some of the findings of this work with the Commission in order to assist its inquiry.

The approach TCC has taken to this submission is to provide answers to selected questions from the Commission Issues Paper where TCC thinks it can add real value to the Commission's inquiry. In some cases TCC has added some general comments where the scope of the questions asked was too narrow to cover the points TCC wished to make.

In addition to this, TCC has attached the following reports to its submission which are relevant to the Commission's inquiry:

- Assessment of Development Feasibility for the Wairakei Urban Growth Area
- Background Report: Funding the Costs of Growth – Long Term Options
- Housing Stock and Housing Demand

These attachments are referred to in the answers TCC has provided to the Commission's questions.

# Answers to Issues Paper Questions

## The Commission's approach

***Q1: How should the Commission think about the concept of housing affordability – its meaning and measurement? Should the Commission focus its work on affordability as it impacts on lower income households or should the focus be broader and examine the market as a whole?***

### Focus on the cost of delivering new housing

TCC's view is that the Commission should primarily focus on the cost of delivering new housing product for both owner-occupiers and as rental stock. The work that TCC has done on housing affordability in Tauranga shows that new housing stock is, in general, much more expensive than existing housing stock.

The price of new housing stock is also an appropriate 'lead indicator' of where house prices are likely to be heading. Focusing on aggregate house prices is likely to downplay the housing affordability issues facing the country – after all we can't adequately house a growing national population unless we as a country build more houses.

As an example of this point, the report title "Housing Stock and Housing Demand" prepared by Council staff in 2009 identified that based on household incomes the vast majority of households in Tauranga would be able to afford a house that cost somewhere between \$0 and \$400,000. Despite 63% of existing properties in Tauranga having a capital value less than \$400,000 only 34% of properties built in the last 5 years had a capital value less than \$400,000. Because the only way to increase the housing stock is to build more houses, the price of new houses is much more relevant to the price of existing houses in an area like Tauranga, Hamilton or Auckland where population growth is high.

There are two main aspects to the delivery of new housing – land development and dwelling construction. It would make sense to consider each of these separately and to focus on areas where there might actually be realistic chance of reducing the cost of new houses by a substantial amount. TCC has undertaken in-depth analysis of the cost of delivering new sections and new houses to market in partnership with the local development community and independent property development experts. The full project report titled Assessment of Development Feasibility for the Wairakei Urban Growth Area is attached to this submission. The following text in *italics* and shaded grey comes directly from that report:

### ***Housing affordability in Wairakei***

*The delivery of houses that are more affordable for middle to low income households to buy or to rent is likely to be an important component in whether residential development in Wairakei (and for that matter any other large scale growth area) is successful. However it seems very unlikely that a significant amount of affordable product can be delivered to these households.*

As noted earlier in this report, because most of the costs associated with delivering sections and houses are substantially fixed there are relatively few ways of delivering cheaper and more affordable houses. The only real ways to reduce costs are:

#### Land development

- More favourable land purchase terms<sup>1</sup> (price and/or timing of purchase)
- Delivering more sections by reducing the average section size
- Lower Council fees (especially subdivision impact fees).

#### House construction

- Building smaller houses
- Using lower cost building materials / specifications
- Lower Council fees (especially building impact fees).

#### Land price

The land price in the base financial model is \$350,000 per hectare based on land being purchased in yearly instalments or \$140,000 per hectare based on land being purchased up front at the start of the development. This is significantly less than the price residential development land sold for during the property boom years in the mid 2000's and because of this, property owners are likely to have expectations that their land is worth substantially more.

Despite this, land, like any other commodity, is only worth what someone is willing to pay for it. In this case the financial model indicates that these amounts are the absolute most a developer could pay for the land and that even at these amounts there is significant risk that development would not be viable. There is scope for these land prices to come back even further given the underlying value of the land for rural use is approximately \$50,000 per hectare.

Lower land price would enable developers to reduce section prices. For instance if the land prices adopted in the base model were reduced by 50%, section prices could be reduced by approximately \$20,000 incl. gst.

#### Section size

Due to a large proportion of fixed costs associated with residential subdivisions (e.g. roads, development contributions) if the average section size was reduced then it would be possible to deliver a lower average section price. For instance if the average section size was reduced from the base assumption of approximately 470m<sup>2</sup> (15 lots / ha)<sup>2</sup> to 390m<sup>2</sup> (18 lots / ha) then the average section price could be reduced by approximately \$20,000 incl. gst.

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<sup>1</sup> This relates to how much a developer pays for land and when settlement occurs.

<sup>2</sup> Calculated based on 30% of land being lot to roads, reserves and the like.

While this may seem like an obvious way to improve the affordability of houses in Wairakei (and elsewhere) there are likely to be significant challenges in changing consumers views about living on small lots especially in such a large scale on the fringe of Tauranga City. Because of this most major developers in Tauranga a wary of delivering significant numbers of small sections (300m<sup>2</sup> to 500m<sup>2</sup>) in new developments.

In addition, most or all of the cost savings would be lost if people still want to live in large houses on these small lots as this would require houses to be two storey. Two storey houses are significantly more expensive to build than one storey houses per m<sup>2</sup> of floor area.

### Development contributions

This includes both subdivision impact fees and building impact fees. These fees have a significant impact on the cost of new houses and if they were reduced the affordability of housing in Wairakei could be improved. As an extreme example if these fees would removed entirely then the cost of a house in Wairakei could be reduced by over \$40,000 + gst.

Because these fees are charged to pay for the cost of necessary infrastructure if they were reduced or removed the costs would still exist and Council would need to find an alternate funding source for the infrastructure. Direct developer funding is not an option as this would not improve the financial viability of the project. This leaves rates as the only realistic alternate funding source available to Council due to the lack of other funding sources available to local authorities in New Zealand.

A considerable amount of work has already been done by Council, in conjunction with developers, in order to reduce the cost of infrastructure required. Significant cost reductions have been achieved for instance through changes to road designs. Other projects, such as stormwater ponds will be delivered by developers on the basis that they believe that they can deliver them at a cheaper cost than Council could.

It may however be possible to further reduce development contributions by re-examining some of the significant infrastructure projects in Wairakei such as the interchange with the proposed Tauranga Eastern Link motorway and the design of stormwater network.

Another possibility is to use a targeted rate over properties that are developed in Wairakei to fund some or all of the growth-related infrastructure costs instead of using development contributions (either completely or in part). Council has undertaken some work on this idea. Given Council's long-term average borrowing rate, each \$1,000 reduction to development contributions would require a targeted rate of \$100 for a period of 20 years.

This implies that if targeted rates were used instead of development contributions they would have to be significant to have a material impact on the amount of development contributions payable. This is likely to have an adverse impact on the desirability of properties in Wairakei relative to the rest of the city as the total amount of rates payable in Wairakei would be much higher than the total amount of rates payable in other parts of the city (potentially multiple times higher).

### House size

*As stated earlier in this report a conservative average of 165m<sup>2</sup><sup>3</sup> has been used for the size of houses in Wairakei. There is probably little scope to reduce this further although it should be noted that in the early 1990's the average size of a new house was much smaller than this at only 140m<sup>2</sup>.*

*It should be noted that each additional m<sup>2</sup> of floor area can cost in excess of \$1,000 and as such reducing the size of a house substantially can reduce the cost of building it substantially. This is significantly less than the average m<sup>2</sup> building costs. This is because there is not a linear relationship between house size and construction costs. In other words, if the size of a house is reduced by 50% the cost of construction will not reduce by 50% but by a somewhat lesser amount due to the fact that there are a number of reasonably fixed costs in rooms like kitchens and bathrooms that tend not to vary as the overall size of a house fluctuates.*

### Building materials

*The type of building materials and building specifications used can have a significant bearing on the final cost of building a house. For instance using plaster over brick rather than just plain brick for the house cladding can add over \$10,000 to the cost of a house.*

### Conclusion

*Given the extent of the challenge to deliver new housing that is affordable to lower and middle income households a combination of all or most of the factors discussed above would need to be adopted. This would involve Council considering its position on affordable housing and its role in delivery it. Given that the most significant impact that Council has on the cost of housing is through development contributions by necessity this would involve a review of the appropriateness of Council's growth pays for growth philosophy.*

It should be noted that a number of the issues the Commission has outlined in its Issues Paper were assumed as givens in TCC Wairakei development feasibility work. These issues include: the productivity of the building industry, the cost of building materials, the tax treatment of housing and the availability of finance. TCC supports the Commission looking further into these issues.

### The cost of new houses influences the cost of existing houses

TCC's work on housing affordability also suggests that the high cost of new housing stock, especially the land component of new housing, may go a long way to explaining why the cost of the all houses has increased so much in the previous decade.

The median section price in Tauranga has increased from about \$90,000 in 2003 to a current median of approximately \$170,000. In a number of the subdivisions in Tauranga where sections are currently for sale, the average asking price for a section is \$200,000 or higher.

As section prices rise it is logical to suggest that the land value component of the existing housing stock will also increase, after all an existing house is only a section

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<sup>3</sup> It should be noted that the average size for new houses in New Zealand and in Tauranga is approximately 210m<sup>2</sup>.

that already has a building on it. The following conclusions drawn from Council research seem to support this hypothesis:

- Between 1997 and 2009, 75% of the increase in the capital value<sup>4</sup> of the 30,000 dwellings that existed in Tauranga as at 1997 related to the land value component<sup>5</sup>.
- Over this period the total land value associated with these properties increased by an average of 181% compared to an increase of only 41% for improvements.
- In 1997, land value made up only 40% of capital value of these 30,000 properties
- By 2009 this had increased to 60% of capital value of these properties.

While this does not prove that increased section prices cause the land value component of the existing housing stock to rise, it certainly suggests that this may be true. If it were true, a large part of the increase to aggregate house prices in Tauranga (and in other locations) over the 2000's could very well be explained by the increasing market price for new sections being embedded in the land value component of the existing housing stock. It would also mean that the affordability of Tauranga's entire housing stock, not just new housing stock, depends, to a significant degree, on section prices in new subdivisions.

Likewise, the cost of residential construction is now much higher than it was in the past. In a similar way, this may cause the value of the existing housing stock to be revalued upwards. However the impact of this on value of the existing housing stock is likely to be more muted than the impact of recent increases to section prices because a) construction costs have increased by much less than section prices have and b) houses depreciate in value unlike land.

TCC urge the Commission to test this general hypothesis given the far reaching effects it would have if it were to hold true in relation to understanding the housing affordability and addressing it.

#### A focus on low incomes or a broader focus

Given that the cost of new housing is unaffordable to many working class and middle class households, TCC is of the view that the Commission should take a broad view of the issue of housing affordability rather than having a narrow focus on the effects of housing affordability on low income earners. After all, as a country New Zealand cannot just expect to build houses just for those on high incomes or those who already have significant equity as we are pretty much doing at the moment. Given New Zealand's population growth, this would create significant housing shortages and have far reaching social effects.

#### Owning vs. renting

TCC is encouraged by the Commission's Issues Paper covering both owner-occupied housing and rental housing. The research that Council has undertaken suggests that there is a huge disconnect between the cost of delivering new houses and what a rental investor could afford to pay for a new house to make it a sensible investment choice. This research involved the development of a financial model for the calculation of the value of a house to a prospective rental investor. TCC would

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<sup>4</sup> Capital value is made up of both land value and improvements (e.g. buildings such as houses).

<sup>5</sup> Based on valuations for Council rating purposes.

be happy to share this model with the Commission if it would be of any assistance. A summary of TCC's research on rental investment is set out below in *italics* and shaded **grey**. It is from the Wairakei development feasibility project report which is attached to this submission.

## **House prices and rents**

### **House prices**

*As identified earlier in this report Council has undertaken some research into housing affordability in Tauranga. This research indicates that new housing needs to be delivered between \$300,000 and \$400,000 to be affordable to a large part of the city's residents. The builders and developers that Council has been working with in this project have consistently voiced the same opinion.*

*The Table below shows the likely range of house prices in Wairakei. They are based on section prices used in the financial model and building costs provided by the local building industry. They are considered to be a reasonably accurate reflection of current average development costs. In reality prices will vary somewhat (especially upwards) based on factors such as the type of building materials used and the quality of the fit out. It should also be noted that 'spec' homes are likely to be more expensive than the prices in the Table below as discussed earlier in this Report.*

**Table 6: Likely range of house prices in Wairakei**

<b>Section size</b>	<b>House floor area / type</b>				
	<b>120m<sup>2</sup></b>	<b>140m<sup>2</sup></b>	<b>160m<sup>2</sup></b>	<b>180m<sup>2</sup></b>	<b>200m<sup>2</sup></b>
	<b>2 bedrooms</b>	<b>2-3 bedrooms</b>	<b>3 bedrooms</b>	<b>3-4 bedrooms</b>	<b>4+ bedrooms</b>
<b>300m<sup>2</sup></b>	\$340,000	\$360,000	\$380,000	n/a	n/a
<b>400m<sup>2</sup></b>	\$355,000	\$375,000	\$395,000	\$420,000	\$440,000
<b>500m<sup>2</sup></b>	\$385,000	\$405,000	\$425,000	\$450,000	\$470,000
<b>600m<sup>2</sup></b>	\$410,000	\$430,000	\$450,000	\$475,000	\$495,000
<b>700m<sup>2</sup></b>	\$430,000	\$450,000	\$470,000	\$495,000	\$515,000

*Note: Prices include gst at 15%.*

*The Table indicates that a modest / basic three bedroom house with probably a single garage could be built for \$400,000 or less on sections in Wairakei up to about 500m<sup>2</sup>. A standard three bedroom house with double garage could be delivered for \$400,000 or less on sections up to about 400m<sup>2</sup>. Larger houses and/or small houses on larger sections would cost in excess of \$400,000 to deliver.*

*Based on an estimated distribution of section sizes in Wairakei and a distribution of house sizes based on an overall average floor area of 165m<sup>2</sup> per house, the Table below provides a general indication of how many houses are likely to be delivered in each price range. Based on this information the average house price in Wairakei is estimated to be about \$435,000. Although, again, it is likely to be higher than this is a significant amount of 'spec' homes are built.*

**Table 7: Likely distribution of house prices in Wairakei**

Price range	Proportion of houses
<\$300,000	0%
\$300,000 - \$350,000	4%
\$350,000 - \$400,000	29%
\$400,000 - \$450,000	13%
\$450,000 - \$500,000	51%
\$500,000 - \$550,000	3%
>\$550,000	0%

Note: These prices include gst at 15%. The 5% of residential product in Wairakei that is likely to be attached rather than detached (e.g. duplexes, terraced housing, apartments etc) has been ignored due to greater uncertainty about its likely price.

It should be noted that the assumption of 165m<sup>2</sup> for the average house size is conservative. To put it in context the average size of new houses across New Zealand is currently 206m<sup>2</sup>, in Tauranga it is about 210m<sup>2</sup> and in the large scale and reasonably upmarket subdivision in Tauranga called The Lakes which is partly developed, 236m<sup>2</sup>. If for instance the average floor area assumption for Wairakei was increased by 40m<sup>2</sup> to the national average it would push the average house cost up by approximately \$40,000 or to an average of approximately \$475,000 or more if a significant amount of 'spec' homes are built.

### Rents

Given the trend away from home ownership to renting that has gone hand in hand with the large house price increases over the last decade, consideration has been given to the likelihood of houses being built or purchased as rental investments in Wairakei. This was done by calculating the net present value of the costs and revenues associated with rental property ownership.

Based on the assumptions in the Table below it is estimated that the weekly rent required for investment in a three bedroom house costing \$400,000 to be financially viable would be \$455 / week. To put this in context, the current upper quartile rent for a three bedroom house in Papamoa is \$360 / week<sup>6</sup>.

Refer to Attachment D for further information about current rents in Papamoa and rents that would be necessary for property investment to be viable in Wairakei based on the assumptions in the Table below.

<sup>6</sup> Source: Department of Building and Housing.

**Table 8: Assumptions used to calculate acceptable weekly rental payment for investor**

<b>Variable Description</b>	<b>Value</b>
Marginal Tax Rate	33.0%
House Price	\$400,000
Rate of inflation	2.80% p.a.
Long run capital gain on property	4.80% p.a.
Mortgage interest Rate	7.50%
Acceptable return (discount rate for NPV calculation)	8.80%
Tax deductible maintenance costs as a proportion of capital value	3.15%
Proportion of debt funding	80.00%
Term of mortgage (years)	15
Mortgage type	Interest only <sup>7</sup>
Length of investment (years)	15
Selling costs (% of sale price)	3.00%
No. of weeks property empty / year	2

To put it another way, based on these assumptions, an investor would be prepared to pay approximately \$320,000 for a three bedroom house if the expected rent is \$360 / week. Given the cost structure of subdivision and construction in Wairakei it is not possible to deliver a three bedroom house at this price.

Based on this information it has been concluded that the likelihood of rental investment underpinning a strong demand for sections and houses in Wairakei is very remote. If it were to happen it would be reliant on rental income being significantly higher than it currently is and/or expected capital returns being significantly higher (at least 5.7% p.a.) than the 4.8% per annum assumption above.

In regards to capital growth, it should be noted that at 4.8% per annum a \$400,000 house would be worth \$1,000,000 in 20 years time. Even this may seem optimistic given the significant rise to household incomes that would be required to sustain this. With year on year capital growth of 5.7% a \$400,000 house would be worth \$1,000,000 in about 17 years. The Table below shows how housing affordability is likely to decline significantly from today's levels based on these scenarios for capital growth, assuming an annual growth rate of 3.2% for household incomes. 3.2% is the national average growth rate for household incomes over the last 20 years<sup>8</sup>.

<sup>7</sup> If a table mortgage was used instead of an interest only mortgage then rents would have to be substantially higher. Interest only mortgages are relatively commonplace for property investment but maybe not for a period as long as 15 years. As such the rents calculated by using this model are likely to be on the low side of what would actually be required to make property investment a viable proposition.

<sup>8</sup> Source: Statistics NZ care of Covec report for Tauranga City Council titled *Development Contributions Policy: Assessment and Review*.

**Table 9: Impact of various capital growth scenarios on housing affordability**

<b>Year</b>	<b>House price</b>	<b>Annual capital growth</b>	<b>Median household income in Tauranga</b>	<b>House price to income ratio</b>
2010	\$400,000	n/a	\$51,900 <sup>9</sup>	7.7
2027	\$1,000,000	5.70%	\$88,650	11.3
2030	\$1,000,000	4.80%	\$97,450	10.3

## **Attachment D**

### **CURRENT RENTS AND NECESSARY RENTS**

The Table below shows the current rents in Papamoa based on information collected by the Department of Building and Housing from tenancy agreements. It should be noted that Papamoa is characterised mainly by good quality houses that were built in the 1990's and 2000's.

#### **Current rents in Papamoa, Tauranga**

<b>Dwelling type</b>	<b>Bedrooms</b>	<b>Median</b>	<b>Upper quartile</b>	<b>Standard deviation</b>
House	2	\$267	\$295	\$47
House	3	\$320	\$360	\$63
House	4	\$395	\$420	\$55

It is likely that new houses would achieve rents more in line with the upper quartile rather than the median.

The Table below shows the actual rents that are likely to be necessary for property investment in Wairakei to be viable based on the assumptions in Table 8, section 7.3.8 of this Report and the likely house prices for Wairakei as per Table 6, section 7.3.2 of this Report. It should be noted that these rents are in today's dollars and are assumed to increase at 2.8% per annum on a compounding basis.

It should also be noted that the rents identified below may be on the low side given the assumption that interest only mortgages instead of a standard table mortgage would be available over the lifetime of the investment (15 years).

<sup>9</sup> Source: 6<sup>th</sup> Annual Demographia Housing Affordability Survey (<http://www.demographia.com/dhi.pdf>).

**Rents likely to be necessary for property investment to be viable in Wairakei**

Section size	House floor area / type				
	120m <sup>2</sup>	140m <sup>2</sup>	160m <sup>2</sup>	180m <sup>2</sup>	200m <sup>2</sup>
	2 bedrooms	2-3 bedrooms	3 bedrooms	3-4 bedrooms	4+ bedrooms
300m <sup>2</sup>	\$385	\$405	\$430	n/a	n/a
400m <sup>2</sup>	\$400	\$425	\$445	\$475	\$500
500m <sup>2</sup>	\$435	\$460	\$480	\$510	\$530
600m <sup>2</sup>	\$465	\$485	\$510	\$535	\$560
700m <sup>2</sup>	\$485	\$510	\$530	\$560	\$585

As is evident, there is a large gap between what rents currently are and what they would need to be for property investment to be a viable proposition in Wairakei.

**Q2: Does this stylised framework (Figure 1) capture all the important determinants of housing affordability? Are there others that are important?**

Figure 1 covers most of the important supply and demand aspects that influence housing affordability. However there are some notable omissions from the supply side that relate to the cost of delivering new housing. These are:

- The cost of developable land and how it is purchased (upfront, delayed settlement, in multiple stages etc)
- The size of sections (smaller sections permit prices to be lower)
- Profit margins necessary to secure project finance
- The size of new houses
- Type of building materials used
- Building specifications and design
- Restrictive covenants
- The time period from project commencement to having all section sold (this can have a huge impact of holding costs especially if large upfront costs are incurred) – refer to pages 30 & 31 of the Wairakei development viability report.

**Q3: Is there a more appropriate framework for examining the housing market and issues of affordability?**

As mentioned above, TCC view is that Commission should focus primarily on the cost of delivering new houses. In doing this TCC suggests that the Commission should:

- Separate the issues of land development and dwelling construction;
- Identify the aspects of the cost structure of both land development and dwelling construction that are a) significant and b) could potentially be reduced and focus on these.

TCC's view is there would be little to gain in focusing significant attention on the price of the existing housing stock. If the cost of delivering new housing stock can be

reduced then this should naturally flow through the value of the existing housing stock.

TCC also urges the Commission to consider the impact of cost of delivering new houses on the quantity of rental housing stock and the cost of renting. This issue has received little attention to date in the debate about housing affordability but TCC's research indicates that it is a major issue.

### **Recent trends in housing markets**

#### ***Q4: What factors have caused recent housing price increases? Are some of them temporary?***

As mentioned earlier in this submission, TCC's view is that the largest single driver to the increase in aggregate house prices in recent times has been the huge cost increases to delivering new residential dwellings. In TCC's view these cost increases have worked their way into the price of all houses, not just new houses.

There are numerous reasons why the cost of new sections and houses has increased. These include:

#### Sections

- Higher prices being paid for developable land
- Higher infrastructure charges
- Higher costs of subdivision infrastructure
- Higher cost of project finance

#### House construction

- Larger houses
- Higher materials costs
- Higher labour costs
- Use of more expensive building materials, building specifications and house designs (often dictated by restrictive covenants imposed by developers)
- Higher standards due to government regulation e.g. compulsory insulation.

#### ***Q10: How should affordability for home buyers/owners be defined and measured, both in principle and in practice (taking account of data availability)? Is it possible to assess affordability using a single measure?***

TCC is reasonable comfortable with price to income measures. However in addition to measuring housing affordability at an aggregate level across NZ or in different regions / cities, TCC would like to see a specific measure for the affordability of new housing developed. This could be based on a price to income basis but using only sales data for new houses e.g. houses less than 5 years old perhaps.

***Q14: How should affordability for renters be defined and measured, both in principle and in practice (taking account of data availability)? Is it possible to assess rental affordability using a single measure?***

General comment – rental housing

TCC notes that it seems to be generally assumed that housing affordability is really only a significant issue for those wishing to buy a house and that there is no fundamental housing affordability problem in relation to rental housing as there is, and always will be, a sufficient supply of appropriately priced houses for rent that can cater for those not in home ownership.

The problem with this view is that someone ultimately needs to own each house and that if property investors are going to buy new houses then market rents in places like Tauranga are going to have to increase at many times the rate of income growth for this to occur.

From the work that TCC has done, if market rents don't rise substantially the prospect of rental investment underpinning strong demand for new sections and houses is remote meaning that the supply of rental stock will be significantly constrained.

If market rents do rise they will place significant pressure on the finances of many households and materially reduce many households standard of living. This is already the case in Auckland as documented in the November 2010 CHRANZ report "Auckland Region Housing Market Assessment: 2006-2026". That report notes that 49.9% of all private renter households are experiencing financial housing stress. The report defines housing stress to be households that spend more than 30% of their gross household income on housing costs (i.e. rent).

***Q17: Are the current rental affordability trends likely to persist, or are they temporary?***

As discussed above, TCC's view is that at some point in the near future market rents, especially for new housing stock, are going to have to increase by a large amount in real terms in places like Tauranga where population growth is high and current market rents are not high enough to make rental housing a worthwhile investment (even assuming reasonable capital growth at about 5% p.a.).

**Urban planning, design and land use policies**

General comment – urban limit policies

The majority of the questions in this part of the Issues Paper relate to land supply and therefore to urban limits policies. The TCC staff view on urban limits is set out below. It is an adaption of thoughts in the Wairakei development feasibility report which is attached to the submission.

Introduction: Urban limits in Tauranga

Tauranga City Council like many other cities has identified certain areas where urban development will be allowed and other areas where it will not be permitted in its long-term growth management strategy (SmartGrowth). The boundaries between these two areas are what are known as the urban limits. Tauranga's urban limits identify land that can be developed for urban purposes now and land that is anticipated to be

rezoned for urban development in the short and long-term (out to 2050). It is fair to say that some readily developable land close to the city has not currently been identified for urban development in the short term or the long term. The reason it has not been identified for urban development is that sufficient other land has been identified to meet the anticipated growth of the city, or land is multiple-owned Maori land and tangata whenua have expressed reservations about such land being alienated through the pressures of urban zoning and rates.

### Arguments against urban limits

There is an argument that urban limits are the primary reason why new housing is so unaffordable or that these limits are at least a significant factor that contributes to the high cost of new housing. The argument goes that urban limits constrain the amount of available land for development and this in turn gives market power to the owners of this developable land who are able to extract high prices when selling to developers. In addition, developers who own land within the urban limits have increased market power because competition (or the threat of competition) is limited and because of this they are able to sell sections at prices significantly above what would exist in a more competitive market (i.e. they are able to make profits that are higher than would be sufficient for development to occur).

It is conceivable that the arguments above have at least some merit, especially in situations where the market demand for sections exceeds supply within the urban limits, i.e. in circumstances where urban limits are a binding constraint on development. This is certainly not the case in Tauranga where there is sufficient zoned and serviced land to meet many years of demand. In addition, Council plans to rezone significantly more land for development in the immediate future which includes land in Wairakei, Northwest Bethlehem and Pyes Pa West (these being part of the SmartGrowth, long term approach). Council also has a capital works programme that provides for the timely servicing of this land to allow development to proceed.

### Infrastructure servicing: De facto urban limits

TCC does not argue that urban limits do not affect the price of land for development or the sales price of sections, nor does it argue that it has only a relatively small impact on these things. TCC wishes to point out that if urban limits were removed it is likely that the situation in regards to the amount of land available for development would probably not actually change very much due to infrastructure servicing constraints. Therefore rather than urban limits actually being the problem the underlying cause of this problem is infrastructure servicing and this is where discussion and debate should be focused.

All urban development whether it be residential, commercial or industrial requires water, wastewater, stormwater and road services. TCC is not referring to localised services supplied within a subdivision itself but the aggregated bulk / trunk services to new growth areas. To service large new development areas these services come at considerable cost. In many instances these costs include:

- Significant costs to get water and wastewater pipes to the boundary of a growth area<sup>10</sup>.

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<sup>10</sup> For development bordering the existing urban fringe of a city there is often roads and pipes right up to this boundary. However these roads and pipes generally have not been designed

- Significant lead infrastructure that needs to be built at or near the start of a large development that will take many years to complete.
- Major costs to connect local roads to the State Highway network or major arterial roads.

These costs generally fall on councils to fund via loans, rates, development contributions and other funding sources because councils are the logical coordinator of such bulk services. Councils, especially high growth Councils with significant debt like Tauranga City Council, only have so much fiscal capacity to incur these sorts of costs. Generally decisions have to be made to focus growth into a relatively small set of defined areas to ensure that Councils can maintain a sound financial position and that infrastructure is used efficiently. Because there is only a finite amount of growth, if significantly more land is serviced than there is demand to develop significant unused capacity will exist in infrastructure networks for a long period of time.

There may be some scope for developers to directly fund these bulk infrastructure costs however due to the significant dollar amounts involved, the high level of risk and the long payback periods there are few, if any, developers who are in a financial position to contemplate this, let alone to be able to source finance to actually do it on a significant scale.

As such, it is the view of TCC staff that whether urban limits are drawn on a map or not they will always exist (although maybe not quite to the same limiting extent<sup>11</sup>) due to financial and other constraints associated with the servicing of greenfield land on the city fringe. If this view is accepted (and it is the view of TCC staff that it should be) it brings into question the validity of the argument that urban limits have a significant impact on new housing costs (at least in circumstances where there is ample land within the urban limits to easily satisfy demand in the foreseeable future).

#### Land purchase: Not the only cost

It often seems to be assumed that the cost of land is the sole, or at least the major, determinant in the cost of delivering developed sections. In almost all instances this is not actually the case. The costs involved in delivering developed sections include civil works (earthworks, roads and other services), consultants, development contributions, other Council costs, marketing and sales costs, legal costs, interest costs and (to the purchaser) gst. For the most part it would be expected that land purchase costs would be a relatively small portion of total development costs. On this basis land purchase costs should not be the overriding factor in the cost of delivering sections to the market. This needs to be remembered when considering the impact of urban limits on new housing costs because urban limits have no direct impact on these other cost items.

#### Conclusion on urban limits

Land costs can have a significant impact on the cost of delivering new houses and in many cases there is significant scope for land prices to come back due to the premium that is (or has been) paid above the underlying rural values. The TCC staff view is that removing or freeing up existing urban limits would have limited (if any)

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to cater for significant growth meaning that additional infrastructure capacity generally has to be built for substantial new developments that border the existing urban fringe.

<sup>11</sup> For example, some small scale developments directly on the urban limits boundary may be able to occur without the need for significant infrastructure investment.

impact on new housing costs unless the issue of infrastructure servicing, primarily the funding of it, is also tackled at the same time. This is because infrastructure servicing constraints will act as de facto urban limits even if formally adopted urban limits are removed from a regulatory framework.

### Disclaimer

It should be noted that financial constraints are one of a number of policy reasons that contributed to the urban limits that have been adopted in Tauranga. These wider policy considerations (such as rural productivity and social impacts) are well documented in the SmartGrowth Strategy for the western BOP sub region. As such, even if the financial issues associated with infrastructure servicing were resolved or reduced Council does not necessarily support removing or freeing up urban limits.

### ***Q28: What are the relative costs and benefits of intensification and expansion (greenfields development) to urban planning? What research literature and overseas developments are most relevant to New Zealand?***

There are a number of costs and benefits of both intensification and greenfields development. TCC does not intend to traverse them all however there are a few points that TCC considers are worth making.

Firstly, the cost of providing infrastructure to service intensification is generally significantly less than the cost of providing infrastructure to service greenfield development. In many cases intensification can occur without any further infrastructure investment due to surplus infrastructure capacity existing. Given this financial reality intensification is a popular growth policy idea with most urban Councils.

Secondly, while intensification is still an integral part of Tauranga's growth strategy there is a number of significant challenges that need to be resolved for it to occur on any real scale. These include:

1. The lack of any large scale redevelopment sites (brownfield sites). Because of this there is a need for site amalgamation and for the destruction of significant capital improvements (e.g. existing houses). This is a significant hurdle for intensification projects. Capital improvements are lowest in lower decile suburbs but there is little demand for intensive living in these suburbs and it would necessitate the removal of some of Tauranga's lowest price and therefore affordable houses.
2. More intensive residential development often involves building upwards. The cost of doing so compared with building single level dwellings is much higher. This is especially true for medium to high rise development with concrete and steel construction and underground car parking. A significant density increase is required to overcome these costs.
3. The final cost of intensive housing product often means that it is only affordable to the upper / luxury end of the market. An intensive product may not compare favourably with the cost of alternatives to this market e.g. detached dwellings unless there is a market premium such as for views or coastal location.
4. Development finance is relatively expensive and difficult to obtain for this type of housing product.

5. Mortgage lending criteria is substantially tighter for this type of residential product. In particular, minimum deposit requirements are much greater. This reduces the pool of people who can afford this type of product compared to a detached dwelling at the same price.
6. Like several other NZ councils TCC has experienced significant community resistance to proposals for large scale intensification projects in existing, well established suburbs. Existing property owners seem to jealously guard their existing and foreseeable 'suburban' amenity which they perceive as threatened by the process of replacement of existing dwellings with much more intensive residential housing typologies.

***Q29: How do these different approaches to urban planning support competitiveness and economic growth?***

TCC believes these policy issues are well documented in existing literature and form part of the support for a long-term, realistic urban growth strategy such as SmartGrowth. Over the last 20 years TCC has endeavoured to support a range of development opportunities within both inner city and greenfield areas; and considerable investment in major infrastructure, not without a considerable economic cost to ratepayers.

The long term view is that this provides as strong economic base for the city and its role and function within the upper north island. Successive 10 Year Plans and annual plans under the LGA 2002, and other key tools such as Regional Land Transport programmes provide the mechanism for community discussion on the priorities for capital investment, and these work in conjunction with the city plan as the regulatory instrument. Urban planning is a lot more than just policies and rules in a district plan.

***Q30: To what extent do these different approaches to urban planning support environmental objectives?***

Again, TCC believes these policy issues are well documented in existing literature and in the SmartGrowth Strategy. Being a coastal city, a significant part of the council's investment on large-scale infrastructure, such as stormwater management and sewerage treatment, is to meet environmental objectives set at either national or regional level. Capital investment in such infrastructure needs a long term, consensus view of what, how, when and where a city will grow so that the best return can be gained from such investment.

***Q31: In New Zealand, do home owners prefer living in dense urban settlements or less dense suburban developments? What are the reasons for this preference?***

Again, TCC believes these policy issues are well documented in existing literature and in the SmartGrowth Strategy. TCC monitoring of development trends within the city indicates that a range of living opportunities will be used by people indicating a range of preferences according to individual and household circumstances. There is no black and white 'preference'. A general trend is that section sizes are slowly reducing but also so are household sizes. House sizes (floorspace) do not appear to be mirroring that trend, which may influence the cost of housing.

***Q32: Has there been a reduction in the rate of land release, either at the urban fringe or in in-fill areas? If so, why?***

TCC continues to release land at a rate that ensures that many years supply is available for development at any one time. This fundamental approach has been in place since the early 1990's

The experience of TCC over the last 20 years of growth management is that it has aimed (and largely been successful) in maintaining a good supply of serviced urban land for residential, business and recreational purposes. But, this has come at a considerable cost in terms of council debt levels, and is particularly vulnerable to economic downturn, such as the current global financial crisis..

***Q33: Are local authorities' land release policies enabling or constraining the supply of land for development?***

This answer to this question is both yes and no.

No, in the sense that TCC ensures that sufficient, serviced land is available at any one time to meet many years supply.

Yes, in the sense that more land could be released for development if the financial costs and constraints of servicing land with appropriate infrastructure didn't exist. These financial costs come in three forms: Firstly, the direct financial cost of having to provide more infrastructure. Second, the on-going operating costs associated with this additional infrastructure. Thirdly, additional interest costs on debt that has been incurred on other growth related infrastructure.

This third cost arises because some growth is diverted from existing growth areas to new growth areas. There is a finite level of sustainable growth as Tauranga competes with other growth areas. This in turn diverts infrastructure contributions from paying off existing infrastructure in existing growth areas, to paying off new infrastructure in new growth areas. Because interest costs form part of infrastructure charges, the additional interest costs mean that these charges would naturally increase.

A reasonable question to ask would be whether developers could play the facilitating role of providing **bulk** infrastructure instead of Council? In Tauranga, this is not realistic given the high cost involved (\$10's-\$100's million), the fact that these costs are often 'front loaded' at the beginning of a development prior to positive development cashflows, the need to secure cost sharing agreements amongst multiple land owners / developers, and the difficulty of obtaining project finance.

For example, The Lakes residential development of over 2,000 residential sections in Tauranga was based on a model where the developer was to provide the bulk infrastructure costing tens of millions of dollars instead of the Council. This infrastructure was built but the development is now in receivership. The up front bulk infrastructure costs were a significant factor in this receivership together with the downturn in demand.

***Q34: What is the likely minimum lead time for release and development of new land and housing?***

TCC has had considerable experience in opening up new urban growth areas in the last 20 years. That experience indicates that a rezoning process under the RMA (by

way of plan change) can take from 4-10 years, depending on the level of complexity and/or opposition. After that, development of fully zoned and planned infrastructure land would occur as and when demand dictates.

***Q35: Is land release delayed unnecessarily either by inadequate supply of infrastructure services or a lack of responsiveness on the part of infrastructure service providers? If so, to what extent is this affecting development costs?***

As noted above, TCC has limited financial resources to provide bulk infrastructure. As such, there is a need to balance land release against the efficient provision and use of existing infrastructure. While this results in sufficient land being available to accommodate the city's growth it does mean that land controlled by some developers currently is not serviced and is therefore not developable.

***Q36: Are the planning policies that are designed to encourage higher density housing consistent with, and flexible enough to accommodate, changing community preferences?***

Theoretically yes, if sufficient density can be achieved. A range of housing styles provides a range of housing choices to suit different household needs. In reality, TCC research indicates that the economics of higher density housing are complex and the proposition (at least in non high-amenity areas) appears to be risky for councils, lending institutions and developers.

Recently Tauranga's development community has expressed significant reservations about the delivery of higher densities in greenfield development areas at or above 15 lots per hectare which is greater than the historic delivery of about 9-12 lots per hectare. This is due to their perceptions about market demand and preference, which they interpret as not supporting a policy shift towards higher densities and more efficient use of urban land.

***Q37: Is there evidence of 'land banking' by some developers? Is this a problem?***

In Tauranga City there is significant evidence of land banking by a few developers. Most large parcels of land that will be earmarked or zoned for urban development in the next 20 years are either owned or otherwise controlled by a relatively small number of developers.

TCC has no direct evidence that this is creating a supply problem but it certainly has the potential to be a problem if these few developers are able to exert market power by constraining supply and increasing prices to maximise profits.

At the moment there is significant excess supply of developed sections in Tauranga and as a consequence the construction and release of additional developed sections is slow.

***Q38: Is the current planning regulatory system more complex and fragmented than it needs to be? Does the planning system include elements that detract from quality urban development and impose unnecessary costs and uncertainty on developers?***

As a general observation localised planning responses to the RMA requirements appear to be complex and complexity imposes costs on all sectors. The RMA itself raises expectations for environmental and heritage outcomes (Part 2 of the RMA),

and in community participation (consultation, submission and appeal rights). Urban quality matters are not well addressed – in fact urban is not really mentioned at all, yet over 80% of NZ's population live work and play in urban areas.

Hence most council's take a risk adverse approach to plan making or development activity decision making.

Even liberal district plans (and the TCC operative plan is seen as one of these) imposes costs as it tries to balance flexibility for activity with certainty; for not only developers – but the local communities who are affected by new development.

***Q39: How could urban planning and development be improved to better integrate strategies for land use, economic development, transport and infrastructure?***

By working in a coordinated and collaborative manner, as demonstrated by the western BOP SmartGrowth approach.

***Q40: Do local authority planning schemes and approval processes create unnecessary costs? If so, how could they be improved?***

This is a complex question. It has partly been answered in Q. 38 above. TCC also made an extensive submission to the MFE discussion document “*Building Complete Cities*” that has comment on this type of question.

If it was easy, costs and benefits would be in perfect harmony. The reality is that urban areas are complex and the interests of sectors within that urban system are often conflicting and competing with each other. There is no “one size fits all”.

There would be benefit in:

- clearly establishing national policy expectations for the subdivision, use and development of urban areas;
- in reducing the compliance costs with meeting RMA requirements (simplify the policy objectives in Part 2 and participation expectations throughout but particularly in Schedule 1)
- making the links between the LGA, RMA, Building Act and LTA explicit.
- reducing the planning process complexity and costs around public works projects.

Discussions with the development sector in Tauranga have identified concerns about high compliance costs and time delays in relation to resource consent and building consent processes. Council has made a commitment to work through these issues with this sector.

However, the Council is aware that planning policy needs to have regard to the interests of the wider community as well as the development sector.

***Q41: Do external or third-party appeal mechanisms unnecessarily delay planning approvals?***

The simple answer must be yes. The appeal costs for NZ generally are significant for all players. The time and cost delays arising from appeals in the plan making process under schedule 1 RMA need to be seriously looked at. There has to be more sanctions against frivolous and vexatious appeals.

On the other hand it is acknowledged often third parties can raise matters that lead to a better development outcome through negotiation and discussion. And, there are some development proposals that simply are not worthy of approval, and these do need to be tested through a decision making process with associated costs to all parties with an interest in that proposal.

## **Infrastructure charges**

### **General comment**

TCC supports the continued ability of local authorities to require infrastructure charges in the manner that currently exists. Council however acknowledges that infrastructure charges, as with any type of funding mechanism, do have downsides. As such, TCC also would fully support the consideration of other growth funding approaches which could fully or partially offset the need to require infrastructure charges.

To ensure a balanced debate is had on the merits of infrastructure charges, the TCC experience is that without them some local authorities may not be in a fiscal position to deliver as much growth infrastructure as they currently do due to a lack of alternate funding sources and due to the likelihood that ratepayers would not be willing to have rates increases to fund additional growth-related infrastructure costs.

As such, the effects on housing affordability of not having infrastructure charges might in some cases be significantly greater than the direct effect that infrastructure charges have on the cost of new dwellings. For example reduced infrastructure investment might constrain land supply and push the cost of developable land and developed sections upwards.

### ***Q42: What infrastructure costs should be recovered through infrastructure charges? Should the costs of providing services such as schools, parks and libraries be recovered via infrastructure charges?***

Presently the capital cost of parks and libraries that relate to growth can be recovered through infrastructure charges but the cost of providing schools cannot. Schools are provided by central government and are funded through general taxation.

TCC supports the retention of Council's ability to fund growth related park and library capital costs through infrastructure charges. If Council was no longer able to do this it would have to either increase rates to fund these costs or decide not to provide this infrastructure. Sustainable urban communities require social infrastructure as well as 'pipes' and 'roads'.

TCC does not support the collection of infrastructure charges to fund the cost of building new schools. This would further increase costs to the residential development sector making housing even less affordable. Instead of imposing more central government funded costs onto local communities TCC supports the opposite – a greater central government contribution to key local infrastructure projects that provide capacity for the sustained growth and development of New Zealand's urban communities and economies. After all, these projects have a critical role in growing New Zealand's economy and increasing government tax revenue.

***Q43: Are current infrastructure charges justified by the efficient cost of providing services? Is there evidence of over-recovery of infrastructure costs?***

TCC view is that the debate of the economic efficiency of infrastructure charges is complex. A general point is that they result in infrastructure costs being borne by those that cause them. As such, they must in at least one sense be efficient.

TCC's infrastructure charges are set on a full cost recovery basis i.e. the charges are set at all level so that in theory all the costs allocated to growth funding are recovered through infrastructure charges.

In practice this is often not the case and for various reasons under-recovery (rather than over-recovery) occurs. Presently, TCC is working through the transfer of over \$30m of historic under-recovery relating to infrastructure charges from growth funding to rates funding.

It should be noted that any reduction to the ability of Councils to require infrastructure charges would mean that alternate funding sources for these costs would be required. As such, the debate about infrastructure charges cannot be had in isolation from the broader debate about local government funding sources.

***Q44: Is the basis for calculating infrastructure charges transparent? Is it subject to undue discretion by local authorities?***

TCC is completely transparent in how it calculates its infrastructure charges. TCC's Development Contributions Policy of approximately 300 pages contains a full explanation of the methodology, assumptions, growth funded projects, cost allocations and cost estimates that have been used in the calculation of TCC's infrastructure charges.

The downside of this type of complete transparency is complexity. It would be fair to say that Council's Development Contributions Policy itself would not be easily understandable to the average person on the street, but it well understood by the development sector and advisors active in city development.

***Q45: Are there different regional or local features that justify different approaches to when and how to apply infrastructure charges?***

TCC's view is that at a high level there should be consistency between how infrastructure charges are calculated and applied across New Zealand. It is also TCC's view that the current framework of the LGA 2002 provides adequately for this.

At a more detailed implementation level there may be different regional or local features that justify different approaches to when and how infrastructure charges are applied. For example TCC currently split its infrastructure charges between land development (subdivision) and the subsequent construction of buildings.

At the subdivision stage infrastructure charges are payable for local infrastructure that services the particular growth area that a development is located in. The rationale for this is that local infrastructure must be in place to allow subdivision to occur.

At the building construction stage infrastructure charges are payable for city-wide infrastructure i.e. infrastructure that services the whole city regardless of its location.

The rationale for this is that city-wide infrastructure capacity only needs to be in place when the increased infrastructure demand from growth actually arrives.

This approach of splitting infrastructure charges between land development and construction is unique to TCC. Other Councils generally choose to take all infrastructure charges at the first opportunity (subdivision). There are different but equally valid reasons for doing this.

In addition to this difference, TCC's infrastructure charges at the subdivision stage are charged on a land area basis rather than a per lot basis in new growth areas. Again this is different to most other Councils who adopt a per lot approach. The reason for TCC's approach is that it encourages more efficient use of infrastructure through incentivising more intensive development<sup>12</sup>. It is also broadly reflective of the nature of local infrastructure costs which tend to be relatively fixed in nature and determined primarily on the area of land that needs to be serviced as opposed to the infrastructure demand from the expected land uses.

***Q46: Are infrastructure charges an equitable and efficient way of funding infrastructure services?***

As mentioned above, TCC does not wish to get into the debate of the economic efficiency of infrastructure charges given the complexity of this issue except to say that they result in infrastructure costs being borne by those that cause them. As such, they must in at least one sense be efficient.

TCC does however note that infrastructure charges do have their downsides. One is the significant upfront cost that they add to the cost of delivering new sections, houses and other developments to market. Ultimately, this must have an adverse effect on housing affordability.

Looking ahead at the areas TCC has identified for future growth and the cost of providing the necessary infrastructure to these areas it is likely that infrastructure charges will increase substantially in the future. As such, TCC has some concerns about the long-term sustainability of using infrastructure charges as the primary mechanism to fund growth infrastructure. It is TCC's view that broader funding options than just rates and infrastructure charges will be required for local authorities to sustainably and prudently manage urban growth in the future.

TCC is open to considering other funding options and is in fact in the initial stages of doing this anyway. Attached to this report is a background report prepared by TCC staff for a joint Council / development community workshop on long-term approaches to funding the costs of growth. It may be of assistance to the Commission in this inquiry.

TCC is frustrated in not being able to set its infrastructure charges under the LGA 2002 in a way that achieves equity over time. TCC wishes to set charges that start lower than they currently are but increase over time at the rate of inflation so that they remain constant to real (purchasing power) terms. This approach would create equity between today's developers and future developers. TCC is willing to provide the Commission with a summary of the legal issues that prevent this approach being

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<sup>12</sup> The infrastructure costs are a fixed charge for a given land area. As such, as the intensity of development within that area increases the infrastructure charge per unit of development (e.g. per lot or per dwelling) reduces).

adopted and result in current developers paying higher infrastructure charges than they otherwise would in Tauranga.

The development contributions provisions in the LGA 2002 also provide some difficulties in aligning infrastructure charges with developer cashflows in a manner that provides security to Councils. TCC would consider charging infrastructure contributions on subdivisions at the time sections are sold rather than the time the subdivision is completed (s224 certificate issued under the RMA 1991) if the development contribution charge could be secured appropriately. A simple amendment to the LGA 2002 should be able to resolve this matter.

TCC also notes that Code of Compliance Certificates under the Building Act are not mandatory. This presents issues for local authorities who charge development contributions on building consents because all a Council is able to do is withhold the Code of Compliance Certificate.

***Q47: Do infrastructure charges become fully capitalised into the value of the land?***

This question can be rephrased as who bears the burden of infrastructure charges? This could be:

- the original land owner who sells his/her land to a developer at a lower price than they would of if infrastructure charges didn't existed
- the land developer / building company by taking a lower profit margin
- the person who purchases the developed property buy paying a higher price
- a combination of the above.

There has been little evidence of developable land prices adjusting downwards in Tauranga to reflect the cost of infrastructure charges, although the property valuation industry is beginning to understand infrastructure charges better and incorporating them appropriate into their land valuations. In future, this may result in lower prices for developable land.

While in the past there may have been scope for developers to reduce profit margins to absorb infrastructure charges this is not the case at the moment with most development projects being at best marginal propositions. Land developers are required to have significant profit margins in order to secure project finance.

This leaves the purchaser of the developed property. In TCC's view it is likely that the majority of the burden of infrastructure charges falls on the person who buys a developed section or a house and land package. It is also TCC's view that because of this, infrastructure charges are largely capitalised into the value of developed land (or into the improvements on this land).

***Q48: What alternative methods of funding could deliver fairer and/or more efficient outcomes?***

As mentioned earlier in this submission, attached to this submission is a background report prepared by TCC staff for a joint Council / development community workshop on long-term approaches to funding the costs of growth. In TCC's view, the alternate funding methods outlined in that report should all be given due consideration by the Commission.

TCC is concerned about the historic trend of central government reducing its contribution toward core Council provided infrastructure that facilitates the economic growth of New Zealand's cities. Whilst understanding central government's present fiscal situation, TCC believes that an open debate is necessary to consider whether central government financial support is merited for key projects that facilitate economic growth and are therefore a catalyst for increased government taxation revenue. The same discussion might also be useful in terms of regional taxation opportunities.

It should be noted that Councils and their ratepayers do not receive any direct financial benefit from growth. Yes, growth causes a Council's rating base to increase but it also brings with it significant additional capital and operating costs that offset this benefit. Overall in Tauranga's case, the growth of the city is one of the key reasons why the city's ratepayers are facing such large and sustained rate increases. Central government needs to ensure that local authorities have real incentives to facilitate economic development through making land available for development and servicing this land in a timely manner with appropriate infrastructure. The current funding sources available to local government do not provide these incentives.

### **Performance of the building and construction industry**

#### ***Q54: Are construction costs higher than they need to be? If so, why?***

TCC understands that residential building costs per m<sup>2</sup> of floor area are significantly higher in New Zealand than they are in Australia (and in other countries like the US). TCC is not sure why this is the case or whether the reasons for this are actually known. TCC strongly urges the Commission to research this issue in some detail to determine why this is the case.

Given the amount of competition there is between house building companies it would seem that the answer to this question is not unnecessarily high profit margins.

Possible answers for the Commission to consider are:

- The high cost of building materials (maybe due to the lack of competition there is in aspects of this market)
- The structure of the house building industry which is characterised by large fragmentation and low volumes
- Restrictive covenants imposed by land developers that require high cost building materials, building specifications and design elements to be incorporated into new dwellings (this is commonplace in almost all new subdivisions), and prevent further infill subdivision taking place.
- Increased costs and reduced productivity as the result of government regulation of the building industry.

#### ***Q55: Have rising construction costs contributed to rising housing prices and affordability in New Zealand? Have construction costs increased because the level of building activity has risen more rapidly than supply capability? What other factors are relevant?***

The building industry must remain profitable. As such, increased construction costs have resulted in higher prices for new houses.

***Q57: Are there any concerns with the level of competition in the building materials market or any other part of the building and construction supply chain?***

TCC is not in a position to answer this question but it is certainly a question which needs to be examined in some detail by the Commission.

**Population and demographic change**

***Q66: To what extent have changes in household composition affected the demand for housing?***

Due to factors such as the aging of New Zealand's population and the increase in the number of single parent / person households, household occupancy is predicted to decrease over time. In Tauranga it is predicted to decrease from approximately 2.50 people per dwelling to about 2.20 people per dwelling by 2050.

By way of example, if these projections were accurate, based on a population of 100,000 people a further 5,450 houses would need to be supplied by 2050 in Tauranga even if the population was not to grow at all. As such, the occupancy level of households has the potential to have significant implications for housing demand and supply.

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