

7 September 2017

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via email: blair.devlin@qldc.govt.nz

RE: Ladies Mile developer contribution

Dear Blair,

As requested I have reviewed the material supplied relating to the proposed residential development at Ladies Mile, and undertaken an assessment of the expected financial implications for the developer of Council levying a developer contribution different to the base 5% contribution currently identified in the Lead Policy for Special Housing Areas. This letter sets out the findings of my assessment.

Background

Historically Queenstown Lakes District Council (QLDC) has required a contribution of approximately 5% from developers through Stakeholder Deeds. These have been negotiated through both Plan Changes and through EOIs for Special Housing Areas (SHAs).


A large residential development, which in its most recent iteration would accommodate a maximum of approximately 2,185 dwellings, is proposed for Ladies Mile, between the Shotover River and Threepwood. For that development the proposal was to increase the contribution to 10% to recognise the significance of the area and the higher densities and yield being sought there.

Queenstown is currently affected by a lack of affordable housing, and a relevant issue is the effect that increasing the developer contribution from 5% might have on the sale cost of the new dwellings created in the development, and therefore the effect on housing affordability in Queenstown.

The proposal to investigate an alternative (higher) developer contribution has its origins in the key agenda item from Council's 17 August meeting, in which Council officers were asked to report back on possible implications of the proposal. This letter was requested to assist Council officers with that reporting.

Key questions

There are three key questions relevant to the request, and they form the basis of this assessment. The questions are:

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- 1 “What level of contribution could come to the Queenstown Lakes Charitable Housing Trust (QLCHT) from landowners? (recognising we need real value to the community)”. This was the primary question Council officers were asked to respond to.

Breaking that primary question down, two related questions are;

- 2 “What is the economic impact of different levels of contribution from a developer on a development”? This second question is related to the first, and essentially asks the same question in a different way.
- 3 A related issue that flows from the questions 1 and 2 is “what impact a higher contribution would have on the cost of sections”. This relates to housing affordability.

Approach

Land development viability is a complex matter, and one which is highly dependent on input assumptions, and the particulars of each development. For this assessment I have applied the Ministry of Business Innovation and Employment’s (MBIE) “NPS-UDC Development Feasibility Tool”, a spreadsheet-based tool to estimate the feasibility of land or building development in local areas. It seeks to imitate the feasibility calculations a typical developer might undertake when choosing whether to proceed with a development. For this assessment I have applied the land development feasibility module. That part of the model analyses the commercial feasibility of developing new residential sections from previously undeveloped land.


The MBIE model was applied because it is a tool recognised by central government, and is supported by background research from a number of agencies supporting input assumptions. The model contains indicative assumptions relating to the cost of land purchase, holding¹ and development, including civil works², fees and charges³ and potential sales prices for bare land (although as per below, Queenstown specific values are applied for this assessment). The model includes allowance for the cost of capital, and compares total revenue with total costs (including land purchase and holding) to calculate expected profit and hence development feasibility.

For the purposes of this modelling I have run a core scenario which contains the best estimate of current development parameters (lot yield etc.), and which applies the model’s core assumptions relating to the cost and timing of civil works, consultants fees and infrastructure connections. The consent fees and development contributions applied were sourced from QLDC, and therefore differ

¹ The CV of the land is a cost in the model so that the \$15.1m CV block of land here represents a \$15.1m cost, to which is added a holding cost (calculated as a 10% average annual cost of capital for the assumed development timeframe)

² Subdivision costs, land clearance, earthworks and site preparation, roading, water supply, wastewater, landscape and stormwater reserves, civil works contingency

³ Resource consent fees, council development and financial contributions, legal, connections for water, sewerage, electricity, telecoms and gas, site and project management, fees for consultants and other professionals, sales and marketing and contingency



slightly from the MBIE model's core assumptions. Note that all costs and revenues exclude GST unless otherwise stated. The assumed development yield is 2,185 lots, per Attachment D to the meeting's minutes. The average sales price of each lot is assessed using recent sales in the vicinity of the development, and takes into account average value per unit area, per the framework in the MBIE model.

I have then applied several alternative scenarios in which the base fees and other assumptions vary, to show the sensitivity of the development feasibility conclusion to the input assumptions. I have applied scenarios to show the sensitivity to different costs, different dwelling yields, different development timeframes and different raw land capital values (CV), and present 12 scenarios, split across two tables where each table has a common assumed CV. In each table scenario 1 is the base, and applies a best estimate to each parameter. Scenarios 2-5 then change a single input assumption and scenario 6 applies a combination of all of the least profitable scenarios to show profitability if all assumptions are adverse to profitability.

My understanding is that land in the area is held across many different parcels, some more or less developed than others, and with other difference which would give rise to variable assessments of CV for the bare land. In short, there is no single, definitive CV for the bare land that is the subject of the proposal. That being the case I have estimated the possible CV from a sample of similar sites in the immediate vicinity, all of which are zoned Rural General and some of which are within the boundaries of the proposed development. The area-weighted average of those land values:

- \$224,500/ha across all parcels
- \$475,000/ha for the smaller parcels (less than 3ha)
- \$172,000/ha for the larger parcels (more than 3ha).

For this assessment I have applied two different CV estimates for the 77ha block of land that is the subject of the application: a base estimate of \$200,000/ha (\$15.5m for the 77ha), and a higher estimate of \$400,000/ha (\$31.1m for the 77ha). The lower of those estimates is preferred, given the large size of the current landholding. Larger blocks of land tend to have lower values per hectare than smaller lots, and the 77ha Ladies Mile area is larger than any of the sample lots assessed in deriving an indicative CV for the development.

Results: Low CV assumption

For the Low CV assumption (which is preferred to the High CV assumption), the base scenario indicates that profit from the development of the entire Ladies Mile area would be \$227m (93%). That is far greater than the 20% target set as a default in the MBIE model, indicating the proposed development would, under the default input assumptions, be very profitable (Table 1). Results for the other scenarios are:

- Scenario 2 (higher yield, 50% more dwellings than base scenario): this would yield a higher profit margin than the base, with a profit of \$359m (120%).

- Scenario 3 (lower yield scenario, 25% fewer dwellings than the base scenario): this would be less profitable than the base, but still yield a profit of \$167m (77%).
- Scenario 4 (six years to develop instead of four): profit would be \$193m (70%).
- Scenario 5 (costs are 20% higher than in the base scenario): profit would be \$183m (64%).
- Scenario 6 (low yield, longer development timeframe, high costs): profit would be \$94m (33%).

Because the development is on a greenfields site I have assumed that the QLCHT contribution of 5% would be made in the form of land, and therefore the value of the contribution would equate to 5% of the value of the land, the total value of which is assumed to be \$15.5m (Table 1). Taking 5% of that \$15.5m would yield developer contributions to the QLCHT of \$776,000. To that is added additional cost to the developer, as the contribution would be in serviced lots, and the cost to service those lots would be \$10.9m (under the base scenario, or \$9-\$13m under other scenarios). The total contribution then would have a value of \$11.8m under the base scenario (\$10.4-14.5m under the alternative scenarios). It would be possible to significantly increase that 5% developer contribution under all scenarios, even the most pessimistic profit scenario (#6), and still have a very profitable development.

Table 1: Site development feasibility at Low CV (CV=\$15.5m)

	1	2	3	4	5	6
	Base	High Yield	Low Yield	Long time	High costs	All adverse
Gross site area (ha)	77.7	77.7	77.7	77.7	77.7	77.7
Lots created	2,185	3,268	1,647	2,185	2,185	1,647
Bare land capital value	\$ 15.5	\$ 15.5	\$ 15.5	\$ 15.5	\$ 15.5	\$ 15.5
Months to develop	48	48	48	72	48	72
Developer contribution	5%	5%	5%	5%	5%	5%
Average sales price	\$ 226,400	\$ 212,200	\$ 245,100	\$ 226,400	\$ 226,400	\$ 245,100
Total revenue	\$ 469.9	\$ 658.6	\$ 383.5	\$ 469.9	\$ 469.9	\$ 383.5
Total costs	\$ 243.2	\$ 299.0	\$ 216.4	\$ 276.5	\$ 286.7	\$ 289.2
Pre tax profit \$	\$ 226.6	\$ 359.6	\$ 167.1	\$ 193.4	\$ 183.1	\$ 94.3
Pre tax margin %	93%	120%	77%	70%	64%	33%
Gross profit margin target	20%	20%	20%	20%	20%	20%
Development feasible?	Yes	Yes	Yes	Yes	Yes	Yes
Devt unfeasible at dev con of \$m	\$ 160.1	\$ 264.4	\$ 113.6	\$ 128.3	\$ 118.8	\$ 44.2

That potential is evident in the last row of Table 1, which shows that the contribution would need to be \$44m under scenario 6 to not achieve a 20% profit (20% being MBIE's indicative profit margin target, i.e. how much the developer wants to keep). If a higher profit margin target were applied, the development would still be profitable, but the possible contribution would be lower:

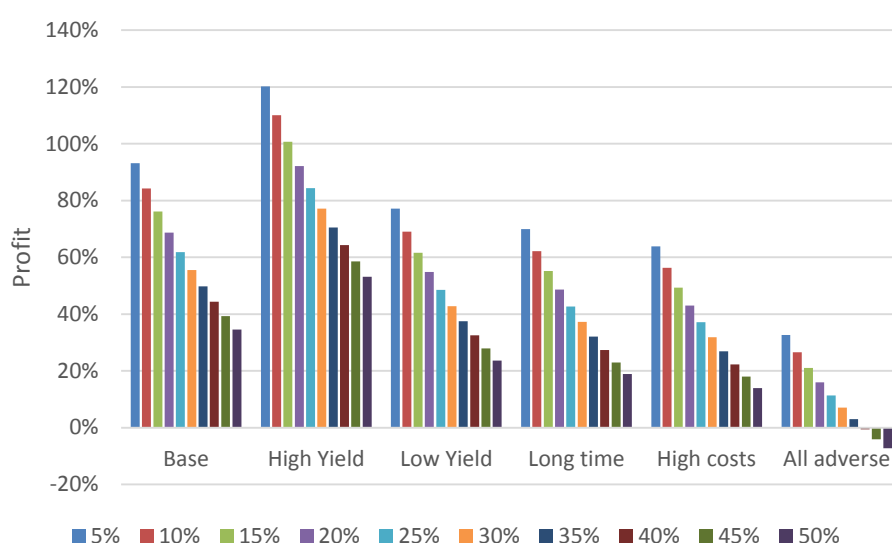
- For a target of 30% profit the contribution could be up to \$19.6m (126% of CV)
- For a target of 39% profit the contribution could be up to \$0.5m (3% of CV)

- For a target of 40%+, the development would cease to be profitable with any contribution.

In summary, under the most pessimistic of the scenarios presented if the CV of the development site has a CV of \$15.5m, the development would still yield 33% profit (\$94m). At that level of profitability, the QLCHT contribution could be three times larger than the 5%, \$13.8m contribution and leave the developer a profit of 21% (i.e. more than the indicative MBIE 20% profit target). Under the most likely scenario (the base) the contribution could be tripled from \$11.8m to \$35.3m, and leave a 76% profit (just over \$200m).

Figure 1 shows the profit that would be achieved for each level of contribution.

Figure 1: Profit (%) by contribution by scenario (bar colour=contribution), Low CV



Results: High CV assumption

Given uncertainty in the CV of the development site, an alternative set of scenarios is presented here, using a High CV assumption. These are less preferred than the Low CV assumption, given the CV applied is much higher per hectare than for other large blocks of land.

Profit under the base scenario with a High CV is indicated to be \$201m, a profit of 75%. That is lower than the profit under the low CV base scenario, because the holding costs for the higher CV land are greater, reducing profit. The profit is still, however, far greater than the 20% target set as a default in the MBIE model, indicating the proposed development would, under the default input assumptions, be very profitable (Table 2). Results for the other scenarios are:

- Scenario 2 (higher yield, 50% more dwellings than base scenario): this would yield a higher profit margin than the base, with a profit of \$334m (103%).
- Scenario 3 (lower yield scenario, 25% fewer dwellings than the base scenario): this would be less profitable than the base, but still yield a profit of \$141m (58%).

- Scenario 4 (six years to develop instead of four): profit would be \$162m (53%).
- Scenario 5 (costs are 20% higher than in the base scenario): profit would be \$157m (50%).
- Scenario 6 (low yield, longer development timeframe, high costs): profit would be \$63m (20%).

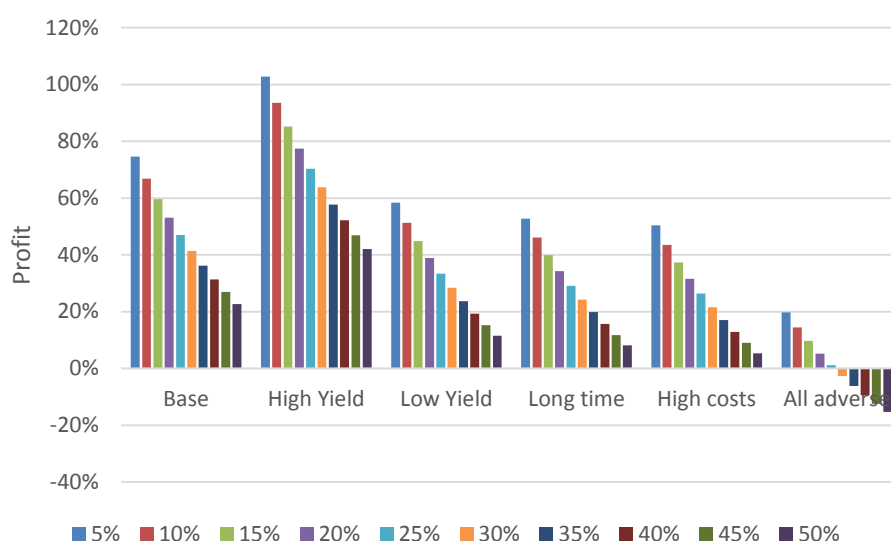
A 5% contribution (that is 5% of \$31.1m, plus costs to service that 5% area) would yield developer contributions to the QLCHT of \$12.7m under the base scenario, or between \$11.3-\$15.4m under other scenarios. It would be possible to increase that 5% developer contribution under all scenarios except the most pessimistic profit scenario (#6) and still have a very profitable development.

Table 2: Site development feasibility at High CV (CV=\$31.1m)

	1	2	3	4	5	6
	Base	High Yield	Low Yield	Long time	High costs	All adverse
Gross site area (ha)	77.7	77.7	77.7	77.7	77.7	77.7
Lots created	2,185	3,268	1,647	2,185	2,185	1,647
Bare land capital value	\$ 31.1	\$ 31.1	\$ 31.1	\$ 31.1	\$ 31.1	\$ 31.1
Months to develop	48	48	48	72	48	72
Developer contribution	5%	5%	5%	5%	5%	5%
Average sales price	\$ 226,400	\$ 212,200	\$ 245,100	\$ 226,400	\$ 226,400	\$ 245,100
Total revenue	\$ 469.9	\$ 658.6	\$ 383.5	\$ 469.9	\$ 469.9	\$ 383.5
Total costs	\$ 269.0	\$ 324.8	\$ 242.2	\$ 307.5	\$ 312.5	\$ 320.2
Pre tax profit \$	\$ 200.8	\$ 333.8	\$ 141.3	\$ 162.3	\$ 157.3	\$ 63.3
Pre tax margin %	75%	103%	58%	53%	50%	20%
Gross profit margin target	20%	20%	20%	20%	20%	20%
Development feasible?	Yes	Yes	Yes	Yes	Yes	No
Devt unfeasible at dev con of \$m	\$ 135.2	\$ 239.5	\$ 88.7	\$ 98.1	\$ 93.9	\$ 14.1

That potential is shown in the last row of Table 2, where the contribution under scenario 6 (which would be \$14.7m) would just exceed MBIE's indicative profit margin target 20% profit target (\$14.1m). Under the base scenario, and assuming the higher total area CV, the development would only yield a profit of less than 20% once the contribution exceeded \$135m. Under that base scenario then the profit would drop by around 6% for every additional 5% on the initial contribution. Figure 2 shows the profit that would be achieved for each level of contribution.

Figure 2: Profit (%) by contribution by scenario (bar colour=contribution), High CV




Impact of a higher contribution on the cost of sections

The above assessment relates to the first two key questions. This section now refers to the third and final question: “what impact would a higher contribution have on the cost of sections”. This relates to housing affordability.

This is a complex question and only a high level opinion is ventured here. At its base level I would expect that the contribution paid by the developer should have a nil net effect on housing affordability. If the developer makes a 5% (or 10%, etc.) contribution to the QLCHT, that value can be used to improve affordability, so that, for example, the land could then be developed with affordable houses where the land cost is nil, making for much cheaper sale prices. The flip side of that is that it is likely that some portion, and possibly all, of the 5% (or 10%, etc.) contribution would be added to sale prices of the lots retained by the developer, increasing those prices, and making those lots slightly less affordable. In theory those two parts (the 5% gifted to the Trust, and the 95% retained, would broadly offset.

However there are other issues that are relevant:

- The efficiency with which the 5% contribution is converted into affordable housing is a factor. Administration costs etc. will presumably eat into this contribution, to at least a small extent, meaning that there would be a slight adverse effect on District-wide affordability.
- Houses developed in the remaining 95% of the development may be of above average values in the Queenstown context. That being the case, they would be less affordable than average, and any increase in their price would not adversely affect purchasers in the “affordable” part of the market anyway.

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- There could be flow-on effects for the wider Queenstown housing market as well, because an increase in property value in this development would be likely to increase values elsewhere. Again though this effect would likely be more directed towards higher value properties.
 - The purchasers of new homes in the development may not be resident in Queenstown, and so any increase in the cost of the 95% of the development would not adversely affect purely local Queenstown residents. The origin of home buyers in the development is of course unknown at present, although Council may be aware (at least anecdotally) of where purchasers of new houses are resident. If buyers are not locally resident, houses may either be rented permanently to locals, in which case there may be an adverse effect on rental affordability), rented as holiday homes (with little adverse effect) or not rented but only used as personal holiday homes (with no effect).

Conclusion

Although every effort has been taken to source accurate and representative data to populate the model for this assessment, this kind of development modelling is subject to significant uncertainty, and the developer will naturally offer different opinions about some of the key assumptions. The assumptions presented have been made with a view to providing an objective and impartial opinion to Council, and while some assumption could be adjusted, adjustments could be made in a way that would increase or decrease the assessed profitability.

Notwithstanding these uncertainties, the results of the assessment show quite clearly that there is significant potential to increase the contribution asked of the developer under all but the most pessimistic development scenarios, with only very minimal financial implications for the developer, given the context of the large profits this type of development will generate.

Yours faithfully,

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