



Development Contributions

Review of the economic basis for the revised policy

Hastings District Council

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Executive summary

Hastings District Council (HDC) commissioned GHD to undertake the following main tasks focused on the review of HDC's Development Contributions Policy (DCP). These tasks were:

1. Provide advice and review of the DCP support analysis, documentation and the actual draft DCP:
 - a. Provide advice and assistance in reviewing the DCP support analysis – the rationale for considering different ways to spread the costs of proposed new infrastructure across the development that necessitates it.
 - b. Review the DCP support document that sets out the arguments and analysis completed in (1) above.
 - c. Review the DCP document when in draft.
2. Comment on the likely impact of proposed changes in DCs on:
 - a. fairness and proportionality in terms of the cost of servicing growth in Hastings and the economics of developing within the Hastings District, particularly in the context of council's current 'urban wide' catchment approach
 - b. land/section values and house prices
 - c. development uptake and housing provision
 - d. whether incentives to the developer will have any material effect on development outcomes.

Advice and assistance

GHD assisted through regular meetings with HDC staff, reviews of work to date and draft version of the background document, and a review of the draft DCP. These reviews covered five specific questions related to the DCP review, including balancing administration, efficiency, fairness and equity; the appropriateness of using DCs for achieving other development outcomes; a potential increase in the number of catchments; the option for DC discounts based on dwelling size or number of bedrooms; and an allowance for special assessments.

Our review of work by HDC concluded that the arguments made for the policy approaches in the DCP were reasonable in the context of HDC's particular capital works programme and geography.

Assessment of the policy's economic impacts

The approach HDC has settled upon provides a reasonable balance between accurate pricing (fairness) and the requirements for equity and administrative efficiency.

The revised DCP is unlikely to lead to house price rises as in the long-run, pricing correctly for infrastructure pushes the price of "raw" (un-infrastuctured) land down, not house prices up.

In the short and medium term, some developers who have overpaid will need to re-assess the viability of their developments. Some will need to rescope or may sell to others who can make the development work. This reality is no reason for not increasing DCs to accurately reflect the costs of new infrastructure.

Providing support infrastructure and up-zoning is likely to incentivise development in the city centre and Flaxmere. DCs are unlikely to be a major impediment to where development occurs.

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Purpose and scope

HDC commissioned GHD to undertake the following main tasks focused on the review of HDC's DCP. These tasks were:

1. Provide advice and review of the DCP support analysis, documentation and the actual draft DCP:
 - a. Provide advice and assistance in reviewing the DCP support analysis – the rationale for considering different ways to spread the costs of proposed new infrastructure across the development that necessitates it.
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 - a. fairness and proportionality in terms of the cost of servicing growth in Hastings and the economics of developing within the Hastings District, particularly in the context of council's current 'urban wide' catchment approach
 - b. land/section values and house prices
 - c. development uptake and housing provision
 - d. whether incentives to the developer will have any material effect on development outcomes.

Caveats and exclusions

GHD was not asked to interrogate any of HDC's actual calculations, project cost estimation or spreadsheeting. Our focus was on the reasonableness of the arguments being made, comparison of different options, and whether the proposals fitted with the efficiency, administration and fairness elements required by relevant legislation.

Advice and assistance in developing DCP

This section covers the work done in advising and assisting HDC in reviewing its DCP and supporting documentation.

Context

HDC has grown rapidly in the last several years, as New Zealand's population has surged, particularly between 2011 and 2019. Accompanying this growth is a desire to use land more efficiently, by allowing for redevelopment of existing brownfield areas in the District, particularly in the Hastings city centre and in Flaxmere.

Consequently, a review of the investments required to accommodate recent and future growth indicate that significant additional investment will be needed over the next 10 years, particularly in the wastewater capital expenditure programme.

The implication of this investment is that development contributions (DCs) are expected to rise more than 85% in the Medium Density Housing residential area, and more than 55% in Greenfield Residential areas. Hospitality and Accommodation non-residential uses would see DCs rise around 120% per 100m² of development. In all three of these instances, the increase in DCs per Household Unit Equivalent (HUE) or 100m² in the case of non-residential, is over \$14,000.

Given the scale of the change, it was prudent for HDC to review alternative ways of splitting these costs, allowing consideration of the positive and negative impacts of different approaches.

Assistance format

GHD assisted HDC in its review in three main ways.

1. **Regular meetings with Ashley Humphrey**, Project Manager Strategy Growth and Development at the time of the review, during development of the support documents and the revised DCP. These meetings (typically weekly) were an opportunity for Mr Humphrey to talk through progress in reviewing the DCs policy, to raise questions about different approaches, and for GHD to provide feedback on approaches used elsewhere that may be useful to consider.
2. **Reviews of work to date and draft version of the background document.** GHD reviewed two progress versions of the support document underpinning the DCP, in particular work that reviewed the approach to setting DCs at HDC (using larger or single catchments rather than multiple smaller catchments for example) and whether alternatives would be better. Work also included the inclusion of a special assessments section for larger developments in the proposed DCP. Detailed written feedback was provided in the form of marked-up copies of the draft work.
3. **Review of the draft DCP.** GHD was asked to review the draft DCP that was predicated on the background analysis completed in the support documentation. Detailed written feedback was provided in the form of marked-up copies of the draft work.

Major topics covered in the review

The review was wide-ranging. However, there were five specific areas of detail where GHD assisted in an economic assessment of the review process.

Balancing administration, efficiency, fairness and equity

An overarching issue constantly in mind in any DCs policy review is the question of balancing administration, efficiency, fairness and equity, as required by the Local Government Act (LGA).¹ Maintaining this balance is a challenge. Each of the four further issues examined below deal with at least one of these four elements.

¹ See for instance LGA Section 197AB (g)

The use of DCs for achieving other development outcomes

HDC has a clear vision for more compact development in the city centre and in Flaxmere that makes more efficient use of existing development areas. It intends to invest heavily there to provide the infrastructure needed to support that intensification. At the same time, HDC wants to ensure uptake of that opportunity for more efficient land use. HDC was keen to explore ways to incentivise development in these areas.

One way to incentivise development would be through lower DCs in the city centre and Flaxmere. However, the LGA is clear that DCs should be used only to cover the cost of infrastructure to service growth in the District, and not for any incentivisation. Specifically, a DC can only be required if the effects or cumulative effects of development will create or have created a requirement for the Council to provide new or additional assets or assets of increased capacity.² In other words, reducing DCs for the purpose of encouraging development in a particular area is inappropriate.

As a consequence, GHD's recommendation was that if HDC wished to incentivise development in these areas, a specific grant fund be set apart that was explicitly for funding particular types of development. This would provide elected members with clear visibility over how much money was being allocated to incentivise certain types of development, while keeping the DCs policy clean and in accordance with the LGA.

A potential increase in the number of catchments

Much of the review focused on the question of whether, given the large increase in wastewater DCs anticipated, the number of geographic catchments in the District should be increased. There are arguments on both sides. On the side of increasing the number of catchments is the argument of fairness – that if infrastructure benefits could be shown to accrue to a smaller catchment area, it makes sense that this catchment should contribute more to the costs. But on the other side of the argument, there are questions over whether this multiplication of catchments would increase equity, while it certainly would decrease administrative efficiency. The LGA allows for aggregation provided that it is done in a manner that balances practical and administrative efficiencies with considerations of fairness and equity; and avoids grouping by geographic area avoids grouping across an entire district wherever practical.

HDC evaluated a number of different catchment options, both for the wastewater investment, and for planned investment in other infrastructure types such as transport. This relatively detailed analysis showed that if additional catchments were created for wastewater, then it would have to be argued that additional catchments be created for transport for instance. There is considerable difficulty in establishing the direct beneficiaries of each type of infrastructure, and various scenarios suggested that those who would pay less for wastewater DCs would likely pay more for transport DCs under this larger number of catchments approach. There is also the historical reality of upgrades in some areas (e.g. Havelock North) having been funded by a single catchment where others have effectively subsidised that infrastructure.

Given the administrative difficulty of establishing appropriate catchments, determining who would benefit most and by how much, the “pluses and minuses” reality of where different areas would benefit from different types of investment, and the risk of an ever-growing number of sub-catchments that would become unwieldy, the argument to keep an “urban wide” catchment is a reasonable one.

Discounts for dwelling size or bedrooms

Some councils have evaluated models of charging DCs using different proxies for usage. The argument is that, on average, smaller dwellings, or dwellings with a lower number of bedrooms, tend to have fewer occupants and thus a smaller impact on the network. From an economics perspective, this makes sense as these mechanisms fit with the argument of “user pays”.

However, there are challenges to using a “number of bedrooms” approach in particular. Defining a bedroom, or as some do, what everything other than a bedroom is (to isolate the number of bedrooms) is a subjective process and can, if the change in DCs is sufficient, lead to perverse outcomes. One could expect to start seeing many more “second living rooms” that in reality are very much like a bedroom but attract no DCs.

HDC nevertheless considered these approaches in some detail. Various scenarios of how new development may be split across smaller and larger numbers of dwellings (as measured by number of bedrooms) were examined.

² See LGA Section 197AB (a)

The scenarios tended to provide a major benefit to smaller dwellings and to have a marginal effect on three-bedroom dwellings or bigger homes as they tended to be the vast majority of new homes.

Rather than get into the complication of trying to determine what a bedroom is, HDC decided on an approach that allowed discounts for smaller sized homes as measured in square metres, only if they are additional dwellings to be added to an existing property. Dwellings under 80 m² in size can be charged at a reduced rate, up to a maximum of a 50% reduction from the one Household Unit Equivalent (HUE) DC for a 40m² second dwelling. This is, in our view, a reasonable conclusion.

Allowance for special assessments

Because DCs policy has to be set on assumptions of average use, arguments can be made for why a particular development is likely to use infrastructure more or less than the average. HDC needed to protect its right in representing ratepayers to charge developments more than the usual DC if those developments were expected to have a higher impact on infrastructure. At the same time, there needed to be a mechanism to allow developments to demonstrate that they would have a lower impact on the infrastructure network than DCs suggested.

Again, the question of administrative efficiency arises. HDC examined in some detail the question of an appropriate development size to trigger such a special assessment. The costs associated with reviewing DCs due on a small development could well outweigh the actual DCs savings. It was recommended that HDC include a trigger point (in terms of number of dwellings, for instance) for special assessments being allowed that aligned with other policy at a practical level.

HDC chose to align the trigger point (more than three dwellings) with the Medium Density Residential Standards as set out in Schedule 3A Resource Management Act 1991. While these standards do not apply to HDC given it is a Tier 2 Authority, this level was considered to represent an appropriate level beyond which demands on infrastructure might be expected to be lower, justifying a special assessment.

Assessment of the policy's economic impacts

The previous section summarises the specific areas on which GHD's review of the proposed DCs policy changes focused. This section provides economic commentary on the likely impacts of the proposed changes in DCs policy.

Proportionality of the urban wide catchment approach

The approach HDC has settled upon provides a reasonable balance between accurate pricing (fairness) and the requirements for equity and administrative efficiency.

This report has already touched on the question of an “urban wide” catchment approach as opposed to using a larger number of catchments. Work by HDC as part of the policy review demonstrated the “pluses and minuses” reality of infrastructure provision. While it can be argued that the wastewater investment responsible for much of the proposed rise in DCs will primarily benefit the Hastings city centre and Flaxmere, planned transport investment will primarily benefit other areas, and historical upgrades in Havelock North, for instance, have benefitted other areas but been funded by a single catchment. There is a risk of an ever-increasing number of catchments with a commensurate increase in administrative costs and greater amounts of guesswork in trying to identify who benefits from each specific piece of infrastructure.

Economics argues that charging accurately for everything, including for infrastructure, discourages the market from allocating resources inefficiently. This is a technical way of saying that when we undercharge for infrastructure, we get development in the wrong places. But as already highlighted, there is a balance between reflecting the cost of development infrastructure in each location to the dollar and the challenges with estimating who benefits and managing an ever-increasing number of possible catchments.

Because costs of development broadly balance out across urban catchments once beneficiaries of different types of investment (e.g. wastewater versus transport) are considered, the urban wide catchment approach is unlikely to incentivise development in one area relative to another. As already highlighted, the LGA in any event does not allow for DCs to be used explicitly for the purposes of incentivising development in a particular area.

In fact, economics argues that when there are external benefits (costs) to a certain activity, that do not primarily affect the one undertaking the activity, then there is reason to charge less (more) for that activity. There are arguments to incentivise more compact urban redevelopment because of the external benefits it provides (such as lower congestion and emissions than the alternative), but as already highlighted, the LGA does not allow for this. Consequently, any further incentive for development in the city centre or Flaxmere would need to be provided explicitly as a policy separate from DCs policy.

Impacts on land/section values and house prices

In the long-run, pricing correctly for infrastructure pushes the price of “raw” (un-infrastructure) land down, not house prices up.

Signalling early and clearly that growth should pay for itself is good policy. Aligning the price of development with its true cost as much as is practical from an administrative and equity perspective at least helps ensure development happens where it makes economic sense (using resources to maximise societal wellbeing), as well as financial sense (using resources to maximise financial results).

The earlier a signal is made, the more private investors, such as land developers, can incorporate good pricing information into their decision-making. This early information avoids developers overpaying for land on the expectation of their contribution to funding infrastructure (in this case through DCs) being lower than they had anticipated.

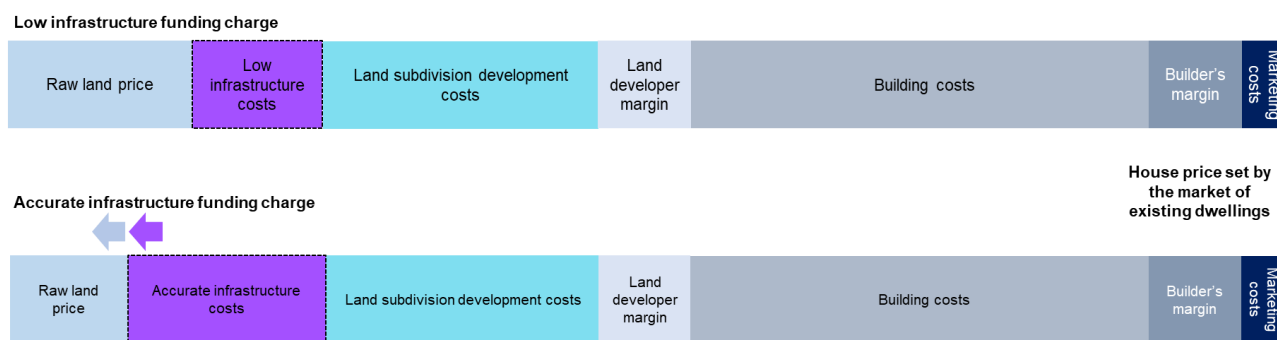
It is a commonly held but inaccurate belief that charging more accurately for infrastructure (such as for wastewater) will significantly raise house prices.

The inaccuracy of this view is demonstrated both by theory and by case studies abroad and in New Zealand. We begin by considering the theory. When a new dwelling is built, it enters a market of thousands of existing homes. New homes delivered into this market have to compete on price with these thousands of existing homes, and especially with other recently constructed homes. As a consequence, developers are what economics calls

“price-takers”. No individual developer sets the price of a home. If they charge too much, people will simply buy somewhere else.

In determining development feasibility, therefore, the developer has to consider the price at which the developed homes will sell at the end of the project; a price set by the market. The developer then works **backwards** to ensure they make a profit and cover all the other inputs required to go from empty or under-used land to a new completed development. This process requires the developer to calculate infrastructure costs, including DCs or any requirement for extra on-site infrastructure, connector roads and the like. What is left after covering profit and all the inputs, is a **residual value** the developer can pay for the undeveloped or under-developed “raw” land. This process of working out the feasibility of the project is demonstrated in the top bar in Figure 1.

Figure 1 How development pricing changes when infrastructure costs rise



If the cost of servicing the land through DCs rises to reflect more accurately the true cost of development, as shown in the second bar in Figure 1, the developer will be very limited in their ability to pass on those costs. Instead, developers will have to pay **less** for “raw” land if the development is to maximise its commercial viability. All things being equal, **house prices are unaffected and raw land prices fall**.

The empirical evidence from overseas and in New Zealand supports this theoretical description. The international evidence on this trend for infrastructure costs to pass up the chain to land prices rather than down to house prices is instructive. Work done by Auckland Council’s Chief Economist Unit summarising the findings of international studies shows that in almost all cases, the vast majority of costs were passed up the chain.³

In New Zealand, the Auckland experience is invaluable in demonstrating that the true costs of infrastructure are internalised rather than passed on into higher house prices. In its independent role, the Chief Economist Unit at Auckland Council evaluated whether that city’s Rural Urban Boundary (RUB) constrained access to developable land and thus artificially inflated land prices inside the boundary, a common accusation against growth boundaries.⁴ While growth boundaries can have this effect, they do not by necessity have this impact. The key finding of the RUB study was that Auckland’s growth boundary does not currently inflate land prices inside the boundary.

However, a further finding was that once the true cost of infrastructure is factored into land values, it appears that land prices **outside** the growth boundary were inflated. This is likely because of speculation on land purchases just outside the boundary, where developers believe that at some point in future, development will be allowed with an ongoing infrastructure subsidy from the general ratepayer. In other words, **developers are offering a price for raw land based on what they think they will have to pay for infrastructure**. If a clear signal is sent that development will need to pay more for infrastructure, raw land prices will fall, rather than house prices rising.

Impacts on development and housing provision

In the short and medium term, some developers who have overpaid will need to re-assess the viability of their developments.

Still, some developers will have already purchased land on the expectation that DCs will remain at current levels and will in effect have overpaid given the DCs proposed by the policy review. Having to pay more in DCs will

³ See Harshal Chitale, *Unshackling Growth paying for itself*. 2018. <https://www.aucklandcouncil.govt.nz/about-auckland-council/business-in-auckland/docsoccasionalpapers/unshackling-growth%20-%20April%202018.pdf>

⁴ See Shane Martin and David Norman, *An evidence based approach: Does the Rural Urban Boundary impose a price premium on land inside it?* 2020. <https://www.aucklandcouncil.govt.nz/about-auckland-council/business-in-auckland/Reports/does-the-rub-impose-a-price-premium-on-land-inside-it-20-Feb-2020.pdf>

reduce the profitability of these developments. At the margins, the policy will make some developments infeasible, especially in the current market of falling land values.

As a consequence, in the short to medium term, the more accurate infrastructure charges can marginally reduce development activity while developers who have overpaid rescope or re-specify their developments, or dispose of the land to another purchaser. This is no reason not to implement the revised policy; perpetuating the current state because some developers have overpaid or because of cyclical weakness in the housing market will only exacerbate the infrastructure funding shortfall in future. There will always be some developers who overpay for land and struggle to make the development commercially viable.

Impact on development of incentives to developer

Providing support infrastructure and up-zoning is likely to incentivise development in the Hastings city centre and Flaxmere. DCs are unlikely to be a major impediment to where development occurs.

Using an urban wide catchment approach reduces the likelihood of developers being incentivised to develop in one location over another. Ultimately, where and how quickly development occurs will be driven by developers' determination as to their likelihood of making a profit.

Economic theory suggests that:

- Development is most likely to occur where people most want to be.
- On average, people most want to be where land values are highest, as that is the market's way of showing the attractiveness of an area. Reasons for higher land values are typically dominated by proximity to jobs and transport links, but also include amenities such as views, and access to goods and services.
- Increasing the development potential of any particular piece of land through up-zoning and/or new infrastructure to support development, raises the value of that land, making that area more attractive for development.

Consequently, development is likely to be stimulated in the Hastings city centre and Flaxmere because of the upzoning and commensurate infrastructure to support that intensification without explicitly reducing DCs in those locations (which would not be allowed under the LGA in any event).

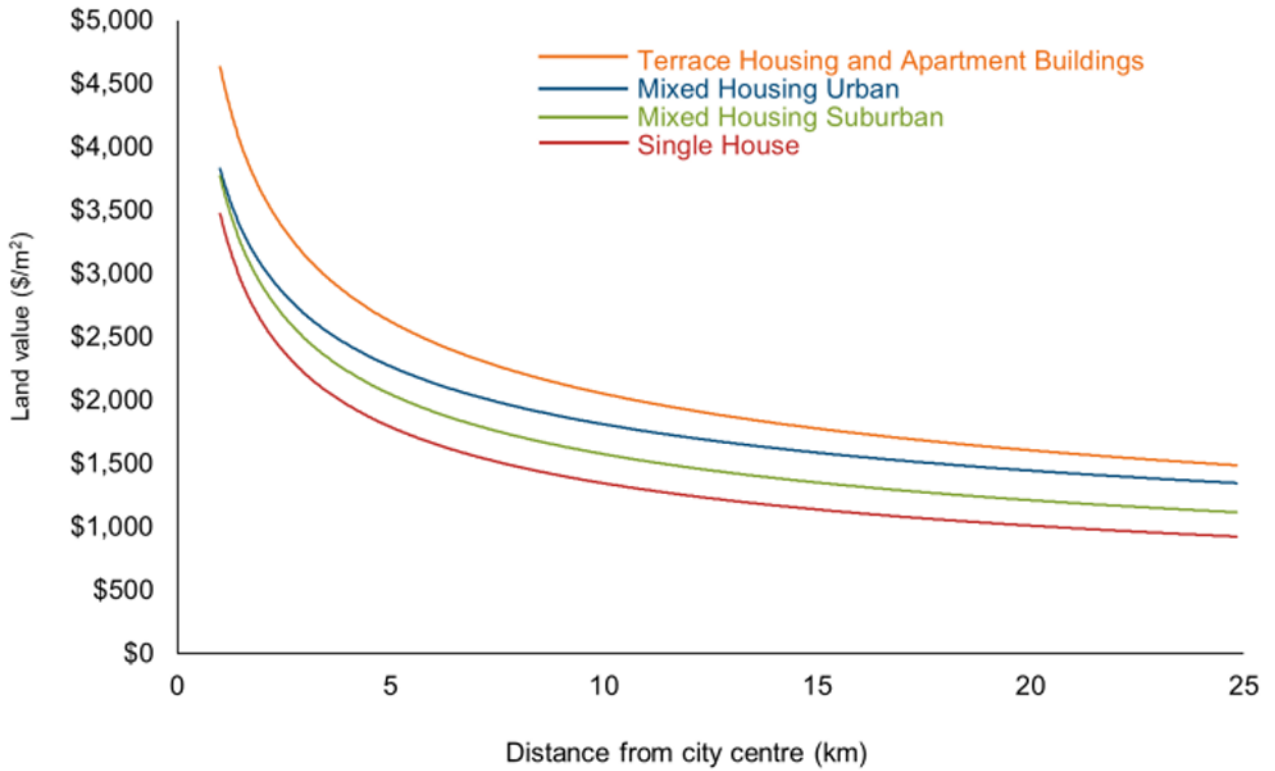
The accuracy of this theory is demonstrated in practically every city in the world, where the city centre tends to have high rise buildings and building height and density declines as one moves outward from that centre. In New Zealand, the accuracy of this theory can be demonstrated using Auckland as an example, where a lot of research has been done on land values. Work by the Chief Economist Unit showed that at any density of residential zoning, properties closest to the best amenities, to jobs and to public transport tended to have the highest values.⁵ In the case of Auckland, as in most areas, this focal point is the city centre.

Figure 2 shows that land values rise sharply as one approaches the city centre, and that land values are higher at the same distance from the city centre when the zoning of the land (Terrace housing and apartment buildings being the densest zoning and single house being the least dense) allows for more density. These facts provide a lot of support to the argument that enabling infrastructure, coupled with proximity to jobs and amenities will incentivise development especially in the Hastings city centre.

⁵ See David Norman and Shane Martin. *Please, Sir, may I have some more?* 2021. <https://www.aucklandcouncil.govt.nz/about-auckland-council/business-in-auckland/docsoccasionalpapers/auckland-economic-quarterly-may-2021.pdf>

Figure 2 How up-zoning, and proximity to job and amenities affect land values

Land value per square metre, by residential zoning type, by distance to the city centre



Scope and limitations

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