Attachment D

# Report to Queenstown Lakes District Council Affordable Housing Contribution Under Special Housing Area Process 16 October 2017

## 1. Background and Objectives

QLDC has sought additional analysis and advice to assist in understanding where to set the Affordable Housing Contribution level under the designation of land for residential development via the Special Housing Area process (SHA).

This has been requested in the principal form of five questions as follows:

a) Commentary and analysis to understand the benefits available when the land is designated and can be developed to residential under the SHA process
b) Impact on a development of an increase in the Affordable Housing Contribution from 5% to 10% (and possibly higher)
c) Value to a developer (with particular emphasis on the increased density available under the SHA process)
d) Understanding the impact the Affordable Housing Contribution could likely have on section sale prices (i.e. – will increased Contribution costs result in increased section prices)
e) Review and Commentary on the Market Economics Report (7 September 2017)

Background information has been supplied by QLDC, whom we have also met with and had extensive discussions regarding these matters.

## 2. Queenstown Market Dynamics/Context

Queenstown (and surrounding areas) have somewhat unusual property characteristics resulting in very high demand for a range of property products and consequently a particularly high average house price. The residential property rental market suffers from the same characteristic. Whilst this creates an attractive property development framework, it also creates issues for the local community in general due to affordability difficulties in attracting workers/families who are needed to resource the various aspects of the business and general community. While there has been (and continues to be) a gap in affordability, the private sector market is not addressing this gap – most likely due to the fact that the private sector market can achieve greater returns due to the high level of demand.

Whilst we are advised there is enough zoned land to meet predicted population growth, this does not in itself mean an increase in the availability of sections on the market.  Some developers tend to drip feed sections to the market to maximise price point.

Accordingly, the Queenstown Lakes region has an excessive gap between income and house price levels making it the most unaffordable place to live in the country.

## 3. Special Housing Area Process

Following discussions with QLDC staff we understand the SHA process can be summarized as follows:

- The Housing Accords and Special Housing Areas Act (HASHAA) provides for the designation of land for residential development with significant benefits to all parties. The local authority (QLDC) and community benefit due to the ability under this framework to deliver land supply faster and with more certainty.

- The landowner has the benefit of speed of process, no appeals, plan change cost savings and potentially increased yield lots via higher density – compared with the alternative rezoning options (e.g. Private Plan Change etc).  These benefits are significant compared with alternative options such as Private Plan changes etc.  Increased density, coupled with the certainty due to appeal risk being removed under the SHA process,  clearly add value to a developer.

- Increased density – while at a high level increased density provides added value, it also potentially means for a different section/house product offering (smaller sections, common party walls and so on). This different product may not be well tested in QLD and market acceptance will need to be proven.

- Christchurch has been through a similar process some years ago when certain residential developments (Living G) were required to have density at 15 lots per hectare. This created smaller sections, smaller homes, common party walls and so on. It is well known in Christchurch that this product has not been easy to sell in the Christchurch market.

- With regard Christchurch, it was not necessarily the smaller sections that were difficult to sell (typically to terrace townhouse style developers), rather the selldown of completed product to the end market.

- The bespoke nature of each development project makes it difficult to model  (with any accuracy)  the specific benefits of residential designation under the SHA process but clearly they are significant.

## 4. SHA Benefits

We understand the current HASHAA legislation expires in September 2019 (extension will depend on Central Government). Accordingly a defined window exists in which contributions can be obtained.

The existence of the Mayoral Housing Affordability Taskforce and the Queenstown Lakes Community Housing Trust provides a somewhat ring fenced vehicle for receiving Affordable Housing Contributions and utilizing those assets for delivering on the various Affordable Housing goals and objectives. Whilst not directly linked to development feasibility, this mechanism does have relevance in that it provides some transparency and accountability for utilizing Contributions for the benefit of the wider community (in relation to dealing with the Affordable Housing challenge).

The proposed affordability housing structure appears to have considerable merit and sustainability. The ability to deliver this outcome however is in part at least dependent upon the funds obtained via contributions.

## 5. History of Affordable Housing Contribution

Following discussions with QLDC staff, we understand there are a number of prior examples where QLDC have negotiated with landowners for designation and residential development under the SHA process and the negotiated Affordable Housing Contribution level has progressively increased to a current level of 5%.

Of recent times, discussions within QLDC and with some landowners, have been at a 10% Contribution level. QLDC recently adopted a policy change to a 10% Contribution level.

We also understand that QLDC has successfully negotiated some Affordable Housing Contributions of up to 5% with developers under a Private Plan change process. This ultimately now appears the benchmark starting point.

## 6. Standard Residential Subdivision Feasibility Parameters

Residential subdivision projects (of any reasonable volume/scale) can typically be very dynamic with multiple variable inputs that can significantly impact the feasibility of a project. Accordingly, residential subdivision is well regarded as being one of the higher risk of development asset classes.

A number of the feasibility inputs are metric (e.g. sale prices, development costs, professional fees and so on).

However there are some inputs that are not metric; (e.g. rezoning/consenting timeframes, sell down period). It is well recognized that larger projects with longer sell down periods expose the developer to higher market risk (i.e. changes in selling market conditions).

Any initial modeling of a residential subdivision always carries risk due to initial inputs being assessments that are yet to be validated.

One of the more unknown variables is the profile, goals, motivation of the developer. This generally varies widely and can have an impact on the project. What is typically accepted is the larger the development, the longer the selldown period, accordingly the greater the level of perceived risk.

## 7. Market Economics Report Review/Commentary

Reference is made to the Market Economics (ME) Report dated 7 September 2017.

This report was commissioned by QLDC to assist with the assessment of QLDC levying a Contribution higher than 5% on, specifically, the proposed Ladies Mile residential subdivision.

The ME Report utilizes the MBIE Development Feasibility Tool (modeled for the Ladies Mile project) which we understand is well recognized by Central Government and is supported by background research from a number of agencies supporting input assumptions.

The purpose of this paragraph is not to critique/criticize the ME Report, rather to provide additional commentary around the manner in which the private development market approaches residential subdivision projects and also how the variability of some key inputs can impact the overall feasibility of a project. In fact the ME Report author, while concluding that there is room for increased Contributions over 5%, also comments - "this kind of development modeling is subject to significant uncertainty and the developer will naturally offer different opinions about some of the key assumptions".

The overriding comment about the ME feasibility modeling is that the profit margins appear too high (and in instances excessive). Whilst this may well be a function of increased density, it does raise questions around validity of inputs.

ME in their modeling appear to have worked on the basis of Contributions being 5% of the land value ($15.5m) equating to a Contribution cost of $776,000. Our understanding is that the Contribution is actually based on a % (say 5%) of the lots created on an area basis (i.e. 2,185 lots created so 5% being 109 lots (area equivalent) forms the Contribution – that will be a value much higher than $776,000).

ME also have a provision for "Months to develop" and have used 48 months as a base norm and 72 months as a "long time" sensitivity. It isn't clear if this 48/72 months is a development timeframe for delivery or a timeframe for sell down of the project to the market. Given the Ladies Mile project is 2,185 lots we suspect this timeframe used by ME is a development timeframe and the (potential) sell down of a project of this scale would take considerably longer than 48 months. Standard valuation methodology applies a discount for sell down risk and, given the scale of the Ladies Mile project, this discount could be substantial, notwithstanding the buoyant local market conditions currently prevailing.

The MBIE Tool appears to utilize a 20% profitability target, while this does form a notional minimum bottom line profit return range for feasibility purposes, the private sector will struggle to accept that when the primary driver for a lower profit result is due to significantly increased local authority levies (albeit for community housing affordability reasons).

## 8. Contribution Level Analysis

For reasons covered in this Report, it is not a straight forward exercise to land on a specific Contributions level that will receive uniform acceptability, both within QLDC and the marketplace.

| Contribution Level | 5% | 10% | 15% | 20% |
|---|---|---|---|---|
| | | | | |
| Benefits | Yield/Timing/Certainty | Yield/Timing/Certainty | Yield/Timing/Certainty | Yield/Timing/Certainty |
| Developer View Point | Baseline – proven to be acceptable | Some reluctance but could live with | Increased reluctance – likely to compromise QLDC objectives | Unacceptable |
| Risks for QLDC | Mitigated (historically proven) | Risks to QLDC appear manageable | Risks to QLDC increasing | Very high risk to QLDC |
| Risk Assessment | Low | Moderate | High | Very High |

## 9. Responses to Key Questions

The body of this report references to the key questions below – specific commentary for each question is also detailed below.

**Commentary and analysis to understand the benefits available under designation to residential status under the SHA process**

- Key benefits to a landowner/developer under residential designation via the SHA process relate to increased density/yield, quicker consenting timeframes and no appeals (creating improved certainty). These aspects, if delivered, provide real value to a landowner/developer. Deriving a metric calculation to quantify the benefits would be a significant exercise and would require comparative feasibility analysis on a site specific basis using assumptions and inputs that are real (as much as possible). That said, at a macro level the benefits have the potential to be significant.

**Impact on a development of an increase in the Affordable Housing Contribution from 5% to 10% (and possibly higher)**

- Refer to paragraph 8, Contribution Level Analysis, covering range analysis for Contribution Levels of 5/10/15/20% options and the likelihood of additional risks as Contribution levels rise higher (say past 10%
- Will be a point where the benefits are not considered worth the contribution and there may be a preference to try the Private Plan Charge path.

**Value to a developer of residential designation (with particular emphasis on the increased density available under the SHA process)**

- Relates also to Question One. Increased density at a high level provides added value benefit however as previously mentioned, this does potentially create a different product offering which may be not yet tested with the Queenstown market place
- Notwithstanding residential designation (for example rural to residential) does create value via the increased development potential, at some point the land needs to be developed to extract value. Prompt development timeframes are we understand a requirement of the SHA process. Accordingly, a developer has no opportunity to sit on the land. This may not appeal to all parties.

**Understanding the impact the Affordable Housing Contribution could likely have on section sale prices (i.e. – will increased Contribution costs result in increased section prices)**

- An increase in Contribution levels is not expected to have any material impact on section prices. The market generally sets its own level and in the event a developer looks to pass costs on and that sees those section prices higher than other competing section product then the market will generally deal accordingly with purchasers offering less and so on. QLD region currently has a very buoyant property market so presumably developers are able to currently press hard for increased sale prices now (regardless of Contribution levels)
- Supply/demand dynamics will set the price regardless of developer price point. If a developer prices end product too high because of adding on costs, this will likely impact selldown.

**Review and Commentary on the Market Economics Report (7 September 2017)**

- Commented on fully under paragraph 6

## 10. Recommendations

Based on the information reviewed, discussions held and high level conceptual analysis, we are of the opinion that a Contributions level of 10% falls within a moderately acceptable range and should be more than compensated for by increased value to the landowner/developer under the SHA process.

Any increases past 10%, while potentially able to be negotiated, are likely to meet with increasing market resistance and could bring about unintended consequences that may have implications for the primary objective of addressing the Affordable Housing issues. In addition, we presume QLDC is also looking to embed a sustainable long term mechanism and, as such, having a Contributions level that is moderate will hopefully enable this to progressively become more acceptable to the market.

Alternatively put, the greater the level of contribution, the higher the risk of non-acceptance and accordingly this reduced level of funds would not assist in delivering on affordable housing, being the ultimate aim of the contribution.

Therefore it is our view it is more favourable to get a 10% contribution (with more likely acceptance) on a potential range of land developments rather than say 15% (more likely pushback) on a reduced number of land proposals.

David MacDonald, Director
MacDonald Consultancy Services

Marius Ogg, Director
CBRE, Valuation & Advisory

**Disclaimer**

The report is based on high level feasibility assumptions only and due to the number of variable inputs into residential subdivision feasibility modeling, to enable greater accuracy, more extensive site specific modeling would be required.

Our conclusions are based on the information provided and discussed in person.