BEFORE THE HEARINGS PANEL
FOR THE QUEENSTOWN LAKES PROPOSED DISTRICT PLAN

IN THE MATTER	of the Resource Management Act 1991
AND	
IN THE MATTER	Hearing Stream 06 - Residential chapters

STATEMENT OF EVIDENCE OF PHILIP MARK OSBORNE
ON BEHALF OF QUEENSTOWN LAKES DISTRICT COUNCIL

ECONOMICS

14 September 2016

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1. INTRODUCTION

1.1 My name is Philip Mark Osborne. I am an Economic Consultant for the company Property Economics Ltd, based in Auckland. My qualifications include – Bachelor of Arts (History/Economics), Masters in Commerce, a Masters in Planning Practice, and have provisionally completed my doctoral thesis in developmental economics.

1.2 For the past thirteen years I have been an economic property consultant for Property Economics. Previous to this I have been a business analyst to several large firms both here and in Europe. I also taught economics at both the secondary and tertiary level.

1.3 I have recently advised, and currently advise, central government organisations such as the Ministry for the Environment and the Ministry for Business Innovation and Employment as well as local authorities including Christchurch City, Napier City, Auckland Council, Wellington City and Wellington Regional Councils, Waikato Regional Council, and Far North councils in relation to forward planning and resource valuation issues. I also provide consultancy services to a number of large private sector clients in regard to a wide range of property issues, including economic impact assessments, forecasting market growth, determining future land demand for the residential and business sectors, and economic cost-benefit analysis.

1.4 My evidence is provided on behalf of Queenstown Lakes District Council (**Council**) and relates to the efficient, effective and appropriate provision of residential development within the Queenstown Lakes District (**District**) based on the current environment and the potential economic costs and benefits associated with a relative focus on providing the market with more intensified residential opportunities.

1.5 Although this is a Council hearing I confirm that I have read the Code of Conduct for Expert Witnesses contained in the Environment Court Practice Note 2014 and that I agree to comply with it. I confirm that I have considered all the material facts that I am aware of that might alter or detract from the opinions that I express, and that this evidence is within my area of expertise, except where I state that I am relying on the evidence of another person.

2. SUMMARY OF EVIDENCE

2.1 The Queenstown Lakes residential market has seen substantial growth over the past 15 years with new household formation at over 5,000 since 2001.

2.2 From 2001 to 2016 it is estimated that demand for residential housing and residential visitor housing rose by nearly 7,000 homes. While new building consents have been buoyant it is estimated that for the 13 year period to 2013 there was a shortfall of approximately 800 homes built in the District.

2.3 As with the national market the District's housing price and sales rate have steadily increased throughout the period with a slight correct following the 2008 Global Financial Crisis (**GFC**). Within 5 years the average house price in the District had achieved pre 2008 prices and has continued to rise at an increasing rate to over $900,000 currently.

2.4 A key statistic in the District's property market is the high level of site sales. Although this would be expected in a District with high growth, the sales levels are materially higher. This would suggest a highly speculative vacant site market that is directing zoned residential land into a tradable commodity. This in itself impacts upon the tools available to the Council in addressing affordability in the District.

2.5 While there is a dearth of properties in the lower price quartile entering the market, the overall affordability for the District's stock is one of the lowest in the country. With only 35% of the resident population owning their own home (and only 8% of the population under 40) finance on an average home is expected to consume over 50% of household income annually and rising.

2.6 By 2045 it is expected that the District will require a further 10,000 to 16,000 new homes to cater for demand, much of this in the bottom two quartiles as the District becomes increasingly attractive to the national labour force rather than just those with high equity.

2.7 In order to maintain the growing employment base the issue of affordability must be addressed.

2.8 It would appear that the issues facing the District are not primarily the result of insufficient supply of residential land but the development locations and options currently provided by the market. The District has the opportunity to address the issues of affordability and build supply through the increased provision for medium and high density residential development in central locations.

2.9 The intensification of residential activity is often accompanied by both economic costs and benefits. It is important to have consideration for these in the Queenstown Lakes District context.

2.10 The potential economic costs of intensified residential activity include:

(a) Increased construction costs;
(b) Increased congestion;
(c) Property value changes;
(d) Increase in land prices;
(e) Market acceptance and viability; and
(f) Financing.

2.11 However, the District's market has several mitigating factors in relation to these costs including:

(a) A lack of supply in the lower price ranges;
(b) A significant level of properties exhibiting low improvement to capital ratios; and
(c) Significant growth potential.

2.12 These factors are likely to reduce the risks associated with medium and high density developments.

2.13 The economic benefits of residential intensification include:

(a) Improved infrastructure efficiencies;

(b) Reduced transportation costs;

(c) Agglomeration and associated activity benefits;

(d) Lower social infrastructure costs;

(e) Providing more diverse lower cost housing options;

(f) Greater affordability;

(g) Improved land efficiencies; and

(h) Greater levels of ownership.

2.14 Rather than simply adding to the land available for redevelopment, medium and high density residential options offer significant economic benefits in the Queenstown Lakes District context. Many of the potential costs of medium and high density development are already mitigated by the market while appropriate provisions can be applied to minimise the remaining costs. From an economic perspective the encouraging and facilitation of medium and high density residential development in the District will improve community well-being and the economic viability of the District.

3. QUEENSTOWN RESIDENTIAL ENVIRONMENT

3.1 The District's residential market has seen substantial changes over the past 15 years and more extensive change occurring in the last 12 months.

3.2 Between 2001 and 2013 the District has experienced resident growth in the order of 4,500 households net or a 70% growth rate. This compares with a national growth rate of 15% and rates in buoyant markets, such as Auckland, of 20%. This level of growth illustrates several factors that currently exist in the market, including:

(a) The overall attractiveness of the District as a residential location;

(b) Growth in corresponding employment generating a more sustainable residential foundation; and

(c) Relative attractiveness of the District.

3.3 The composition of residential growth in the District over the past 15 years has been relatively balanced with a significant proportion of two parent families and couples making up over 67% of the resident households.

3.4 In terms of dwelling numbers, residential growth plays a significant but not complete role in relation to demand for housing. Holiday homes and usually 'empty' dwellings are a material and increasing proportion of the District's housing market. In 2001, 20% of the housing stock was usually empty with this number rising by nearly 1,500 houses to 2013 (24% of the market). Between household growth rates and empty housing, it is estimated that in the 12 years to 2013 the total demand for housing rose by approximately 5,800 units. Additionally, estimates to 2016 suggest growth of a further 1,000 new households.

3.5 Over the corresponding growth period, residential building consents have totalled 7,000 or 540 per annum. Nationally the average 'realisation' of a residential building consent is approximately 75%. This is likely to be higher in a booming market such as the District, even in light of the likely impact of the 2008 GFC. Additionally, some consents are based on the demolition of existing properties. Given this it is estimated that at least 5,000 new homes were available to the market over the 2001 to 2013 period, this would have resulted in a marginal shortfall of some 800 residential units for that 13-year period. This implies that the District currently has a latent undersupply of residential housing.

3.6 Market trends over the past 15 years have been dramatic with both boom and temperate periods of change. To 2008 the average house price in the District rose by 158% from 2000, reaching $680,000 by the end of 2007. Following the GFC houses prices followed national trends and stabilised only reaching 2008 price level by 2013. Following this stabilisation, prices in the District have continued an upward trend rising a further 34% in the last 3 years.

3.7 This growth rate, which exceeds Auckland's, places the average nominal house price above $880,000, which is second only to

Auckland. While the income profile of the District tracks above that of Otago, this still makes it one of the least affordable areas in the country. At the same time the number of sales in the district remains high with approximately 1,000 sales per annum over the last 4 years.

3.8 An unusual feature of the District's residential property market is the significant level of site sales (sometimes referred to as 'lot or section' sales) that make up the market annually. Due to the rapid residential growth levels it is anticipated that this component of the market would be higher than is normal. However, over the past 10 years site sales have consistently made up approximately 40% of all residential sales. This level of turnover is significant even when allowing for the large proportion of new homes and the expected vacant site turnover. It would appear from this market indicator that there exists a greater than average market in the District for the trading of vacant residential sites as commodities. This level of turnover typically indicates a propensity in the market to buy hold and sell vacant sites.[1]

3.9 Other market factors that currently exist in the District's residential property market include:

(a) high rental values with a median rate of $500 per week for an average 3 bedroom house;

(b) a 35% homeownership rate (for residents 15 years and older), one of the lowest in the country;

(c) the largest fall in homeownership rates at 7.8% between 2006 and 2013;

(d) only 8% of adults under 40 own their own homes;

(e) Wanaka continues to be the fastest growing area both in terms of sales and value;

(f) home loan affordability in Queenstown has fallen over the past year with an average mortgage costing 51.6% of after tax income compared to 45.3% last year; and

(g) rental affordability has remained stable albeit high at 34% of after tax income.

1 Typically this occurs in a market where capital gain is unusually high and the potential gains on land value outweigh the risk and additional investment required to build on the property.

3.10 In order to ascertain the potential residential capacity within the District, the Council have undertaken the development of the Development Capacity Model (**DCM**). At this stage of development this model has been reviewed through two processes and is currently in the process of a further review that will seek to address any outstanding issues specifically related to the viability of development capacity. Currently, the total residential capacity indicated through the DCM model is in the range of 17,000 to 18,000 dwellings. Of interest to note is that a significant proportion of the development opportunities are located in more dispersed high priced areas that do not cater for a growing proportion of the resident population.

3.11 Growth in the District's market is expected to continue in the two parent families and couples. However, an increasing component of this market is the employment sectors that these new residents make up. An increasing number of new residents are expected to be employed in service sectors where incomes (and ultimately levels of equity) are lower. Therefore, the likely impact on demand will be for more affordable sites and houses.

3.12 As outlined above the District's housing market is a relatively unique one with a significant proportion of visitor housing (over 25%) playing a crucial role in the demand and uptake of residential properties. It is vital that any policies or objectives developed to cater for residential demand also considers growth in this sector.

3.13 The most recent updates to the growth projections for the District illustrate a continued high level of expected residential growth. By 2045, under the medium projections, it is expected that the District will accommodate an additional 20,000 residents, which is an increase of 1.6% per annum of a further 8,500 dwellings. Additionally, under this scenario it is expected that a further 1,700 private residences will be utilised for visitors with commercial accommodation demand increasing 70%.

3.14 High projections have population growth to 2045 at 30,000 residents requiring 13,500 new homes with private visitor homes adding a further 800 dwellings, giving a total of 2,500 dwellings. Under the high growth scenario commercial accommodation demand will rise 100% by 2045.

3.15 There are several potential market shortfalls and risks that are manifest in the District's housing market, not least of which is the affordability rates. As identified, the District has experienced some of the highest (if not in more recent times the highest) capital growth rates in New Zealand. This coupled with relatively low income growth has led to high rental levels, low ownership rates (especially for those adults under 40 years old) and lack of housing options for those in the first and second income quartiles.

3.16 Given the level of vacant sections (in part driven by growth) that are currently traded on the market, land values have seen a significant increase. This is due in part to the fact that these sites are traded rather than developed. The risk that currently exists in the District's housing market is the lack of provision of affordable housing given average income levels, and therefore the ability for the market to accommodate service employees. This impact is compounded by high rental levels.[2]

3.17 It would appear that the issues facing the District are not primarily the result of insufficient supply of residential land but the development locations and options currently provided by the market. The District has the opportunity to address the issues of affordability and build supply through the increased provision for medium and high density residential development in central locations.

4. INTENSIFICATION OF RESIDENTIAL SUPPLY

4.1 There is an increasing body of economic research relating to the benefits pertaining to intensified residential development and the

2 It is worthwhile noting that while regions such as Auckland have seen similar rise in capital value, the rental levels have not grown commensurately.

potential for local planning provisions to realise these benefits within the market.

4.2 While the historical rise of cities is a testament to the inherent benefits afforded the community through intensified activity, changes in transportation, employment locations and flight from badly designed built form has resulted in a dispersal of residential activity in many cities. A classic example of these condition is the city of Detroit. The fall of the inner city and the continual spread of residential suburbs (albeit affluent ones) resulted in a situation where the city could no longer continue to fund infrastructure and subsequently went bankrupt. Although simplified the economic costs and benefits identified in relation to intensified residential activity (even with regard to the District's smaller nominal population) bear out in reality.

4.3 Intensified residential activity not only has the benefit of aggregating infrastructure and thereby reducing its marginal cost, but it also increases land efficiencies. While medium to high density residential zonings may result in greater land values per square metre, the lower land area per residents typically results in a lower cost of land per resident.

4.4 There are a variety of costs and benefits attributable to intensified residential development. It is important to note that the level and realisation of the economic costs and benefits are often linked to these general benefits and rely on such factors as the quality of built form and the level of congestion and existing capacity of infrastructure (often referred to as 'crowding out').

4.5 The environment in which residential development sits in the District is unlikely to be subject to the crowding out of the potential economic benefits of residential intensification.

4.6 Economic costs and benefits typically fall under two categories. The first relates to externalities in the market (either negative or positive) that occur as a result of the intensification. The market would not consider itself when deciding the price and level of intensified housing to provide. The second relates to efficiencies in infrastructure and public service provision. Infrastructure and public services do not tend to be efficiently priced, meaning that users do not necessarily bear the full costs of the infrastructure they are using.

4.7 In this context, land use regulations can be used to help manage the costs associated with infrastructure provision. For example, planning regulations may enable development in areas with capacity in existing infrastructure networks, while limiting development in areas that lack capacity. This may reduce the costs associated with providing infrastructure or better enable governments to stage the development of new infrastructure.

5. POTENTIAL ECONOMIC COSTS OF INTENSIFIED RESIDENTIAL ACTIVITY IN THE DISTRICT

5.1 Intervention into any market is likely to result in some costs associated with the PDP's ability to redirect at least part of the market. While adherence to many provisions coincide with transactional costs, the provision of greater levels of the Medium Density Residential Zone (**MDRZ**) in the District is unlikely to result in these specific costs. However intensified residential activity is likely to impact upon the potential and level of some costs borne by the community. Examples of these costs are set out below.

Increased construction costs

5.2 While the land cost per unit may decrease typically it is more expensive per square metre to deliver higher density residential product to the market. This increase is dependent on the type of product, but typically ranges from increased propensity for multi-storey dwellings to apartments, and ranges from an additional 10% to over 300%. The District's environment is likely to be at the lower end of this range.

Increased congestion

5.3 The development of greater numbers of residential units within a given geospatial area has the potential to overwhelm existing infrastructure, therefore decreasing accessibility and increasing its marginal cost. It is fundamental that this is considered in the provision of the MDRZ.

Property value changes

5.4 Changes to built form can impact property values. This cost is directly related to the urban design criteria applied to a higher density location. In terms of the values attributable to property in the District, views and sunlight play a significant role. High level residential densities have the potential to impact upon existing wealth levels through property values if these attributes are not appropriately managed. In the long-run these urban design requirements are likely to improve the overall market acceptance of the product and safeguard existing values.

Increase in land prices

5.5 Providing for the development of additional residential activity on a given site directly impacts upon the value of the site. This value increase is ultimately related to both the level of activity as well as the viability of realising the activity levels provided for. Research into the potential increase in price resulting from a medium density provision in Auckland found a 17% increase in land value.[3] This potential cost is balanced with the potential increase in residential units per site. However, I note that if the increased yield is greater than 17% it is expected that the price of land per residential unit will fall.

Market acceptance and viability

5.6 Rather than a direct cost, this factor relates to two risks in the market. The first is the acceptance of residents for a more intensive product. Market research suggests there is a growing segment of the community that accepts, if not prefers this product.

3 The impact of intensification on Auckland housing valuations, NZIER report to Auckland Council, August 2015

5.7 The second factor relates to supply and the viability of development. It is sometimes difficult and expensive to assemble the land necessary for the sort of comprehensive development that is necessary to achieve lower unit building costs in medium density housing. This leaves insufficient price differential between multi-unit housing and detached dwellings to encourage a shift from the latter to the former. This would simply add to the risks that prospective investors and developers face in today's over-complicated regulatory and conservative commercial environments.

5.8 However, the District's market has several complementary factors:

(a) A lack of supply in the lower price ranges;
(b) A significant level of properties exhibiting low improvement to capital ratios; and
(c) Significant growth potential.

5.9 These factors are likely to reduce the risks associated with medium and high density developments.

Financing

5.10 Once again a potential risk in the market is the willingness of financial institutions to finance higher density developments. This risk is again mitigated through the District's housing market buoyancy and an increasing acceptance in the market for this product type.

6. POTENTIAL ECONOMIC BENEFITS OF INTENSIFIED RESIDENTIAL ACTIVITY IN THE DISTRICT

6.1 There are a variety of potential economic benefits associated with the intensification of residential development both direct and indirect. The potential for these benefits to be realised and their accompanying level are, in part, based on the existing environment in terms of capacity, existing market failure, and a general acceptance of the residential objective. Examples of these economic benefits are explained below.

Improved infrastructure efficiencies

6.2 The aggregation of residential activity into existing areas has the potential to reduce infrastructure costs per dwelling. While this cost is also dependent on the specific sites, a report undertaken in the Auckland Region found that on average medium density development cost 20% less per dwelling than low density development (while high density development was over 30% less).[4]

Reduced transportation costs

6.3 Transportation costs relate only to the costs of travel and congestion as the capital expenditure is accounted for in the infrastructure above. Research has found that consolidated residential activity is less likely to result in congestion and reduces the average distance travelled daily by households. In fact, research undertaken in 2011 found that residents in a compact higher density urban form travelled 20% or only 24VKT's (vehicle kilometres travelled) on a daily basis. This reduced the social costs of private transport consumption.

Agglomeration and associated activity benefits

6.4 From an economic perspective, there are symbiotic efficiencies that can be generated when providing residential intensification opportunities within close proximity to a centre or activity hub, as opposed to general suburban environments.

6.5 A balanced planning regime would have flexibility in the provisions of enabling intensification of activities at appropriate levels in appropriate locations such as centres and in other high amenity areas, or employment and community focal points across the District, so as to ensure that appropriate choices are provided to the market. This 'choice' facilitates not only competition in the marketplace (which is one mechanism to assist managing non-market driven (or artificially constructed) dwelling price growth), but an increased propensity to

4 Understanding the Costs and Benefits of Planning Regulations: A Guide for the Perplexed (Auckland Council, May 2016) Technical Report 2016/018

realise increased economic efficiencies in the District's urban form, to the benefit of the District and community as a whole.

6.6 In practical terms, the larger the centre or activity hub, the greater the level of economic wellbeing, social amenity and efficiency the centre / activity hub can afford the community. The level of residential intensification around any one particular centre / activity hub should reflect its status within the District Plan, or position within the network hierarchy of the district (i.e. the higher the centre / activity hub status in the district network, the greater the residential intensification opportunity should be provided and economic benefits can be created).

Lower social infrastructure costs

6.7 The provision of community facilities and infrastructure is a social investment. The justification for this investment is the social value that these services and facilities provide to the community. This is considered to be significant enough that they are publicly funded and supplied. The reason they are publicly supplied is because given their social value to an individual is small, the free market would not supply enough of them.

6.8 These facilities include libraries, civic and administrative functions, community centres, public meeting areas, police stations, transport nodes etc. These are generally provided in centres with high activity so as to coincide with residential activity. Simply put the greater the level of activity and accessibility in a centre, the greater the utilisation of such public assets. Not only is profile important for these types of facilities but they are located to make good use of multi-use trips.

6.9 The provision of these facilities are sometimes seen as 'sunk costs', dismissing their relevance and their potential. However, the utilisation of these assets has community value that must be considered when potentially reducing their usage.

6.10 There are two potential effects of reduced usage of community facilities within intensified areas. The first is that the marginal cost per patron increases thereby reducing efficiency and reducing the social benefits through its provision. The second is that the infrastructure has to be duplicated (even on a small scale) elsewhere, causing significant inefficiencies of community resources. The effects of the efficient operation and provision of these resources are benefits in relation to intensified residential activity.

Providing more diverse lower cost housing options

6.11 While the level of residential sales in the District remains significant there appears to be limited locational options especially when considering the market below $600,000. The provision of increased areas for MDR activity provides greater choice in terms of this subset of the market. This provision also provides a large range of options for residential demand in terms of typology and dwelling size.

Greater affordability

6.12 Given the socio-economic composition of the District, housing affordability is becoming increasingly out of reach for many residents. This is reinforced by the extremely low home ownership rates. The affordability barrier to private housing might be best addressed by redirecting medium density housing options to current owner occupiers. This would then free up second-hand stock in areas and at prices that might enable the growing numbers in the intermediate housing market and young family segments greater ownership opportunities.

6.13 More options for medium density housing in more parts of the District could also reduce investment and development thresholds, as well as increasing the capacity of the market to supply through a proliferation of diverse, quality small and medium developments. However, this implies a significant shift from the sort of development that has dominated the growth of the medium density market over the past decade, and far greater provision for and encouragement of diversity in type, style, and location.

6.14 Affordability itself is directly impacted by the decrease in land cost per residential unit. As outlined above there are additional costs associated with medium and high density development both in terms of the per square metre rate for land and the build costs associated with the dwelling types. Given the type of conditions that exist in the District currently, it is expected that a proportional increase in dwelling capacity (between medium and low density housing) of 30% would result in a potential moderation of housing prices.

Improved land efficiencies

6.15 A key purpose of planning is to produce the most efficient use of an economy's land resource. Planning regulations are designed to control private uses for this resource so as to produce a sustainable long-term outcome. Increasing the level of activity on a given quantum of land provides greater levels of land for other uses. This provision is especially relevant in an environment such as the District where safeguarding of the Outstanding Natural Landscape is so crucial.

Greater levels of ownership

6.16 Given the long-standing cultural, economic, and social commitment to owner occupancy in New Zealand, its association with family and social stability and economic progress, the aspirations of the population, and especially expectations associated with a maturing population, maximising ownership should remain a priority in policies directed at medium and high density housing. Ownership will be achieved more readily in settings which provide for diverse household types, design and location. While policies directed at affordability should ensure that rental levels remain reasonable, it can be argued that their objective should remain focused on facilitating the transition to ownership.

6.17 The current housing market in the District does not provide sufficient opportunities for residents to own their own homes. It has resulted in house prices that have become materially out of reach for the increasing number of employees that have sought to locate here.

6.18 While a significant level of development has occurred over the past 15 years, growth has occurred at a faster rate than the development, out stripped it and is expected to continue to grow both in terms of local resident and visitor demand. While a potential solution appears to be to simply open up greater levels of residential land, the market does not appear to be responding in a manner that would result in a fall in housing prices nor an increase in housing choice. There currently exists a significant market in the District for vacant residential sites that rather than being developed are being traded in an upwardly mobile market.

6.19 A second approach to the current housing situation is the expansion of medium and high density zones as well as height provisions. This approach seeks to provide increased impetus to the market to develop existing sites, which in effect reduces the improvement to capital ratio and increases the viability of medium density development.

6.20 This approach provides for a variety of economic benefits while avoiding many of the potential costs. In any given market, the potential impacts of development are less likely to relate to the relative size of development (to the entire market) but instead to the conditions that exist in the market overall. The District offers a pertinent example with a potential shortfall of only 1,000 homes resulting in housing price increases far in advance of the relative 9% shortfall. So too can a relatively small increase in the viability of medium density residential development have a more than linear impact upon the average house price and composition within the QLD market.

Philip Osborne
14 September 2016